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Financing Intellectual Property under Federal Law: A National Imperative

Lorin Brennan

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Financing Intellectual Property under Federal Law: A National Imperative

by
LORIN BRENNAN*

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* J.D., 1978 Hastings College of Law; Member, California Bar.

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Introduction

Our country is in the midst of profound economic restructuring. Information industries have become the center of national growth and opportunity, employing more people than the manufacturing sector, generating more of our gross national product, and expanding at a rate double the economy as a whole.¹ Information has become the number one American export,² and other countries are looking to compete. The European Commission is committed to making Europe the leader in the global e-commerce.³ Japan's MITI has an active Electronic Commerce Promotion Council to do the same for Japan.⁴

American competitiveness in the twenty-first century will depend in no small part on how well the American legal system supports the emerging information economy. At the outset, this means recognizing that information is qualitatively different from goods.⁵ The policies behind its creation and exploitation differ

1. Stephen E. Siwek & Gale Mosteller, *Copyright Industries in the U.S. Economy: The 1999 Report* (1998). This report was prepared by Economists Incorporated for the International Intellectual Property Alliance (available at <http://www.iipa.com/html/reports_by_issue.html>) (accessed May 15, 2000).

2. *Id.* For a discussion of the emerging possibilities for global e-commerce, see Lorin Brennan, *Through the Telescope: Article 2B and the Future of E-Commerce*, 37 UCC Bulletin, Rel. 3 (Apr.-May 1999); *Through the Telescope II: The Meaning of UCITA*, 39 UCC Bulletin, Rel. 43 (Jan.-Feb. 2000).

3. See *It's a Revolution: Electronic Commerce* (available at <<http://europa.eu.int/ISPO/ecommerce/>>) (accessed Sept. 5, 2000):

Electronic commerce is a revolution that is sweeping across the world, changing the way we do business, the way we shop and even the way we think. And at the forefront of the revolution is the European Commission's electronic commerce unit. We've been supporting research and development in technologies you take for granted now and the technologies that will become the norms tomorrow. We've been helping business in the European Community become more competitive and we're involved in exciting new technologies like mobile e-commerce, smart cards, ubiquitous Internet, digital TV and more.

The Commission has promulgated an E-Commerce Directive mandating recognition of "click-on" and on-line contracts. See *Eur-Lex: Legislation under Preparation* (available at <http://europa.eu.int/eurlex/en/com/dat/1999/en_599PC0427.html>) (accessed Sept. 5, 2000).

4. See *The Electronic Commerce Promotion Council of Japan* (available at <http://www.ecom.or.jp/qecom/ecom_e/index.html>) (accessed Sept. 5, 2000).

5. See Raymond T. Nimmer, *Through the Looking Glass: What Courts and UCITA Say about the Scope of Contract Law in the Information Age*, 38 Duq. L. Rev. 255 (2000); Lorin Brennan, *Why Article 2 Cannot Apply to Software Transactions*, 38 Duq. L. Rev. 459 (2000); Raymond T. Nimmer, *Images and Contract Law - What Law Applies to Transactions in Information*, 36 Hous. L. Rev. 1 (1999); Michael L. Rustad, *Commercial Law Infrastructure for the Age of Information*, 16 J. John Marshall J. Computer & Info. L. 255 (1997).

sharply from those for the manufacture and sale of industrial commodities. State commercial law, long attuned to supporting the industrial sector, must restructure itself to fit the very different policies necessary to build markets in information.

One area in urgent need of restructuring is secured financing law. In the new information economy, intellectual property financing has assumed growing importance.⁶ The federal information statutes, as drafted by Congress, provide an efficient system for perfecting security interests in federal information. The drafters of original Uniform Commercial Code (UCC) Article 9 understood this. Grant Gilmore, the Reporter for Article 9, was emphatic that security interests in federal information could only be perfected under the relevant federal statutes.⁷

Unfortunately, the straight-forward congressional mandate has been confused by errant court decisions. Several commercial law commentators have added to the melee, complaining that the federal information statutes are not suited to what they call the "modern" financing methods under Article 9. By far, the most serious problem, however, is the recent revision of Article 9 commonly called "Revised Article 9" or simply "Revised 9."⁸ It is a radical departure from the original; one that now sets state commercial finance law on a collision course with federal information law. The fundamental purpose of intellectual property law is to encourage new creations. It does this by allowing creators to collect royalties as a reward for creativity. The goal of Revised Article 9, however, is allow financiers of remote licensees to seize creators' royalties without restraint. The result is a statute at odds with the basic policies underlying intellectual property law.

Explaining how Revised 9 runs astray requires a detailed look at two interwoven but distinct subjects. The first is how intellectual

6. See Melvin Simensky & Lanning G. Bryer, *The New Role of Intellectual Property in Commercial Transactions* § 8.4(a), 300 (J. Wiley & Sons 1994).

7. See Grant Gilmore, *Security Interests in Personal Property* § 25.8 674-675 ["Gilmore"] ("Security interests in copyrights and patents (which are 'general intangibles') would have to be perfected under the relevant filing system and not Article 9."). Although information financing has been discussed in several law reviews and treatises, among the commentators Gilmore still towers over all. His opus remains the definitive text, notably for doing what many others have not: he read intellectual property law. After exhaustive review, he insisted repeatedly that federal law governed perfection of security interests. *Id.* at § 1.14, 15-16; § 13.3, 415; § 19.9, 544-545.

8. Revised Article 9 was approved by the National Conference of Commissioners on Uniform State Laws at its 1998 Annual Meeting and promulgated to the state legislatures in 1999. As of this writing, 20 states have adopted Revised 9. For a useful compendium, see *The New Article 9*, prepared by the ABA Business Law Section.

property can and should be financed under federal law. The second involves an analysis of Revised 9 itself. For convenience of exposition, I have divided this study into two articles. This one, *Financing Intellectual Property under Federal Law: A National Imperative*, discusses how intellectual property could and should be financed under the federal copyright, patent and trademark statutes. The companion article, *Financing Intellectual Property under Revised Article 9: National and International Conflicts*,⁹ undertakes a detailed analysis of Revised 9. Together they fully explain the magnitude of the issues raised by Revised 9 and the necessary solutions.

Much of the recent commentary about intellectual property financing falls into two camps. One camp consists of intellectual property lawyers who argue that security interests in patents, copyright and trademarks should be perfected under the federal information statutes.¹⁰ These articles have usually appealed to federal preemption to make their case. They have not proven persuasive to the commercial law bar because they have not coherently explained why federal filing makes better commercial sense than filing under Article 9. The other camp involves commercial finance practitioners

9. See Lorin Brennan, *Financing Intellectual Property under Revised Article 9: National and International Conflicts*, 23 Comm/Ent 2 (2001).

10. See e.g. Ara A. Babaian, Comment, *Striving for Perfection: The Reform Proposals for Copyright-Secured Lending*, 33 Loy. L. Rev. 1205 (2000); Peter L. Choate, Comment, *Belts, Suspenders, and the Perfection of Security Interests in Copyrights: The Undressing of the Contemporary Creditor*, 31 Loy. L.A. L. Rev. 1415 (1998); Shubha Ghosh, *The Morphing of Property Rules and Liability Rules: An Intellectual Property Optimist Examines Article 9 and Bankruptcy*, 8 Fordham Intell. Prop., Media & Ent. L.J. 99, 172 (1997); Shawn K. Baldwin, "To Promote the Progress of Science and the Useful Arts:" A Role for Federal Regulation of Intellectual Property as Collateral, 143 U. Pa. L. Rev. 1701 (1995); Robert H. Rotstein, *Paul Heald's "Resolving Priority Disputes in Intellectual Property Collateral:" A Comment*, 1 Ga. J. Intell. Prop. L., 167, 175-177 (1993); Schuyler M. Moore, *Entertainment Bankruptcies: The Copyright Act Meets the Bankruptcy Code*, 48 Bus. Law. 567 (1993); Harold R. Weinberg and William J. Woodward, Jr., *Legislative Process and Commercial Law: Lessons from the Copyright Act of 1976 and the Uniform Commercial Code*, 48 Bus. Law. 437 (1993); Harold R. Weinberg and William J. Woodward, Jr., *Easing Transfer and Security Interest Transactions in Intellectual Property: An Agenda for Reform*, 79 Ky. L.J. 61 (1990); Melvin Simensky, *Enforcing Creditor's Rights Against Trademarks*, 79 Trademark Reporter 569 (1989); Note, *Perfection of Security Interests in Intellectual Property: Federal Statutes Preempt Article 9*, 57 Geo. Wash. L. Rev. 135 (1988); Raymond T. Nimmer & Patricia A. Krauthaus, *Secured Financing and Information Property Rights* 2 Berkeley Tech. L.J. 195 (1987); Note, *Transfers of Copyright for Security under the New Copyright Act*, 88 Yale L.J. 125 (1978); Gary O. Concoff, *Motion Picture Secured Transactions under the Uniform Commercial Code: Problems in Perfection*, 13 UCLA L. Rev. 1214 (1966). For intellectual property financing internationally, see Melvin Simensky, Lanning Bryer & Neil J. Wilkof, *Intellectual Property in the Global Marketplace* (2d ed., J. Wiley & Sons 1999.). This is the second edition of Simensky, *supra* n. 6. The leading treatise on United States law remains, in this author's opinion, Gilmore, *supra* n. 7.

who argue that intellectual property should be financed under Article 9.¹¹ They complain that it is too difficult to understand the federal statutes, and therefore information should be treated as another type of industrial good and shoehorned into the familiar structures of Article 9. They have been unable, however, to give a coherent answer the most basic question of commercial finance: who owns the intellectual property when the secured creditor forecloses - the state filing secured creditor, or a later *bona fide* purchaser who records federally? As explained below, either the state security interest is commercially worthless (*i.e.* the *bona fide* purchaser prevails) or it is a fraud on creditors (*i.e.* the secured creditor prevails). Neither one makes commercial sense.

Both sets of commentators have proved unconvincing because they make the same incorrect assumption: that intellectual property could or should fit within the financing constructs in Article 9. In fact, it is simply not possible to finance intellectual property effectively using the priority concepts in Article 9. As the federal courts have been saying for more than a century, intellectual property must be financed like *real property*; in essence, one must finance information like an office building, not like a used car. In every information financing transaction, there are potentially *four* separate interests in which a lender needs to perfect. Article 9 is incapable of accommodating all four interests in a commercially efficient manner. The federal information statutes can.

This article explains how federal information statutes can and

11. See e.g. Steven O. Weise, *The Financing of Intellectual Property under Revised Article 9*, 74 Chi.-Kent L. Rev. 1077, 1089, 1093-1094 (1999); Aimee A. Watterberg, Comment, *Perfecting a Security Interest in Computer Software Copyrights: Getting It Right*, 15 John Marshall J. Computer & Info. L. 855 (1997); Alice Haemmerli, *Insecurity Interests: Where Intellectual Property and Commercial Law Collide*, 96 Colum. L. Rev. 1645, 1658-1659 (1996); William A. Dornbos, *Structuring, Financing and Preserving Security Interests in Intellectual Property*, 113 Banking L.J. 656 (1996); Patrick R. Barry, *Software Copyrights as Loan Collateral: Evaluating the Reform Proposals*, 46 Hastings L.J. 581 (1995); Paul Heald, *Resolving Priority Disputes in Intellectual Property Collateral*, 1 Ga. J. Intell. Prop. L. 135 (1993); Note, *Perfection of Security Interests in Copyrights: The Peregrine Effect on the Orion Pictures Plan of Reorganization*, 11 Cardozo Arts & Ent. L.J. 959 (1993); Proto, *The Scope of U.C.C. Article 9: Is Filing under Article 9 Sufficient to Perfect a Security Interest in a Patent or Trademark?*, 93 Commercial L.J. 384 (1988); Robert Bramson, *Intellectual Property as Collateral - Patents, Trade Secrets, Trademarks and Copyrights*, 36 Bus. Law. 1567 (1981). For treatises in this area see e.g. Peter F. Coogan, William E. Hogan, Detlev F. Vagts & Jullian B. McDonnell, *Secured Transactions under the Uniform Commercial Code* § 25.08, 1C, *Security Interests in Intellectual Property* (Bender 1999) ["Coogan"]; William C. Hillman, *Documenting Secured Transactions* 2-19 to 2-20 (Practicing Law Institute 1998); Eldon H. Reiley, *Guidebook to Security Interests in Personal Property* § 16.11, 16-20 (3d ed., C. Boardman Co. 1999).

should provide the basis for financing information. Part II provides an executive summary of how intellectual property financing works and why it is more efficient to utilize the federal information statutes. Part III then contains a detailed description of the law supporting this understanding. This section reviews the evolution of intellectual property financing under the pre-code financing systems, including the examination of the critical concept of *chain of title* - why statutorily, it does not exist for tangible personal property, but why it is essential for intellectual property. It also discusses the crucial concepts for the *bona fide* purchaser and lien creditor, and why the latter does not exist for intellectual property. These concepts are particularly important in case of bankruptcy, a matter examined in detail. Part III concludes with a comparison of the inconsistent case law interpreting the parallel language in the Copyright Act, the Patent Act and the Lanham Act. Finally, Part IV suggests the needed clarifications in federal law to rectify the confusion in the case law and the commentary.

I

Executive Summary

This section provides an executive overview of what information collateral involves, the four factors in any information financing transaction, and a brief review of why using the federal system is a more efficient financing scheme. The purpose is to provide a conceptual structure to address the more detailed discussions to follow.

A. An Information Primer

The term "intellectual property" encompasses a wide variety of interests. These are typically statutory, and are usually classified by the enabling legislation, *e.g.*, patents, copyrights, trademarks, trade secrets, etc. The scope of protection for varying types of intellectual property is not the subject of this article. Instead, the focus is on how intellectual property interests can be transferred for security. In keeping with the modern approach, "information" will sometimes be used as a convenient substitute for "intellectual property."¹²

For analytic convenience, we can divide information into two areas:

- *Federal Information*: This includes federal intellectual

12. For a general discussion of information rights, see Ramond T. Nimmer, *Information Law* (2d ed., Warren, Gorham & Lamont 1998).

property interests under the Copyright Act,¹³ the Patent Act¹⁴ and the Lanham Act.¹⁵

- *State Information*: These are the purely state interests, such as state trademarks and related franchise rights,¹⁶ trade secrets,¹⁷ rights of publicity,¹⁸ pre-1972 sound recordings,¹⁹ rights to ideas,²⁰ *droit de suite*²¹ and the like.

The reason for this classification is the different filing requirements for these classes of information.

Information interests are transferred either by assignment or license. Broadly speaking, an "assignment" is an ownership transfer and a "license" is a use privilege.²² In modern practices, licenses are further divided into "exclusive," meaning the licensor can not make another transfer within the same scope, and "nonexclusive," meaning the licensor can.²³ Transfers can be limited in time, place or effect. Whether a limited transfer is an ownership transfer or a use privilege depends on whether the statutory rights are treated as indivisible. The three patent rights to make, use and vend must be assigned as a unit. The assignment can be limited in time or place, *e.g.* for the Western United States for 10 years, in which case it is a "partial assignment" or "grant."²⁴ An assignment of some, but not all, of the three patent rights, is a license.²⁵ The reason has to do with standing

13. 17 U.S.C.A. § 101 (West 1996). To avoid needless detail, this article will not discuss mask works, rights in digital sound recordings, or vessel hull designs.

14. 35 U.S.C.A. § 1 (West 1984). Similarly, a discussion of design patents is omitted.

15. 15 U.S.C.A. § 1005 (West 1997).

16. See generally J. Thomas McCarthy, *The Law of Trademarks and Unfair Competition*, ch. 18 (2000 ed., M. Bender).

17. See generally Roger J. Milgrim, *Milgrim on Trade Secrets*, ch. 2 (2000 ed.).

18. See J. Thomas McCarthy, *The Right of Publicity* (2d ed., publisher 2000); see also Harold Orenstein & David E. Guinn, *Entertainment Law and Business*, ch. 2 (1997 ed.).

19. See Melville B. Nimmer & David Nimmer, *Nimmer on Copyright* § 8C.03 (Bender 2000).

20. See Nimmer & Nimmer, *supra* n. 19, § 16.01; see also Orenstein & Guinn, *supra* n. 18, ch. 1A.

21. See Nimmer & Nimmer, *supra* n. 19, § 8C.04; Liliane de Perredon-Fawcett, *The Droit de Suite in Literary and Artistic Property* (Louise-Martin-Valiquette trans., Columbia U. School of Law 1991).

22. See J. Thomas McCarthy, *McCarthy's Desk Encyclopedia of Intellectual Property* (Bureau of National Affairs 1991) (definitions of "assignment" and "license").

23. See *I.A.E., Inc. v. Shaver*, 74 F.3d 775, n. 8 (7th Cir. 1996) ("[A]n exclusive license is leave to do a thing, and a contract not to give leave to anyone else to do the same thing.").

24. The Patent Act calls such partial assignments "grants." See *Preload Enter., Inc. v. Pac. Bridge Co.*, 86 F. Supp. 976, 978 (D. Del. 1949).

25. An exclusive license of all three patent rights is treated as an assignment. *Ortho Pharm. Corp. v. Genetics Inst., Inc.* 52 F.3d 1026, 1030 (Fed. Cir. 1995); *Vaupel*

to sue. Only an owner has standing, preventing a multiplicity of suits against an alleged infringer. The Copyright Act has eliminated this "indivisibility doctrine" for copyrights, meaning that the exclusive rights can be owned and licensed separately.²⁶ For copyrights, an exclusive license is an ownership transfer akin to a partial assignment that confers standing on the licensee.²⁷ For convenience, we will refer to both of these as "transfers," sometimes using "ownership transfer" to refer to an assignment and, as applicable, exclusive license, and "use privilege" otherwise.

In information transfers rights flow "down" to the transferee, and money or other consideration flows back "up" to the transferor. Both the information interest and the payments can be transferred for security, either together or separately. Information financing can thus involve transfers for security of intellectual property interests ("rights") or monetary entitlements ("royalties") of either a transferor or transferee arising under an ownership transfer or a use privilege for different types of information. The following chart outlines the various factors:

Information Type	Party	Source of Interest	Interest Type
Federal Information	Transferor	Ownership Interest	Rights
State Information	Transferee	Use Privilege	Royalties

Information Financing Factors

Information collateral can arise from a combination of any factor from each column, e.g. royalties from a transferor's ownership of federal information or rights under a transferee's license of state information. Discussing every nuance for every possible transaction will lead to a discussion of considerable detail, blurring the main points. For manageability this article will focus primarily on security transfers of federal information interests, with some asides on related state information. Although similar principles apply throughout, the alert reader should keep in mind possible differences in detail arising from the particular mix of the factors identified above.

Textilmaschinen v. Meccanica Euro Italia, 944 F.2d 870, 873-874 (Fed. Cir. 1991).

26. 17 U.S.C.A. § 201(d)(2) (West 1996); see *Nimmer & Nimmer*, *supra* n. 19, § 10.02[A].

27. 17 U.S.C.A. § 201(d)(2) (West 1996).

B. The Four Interests in Information Financing

In every information financing transaction there are four different interests to consider:

- The transferor's interest in the information;
- The transferor's royalty income payable from transferees;
- The transferee's interest in the information; and
- The transferee's income from which royalties are due.

For discussion purposes, we can assume that the borrower is the transferor. A secured lender then needs to consider perfecting its security interest all four interests.

Transferor's information interest: This is often an ownership interest, either because the transferor was the original creator or due to an ownership transfer, although it can also be an interest under a nonexclusive license. The lender's goal is to ensure that it is perfected in this interest, since this is the source from which the other interests spring. Unlike tangible personal property, but just like real property, intellectual property has a *chain of title*. This means that there are often prior interests in the information. If any of these prior interests is terminated, such as by foreclosure of a prior recorded mortgage, it can wipe out the transferor's interest.²⁸ This is why it is critical to search the chain of title for each item of information collateral so that lender can obtain any necessary quiet enjoyment agreements ("non-disturbers") from prior parties.²⁹

Transferor's right to royalties: This interest encompasses the royalties a transferor collects from its transferees. The lender's goal here is to ensure that it can collect the royalties ahead of any other creditors of the transferor, including the bankruptcy trustee. Under original Article 9, royalties are not "accounts." An account is a right

28. See *infra* n. 210 and accompanying text.

29. These operate like a "Non-Disturber and Attornment Agreement" common in commercial leases. A senior mortgagor agrees that on foreclosure of its interest it will allow a junior interest to continue under its license provided that the junior interest acknowledges ("attorns to") the senior interest (in real estate practice, creating privity of estate). In exchange, the junior interest agrees to make all future royalty ("rent") payments to the senior interest (in real estate practice, creating privity of contract) after foreclosure. The ability of a senior mortgagee against the property to wipe out junior leases who do not attorn is essential to prevent a practice known as "mortgage milking." During the Depression, some borrowers would mortgage the property, and then offer leases on below-market long-term rates with large up-front payments. Dishonest borrowers would take the up-front payments and head to points unknown, leaving the lender with property encumbered by long-term, low rent leases. For a discussion of the "mortgage milking" cases, see Gilmore, *supra* n. 7, § 14.7. It is the same for information. A foreclosing senior mortgagor wipes out junior licensees who have not attorned, thus controlling "mortgage milking."

to payment arising from goods sold or services rendered, which does not include a license of information.³⁰ Thus security assignments of royalties are financed under the law of assignment, not by filing a financing statement under Article 9. Under common law, a lender generally perfects in royalties by giving notice to the transferees of the assignment. This can be a burden where there are many transferees. *In re Peregrine*³¹ held that since royalties arise from exploiting a copyright, a lender could perfect in royalties by recording in the Copyright Office. This is eminently sensible, allowing a lender to perfect in a transferor's royalties with the same instrument that perfects in the transferor's rights, rather than through extensive notification to transferees.³²

Transferee's information interest: This involves the informational rights granted to each transferee. These rights can also be ownership interests or use privileges. The lender's goal here is to ensure that on foreclosure of its security interest against a transferor, it can take the information free of any of these transfers to which it did not consent. This obviously gives the lender comfort that the transferor has not made improvident transfers that reduce the collateral value. If chain of title is the "look up" problem of ensuring no prior conflicting transfers, then this is the "look down" problem of ensuring priority over later transferees. Unlike personal property, intellectual property does not recognize an "ordinary course" exception to a prior security interest.³³ Infringement is a strict liability tort. Any licensee can be held liable if its licensor's interest is terminated, regardless of any belief, reasonable or otherwise, that it had a valid license. This means each transferee has the burden of finding prior interests and obtaining necessary consents. Again, this is just like real property. A major tenant, knowing its lease can be wiped out by foreclosure of a prior mortgage, often insists on a non-disturber agreement. Such an agreement assures the tenant that its lease will not be wiped out by foreclosure of a senior mortgage on the property, while the ability of a senior mortgagee to foreclose on non-attorning junior leases

30. U.C.C. § 9-106 (West 1996); *In re SSE Intl. Corp.*, 198 B.R. 667, 670 n. 3 (Bankr. W.D. Pa. 1996). See Brennan, *supra* n. 9, § III.D.3(b).

31. *In re Peregrine Enter., Ltd.*, 116 B.R. 194, 199 (C.D. Cal. 1990).

32. Under original Article 9-306(2), a security interest in proceeds is perfected if the security interest in the original collateral was perfected, but under § 9-306(3) it becomes unperfected within 10 days of receipt unless the filing in the original location was sufficient to perfect in the proceeds as well. See U.C.C., Art. 9 (West 1997). Thanks to *Peregrine*, a single filing in the Copyright Office perfects in the copyright and the royalties under Article 9-306. *Peregrine*, 116 B.R. at 203.

33. See discussion in Brennan, *supra* n. 9, § III.I.

protects the mortgagee from mortgage milking.

Transferee's royalty income: A transferee can be expected to exploit the information itself, usually through further sublicensing, and will often owe a share of its income to its transferor as a royalty. The lender's goal here is to ensure that it is perfected in the share of the transferee's income earmarked as royalties ahead of other creditors of the transferee. One way to do this is to treat the royalties as separate from the rights and look to the state law of assignment to perfect. Some cases say that a security interest against a transferee's rights filed after the transfer was made would be subject to the obligation to pay royalties. Another approach would look to filing in the federal system to determine relative priorities. Thus, a federally filed instrument disclosing a reserved royalty should have priority over a later filed security interest against the transferee. In addition, under intellectual property law, nonexclusive licenses are not assignable without consent of the transferor. This means that a transferor, acting on behalf of its lender, must consent to a security transfer of rights and resulting royalties of the transferee's rights under a non-exclusive license, or the transferee's security interest is ineffective. Ownership transfers, however, are considered assignable absent contractual prohibitions.

C. The Commercial Efficiency of Federal Filing

Securing a creditor's rights in all four information interests is far more efficient using the single, national federal filing systems than the scattered state filing rules under Article 9. A lender financing information takes an interest somewhere in the chain of title. In some cases, it may finance the creator, *i.e.*, the first transferor. But more often than not the lender must be concerned about both prior and subsequent interests in the information.

Consider the borrower's (transferor's) information interest. The creditor must make sure that the debtor owns the information, or there is no asset to generate income. This is just like real estate; a mortgage lender must order a title report to verify that the debtor owns the real property and appurtenant office building. Many commercial lenders believe it is only necessary to search the immediate debtor-transferor. This is incorrect. Unless the debtor is the original creator, then will be prior transferors. Later in the text we discuss searching the chain of title for *Terminator 3*, a hypothetical movie based on the popular *Terminator* movies. There are 94 prior transferors to search. Searching for prior security interests using only state UCC filing system would cost more than

\$45,000. Including judgment liens would raise the costs to a staggering \$27,000,000. Compare this to a single search in the Copyright Office, costing only a few hundred dollars.

Turning to the transferor's right to royalties, using just state law procedures, a secured creditor would need to give notice to each transferee every time a license is made in order to perfect, an enormous burden. For accounts – and royalties are not accounts – original Article 9 allows perfection by filing a financing statement against the debtor. But the same rule for royalties would not be cost effective. First, the creditor still has the “look-up” problem of finding financing statements filed against prior transferors which may trump its filing. Second, every time the debtor changes its location to a new state the creditor would need to make a new filing.³⁴ A single federal filing that covers both rights and royalties is far more commercially efficient.

Looking at the transferee's interest, it must be remembered that intellectual property can be exploited anywhere nation wide. Using Article 9, a lender would be required to file a new financing statement against each transferee in every new state. This turns information financing economics on its head. Intellectual property policy fosters new creations by allowing “upstream” creators/licensors to collect royalties from “downstream” licensees. The burden is on “downstream” parties to manage their assets by searching chain of title. This is undoubtedly more difficult for “downstream” transferees when they acquire the information, but it is not the policy of intellectual property law to make life easier for them. The policy is to help creators collect royalties, and a single filing in the federal registers does just that. The transferees get the benefit when they in turn transfer to others. Again, this is just like real estate. A tenant has the obligation of investigating title to find prior mortgages, not the other way around, but gets the benefit against subtenants.

Finally, a lender financing a transferor often wants priority in it's the transferor's share of exploitation income (royalty share) ahead of other creditors of the transferee. Any seller of purchase money collateral wants that. If a federal filing gives priority over the property, *i.e.* the transferee's intellectual property interest, it should also give priority in the proceeds derived from disposition of that property, *i.e.*, the share of exploitation income payable as royalties.

34. See generally *Mellon Bank v. Metro Commun., Inc.*, 945 F.2d 635 (3d Cir. 1991); see also Barkley Clark, *The Law of Secured Transactions under the Uniform Commercial Code*, ¶ 10.04[3] (2d ed., Warren, Gorham & Lamont 1993).

Of course, there is no reason why a transferor cannot be an unsecured creditor of its transferee. But if the transferor does want a security position, the most commercially efficient approach is to indicate the transferor's reserved royalty in the instrument that was filed indicating the transferee's grant.

Some commercial law commentators claim nonetheless that it is "too difficult" to finance intellectual property under federal law. The argue that a creditor should be able to use a floating lien with the catch-all phrase "all general intangibles and intellectual property now owned or later acquired." Filing a financing statement for such a floating lien, they say, should perfect the lender's security interest in any intellectual property against all prior transferors as well as subsequent transferees. It should definitely give the transferee's floating lienor priority over any royalties due to the transferor. It works for industrial goods, why not for information?

I suggest that these floating lienors are not entitled to such priority because they are not really financing the intellectual property. How could they be? They never conducted a chain of title search to determine whether their transferee-debtor *owned* the information. If Joe Swindle says he owns an office building in downtown Manhattan, a bank that loans him money without ordering a title report is not really loaning against building. It is loaning against Joe Swindle's representation, and taking the risk whether it is accurate. A lender who does not determine whether the information held by its debtor is subject to prior encumbrances, royalty obligations or transfer restrictions does not include the real value of the information in the collateral base, only, at best, the represented value. Such a loan is secured by air, not assets. For industrial goods, notorious possession gives an *apparent* ownership, reducing the need to search chain of title. There is no apparent ownership rule for intellectual property.

And what happens when the debtor transfers the information to earn royalties? If the transferees record in the appropriate federal filing offices,³⁵ they qualify as *bona fide* transferees that take free of the lender's floating lien since it was not recorded federally. What happens if a creditor obtains a judgment against the debtor and proceeds to judicial sale? The judgment creditor can also record federally and likewise become a subsequent transferee who takes free of a floating lien not recorded in the information tract registers. In

35. It is a bit more complicated. The Copyright Act allows recording of all transfers, including licenses. The Patent Act and Lanham Act are limited to assignments. See *infra* n. 461 and accompanying text.

other words, it is easy to dispose of the information collateral free of the floating lien. If collateral can be transferred free of the security interest, the lender is not perfected. Some commentators try to get around this obvious problem by saying an ownership transfer is somehow different from a security interest, at least with regard to filing rules. This distinction is specious. A security interest means nothing unless the secured creditor on default can take the debtor's ownership interest in the property. That, after all, is what *secured* financing is all about.

By failing to conduct a chain of title search and file federally, a floating lienor has failed to secure its interest in the debtor's information against prior interests in the information and against subsequent transferees without notice. Such a floating lienor is in reality saying two things: "I don't care if the debtor owns the information, since I have not conducted customary due diligence to find out." And, "I don't care if the debtor transfers the information free of my interest, since I haven't bothered to take the steps necessary to prevent it." There is a term for those who advance funds based solely on an appearance of solvency, caring not what the debtor owns or disposes of - general creditors.

The paramount goal of intellectual property law is to benefit the public by encouraging new creations.³⁶ It does this by facilitating the ability of creators and "upstream" transferors, and their lender, to collect royalties from "downstream" transferees. It is time we examined how.

II

How Intellectual Property Financing Works

Intellectual property financing law developed over an extended period, in interaction with and reaction to developments in the more general currents of personal property financing law. One cannot understand where we are without some understanding of whence we came. As Gilmore said, "An understanding of the historical development of the pre-Code security devices is basic to an understanding of what Article 9 sought to accomplish and why it was drafted the way it was."³⁷ Those who find the study of history an indispensable tool for avoiding past mistakes will, it is hoped, appreciate the need for detail.

36. See discussion in Brennan, *supra* n. 9, § II.A.

37. Gilmore, *supra* n. 7, at Introduction to Part II.

A. Secured Financing Origins

1. The Evolution of Filing Systems

Secured financing is about using property as collateral for a debt. If the debt is unpaid, the creditor looks to take the debtor's property in satisfaction. The law, however, has long exhibited deep suspicion of secret liens that do not put third parties on reasonable notice of the financing. The fear is that such devices would allow a debtor to induce innocent persons to purchase the collateral or extend false credit on the strength of the apparent ownership.³⁸ The earliest personal property financing arrangements therefore required actual delivery of the collateral to the creditor.³⁹ Gradually, various forms of nonpossessory security devices were recognized.⁴⁰ With rare exceptions, a public filing was required as a condition of protecting the creditor against fraudulent conveyance attack.⁴¹ The filing rules in Article 9 can be seen as exceptions to the background policy against fraudulent conveyances.⁴²

38. See Julian B. McDonnell, *Article 9 and the Security Controversy* § 1.01 in Coogan, *supra* n. 11: "For centuries, courts suppressed security arrangements (except for the pledge, where the creditor took possession of the collateral) as fraudulent conveyances. They feared that third parties would be misled by the debtor's ostensible ownership of assets that had been encumbered and that security devices would be used to shield the debtors assets from the claims of unsecured creditors."

39. See Gilmore, *supra* n. 7, § 14.1, at 438:

The requirement that a secured party take possession of his collateral – or at least effectively remove it from his debtor's possession and control – in order to perfect his interest dates from the beginning of legal history. . . . The basic idea is that the secured creditor must do something to give effective public notice of his interest; if he leaves the property in the debtor's possession and under his apparent control, the debtor will be given a false credit and will be enabled to sell the property to innocent purchasers or to induce innocent persons to lend money to him on the strength of the apparent unencumbered asset. . . . The antagonism to the 'secret lien' runs through our law of sales and security transactions alike. (Footnotes omitted).

40. Prof. Gilmore sums the long history thus: "Ultimately, the financial community had its way and personal property, both tangible and intangible, became available for security without a change of possession. The process, however, took the best part of a century, during which the law of personal property security transactions came to resemble the obscure wood in which Dante once discovered the gates of hell." Gilmore, *supra* n. 7, § 2.2, at 27.

41. Gilmore, *supra* n. 7, at § 15.1. A rare exception is the validation statutes discussed at n. 101, *infra*.

42. See Peter Alces, *The Law of Fraudulent Transactions*, ¶ 5.01[4][b] (Warren, Gorham & Lamont 1989): "[I]t would be a mistake to assume that . . . the perfection of a security interest in scrupulous compliance with Article 9 would necessarily be immune from attack under the [Uniform Fraudulent Conveyances Act], the [Uniform Fraudulent Transfers Act] or the Bankruptcy Code."

The first filing system appeared for real property. The Statute of Enrollments, enacted 1535 during the English enclosure period, established a registry system that required a notice filing of the existence of the deed but not all its terms.⁴³ The American States adopted the principle but not the practice, instead opting for recording acts that required public filing of the entire deed.⁴⁴ Although several variations developed⁴⁵, they all required, and still require, timely recording to protect against a subsequent “*bona fide* purchaser” of the property.⁴⁶

Personal property financing started differently. In 1601, *Twyne's Case*⁴⁷ held that a transfer of personal property without delivery of possession was a fraudulent conveyance, void against subsequent purchasers and creditors without notice. This principle entered our common law as the Statute of 13 Elizabeth or Fraudulent Conveyances.⁴⁸ It continues today in the Uniform Fraudulent Transfer Act.⁴⁹ *Twyne's Case* established an important notion for tangible personal property: apparent ownership. Under this principle, notorious possession of tangible personal property gives an apparent ownership that prevails against undisclosed security interests. This principle, however, does not apply either to real property or intellectual property.⁵⁰

Due to *Twyne's Case*, the only method of financing personal property at common law was the pledge. It required the creditor to

43. In 1535, the Statute of Uses, 27 Hen. VIII, c. 10, authorized transfer of real property by deed of bargain and sale. The Statute of Enrollments, 27 Hen. VIII, c. 16, made the deed void unless registered in Westminster within six months. See Rufford G. Patton & Carroll G. Patton, *Patton on Titles*, ch. 1 (1957 ed.).

44. See Patton & Patton, *supra* n. 43, at § 6.

45. The four different types are pure notice, pure race, race-notice, and race-grace. See *In re Walker*, 67 B.R. 811 (Bankr. C.D. Cal. 1986); see also Patton & Patton, *supra* n. 43, at §§ 7–10. The race-grace system has disappeared for state real property systems, but is still used for the federal intellectual property acts. Original Article 9 adopted a race notice system, but the 1972 revision changed it to a pure race system. See Barkley Clark, *The Law of Secured Transactions under the Uniform Commercial Code*, ¶ 3.08[1][a].

46. Patton & Patton, *supra* n. 43, at § 7 (Whether a recording act extends to other parties, particularly judgment creditors, depends on the terms of the statute.).

47. 13 Co. Rep. 806, 76 Eng. Rep. 809 (Star Chamber 1601). For the historical context, see Coogan, *supra* n. 11, at § 1.02.

48. It was also known as the Statute of 13 Elizabeth. See Coogan, Coogan, *supra* n. 11, at § 1.02, describing the history. See also Garrad Glenn, *Fraudulent Conveyances and Preferences* (Rev ed., Baker, Voorhis 1940).

49. NCCUSL has promulgated two uniform laws on the subject, the Uniform Fraudulent Conveyances Act in 1918 and the revised Uniform Fraudulent Transfers Act in 1984. See Alces, *supra* n. 42, at App. A & B (copies).

50. See *infra* n. 208 and accompanying text.

take possession of the collateral, at least before default.⁵¹ While the pledge made sense in the agrarian society of the seventeenth century, it proved inadequate for the onslaught of Industrial Revolution in the Nineteenth. Factory equipment, railroad rolling stock and merchant's wares could not be pledged, since they were clearly needed for the borrower's business, yet they represented a burgeoning ocean of excellent assets.⁵² The solution came with the chattel mortgage. This was an exclusively legislative device, derived by analogy to the real property recording acts.⁵³ The typical statute validated chattel mortgages with a change of possession, but made one without delivery of possession void against *bona fide* purchasers, and often general creditors too, unless the mortgage was recorded in a local filing office.⁵⁴ This meant that a secured creditor could take possession of the collateral and use the common law pledge, or leave the debtor in possession and instead rely on the filing provisions of a chattel mortgage act. It was of course possible to make a chattel mortgage and take possession,⁵⁵ but the real benefit came for nonpossessory security devices.

2. The "Title" and "Lien" Theories

For more than a century a vitriolic debate raged on the proper classification of a mortgage.⁵⁶ At common law, a mortgage transferred the whole legal title to the creditor, liable to defeat on condition subsequent by paying the debt.⁵⁷ This meant that if the debtor defaulted, the creditor, as title-holder, was entitled to any increased value in the collateral. To protect against forfeiture, the equity courts began to recognize a right of redemption allowing a debtor to recover the collateral by repaying the debt and attendant

51. See Gilmore, *supra* n. 7, at §§ 1.1, 2.1; Coogan, Coogan, *supra* n. 11, at ch. 1; 14 C.J.S. *Chattel Mortgages* § 5 (1997) (Apparently, from this practice we get the maxim "possession is nine-tenths of the law.").

52. Gilmore, *supra* n. 7, at § 2.1.

53. *Id.* at § 2.2.

54. See e.g. *Robinson v. Elliott*, 89 U.S. 513 (1875); Gilmore, *supra* n. 7, at § 2.2; Glenn, *supra* n. 48, at § 495 (recording provisions essential to remove chattel mortgages from the Statute of Fraudulent Conveyances).

55. This led to refined distinctions between a pledge and a possessory chattel mortgage which are now only of historical interest. See Garrard Glenn, *The Pledge as Security Device*, 24 Va. L. Rev. 365, 368-377 (1938).

56. An extensive annotation of the debate can be found in 14 C.J.S. *Chattel Mortgages* § 1. The footnotes contain lengthy excerpts of courts throwing bric-a-bracs at each other as they disagree on the proper approach. The theories are analyzed in Glenn, *supra* n. 48, at §§ 498, 499.

57. See 59 C.J.S. *Mortgages* § 2.b (1998).

costs after breach of the mortgage obligations.⁵⁸ Eventually, the equitable right was converted to a legal right, first through the judicial device of categorizing of the transaction as a lien, and later statutorily.⁵⁹ The concepts carried over from land to chattel mortgages. In lien theory states, a chattel mortgage was analogized to a common law pledge, giving the mortgagee a “special property interest” – a lien – that only vested title on condition broken (non-payment) and foreclosure under statutory rules.⁶⁰

The distinction was not academic. A California case illustrates why.⁶¹ A creditor seized furniture subject to a chattel mortgage and sold it without complying with statutory requirements. The court noted that in title theory states, a chattel mortgage gave the creditor full legal title to the chattel, subject only to an equitable right of redemption. In those states, upon an invalid sale, the debtor’s only recourse for wrongful foreclosure was a bill in equity to have the fair value of the property applied to the debt.⁶² But California was then a lien theory state, in which the chattel mortgage merely gave the creditor a special property interest with legal title remaining in the mortgagor. Foreclosure without compliance with the statutory formalities was wrongful against the debtor’s title, canceling the debt and eliminating any deficiency.⁶³

The substantive difference between the title and lien theories was never about the validity of the creditor’s title. Both theories vested title in the creditor relating back to the record priority date after default and proper foreclosure.⁶⁴ The real difference was in the debtor’s rights.⁶⁵ “Title” was merely a device - the legal realists would

58. *Id.* at § 911.c.

59. *Id.* at § 911.b, § 911.c.

60. See 14 C.J.S. *Chattel Mortgages* § 577 (1997).

61. See *Metheny v. Davis*, 107 Cal. App. 137, 290 (1930).

62. See 11 C.J.S. *Chattel Mortgages* § 577.

63. *Metheny*, 107 Cal. App. at 139; see also 11 C.J.S. *Chattel Mortgage* § 525 (1991); Author, *Chattel mortgagee’s failure to pursue proper course as effecting mortgagee*, 47 U. Pa. L. Rev. 582 (Date).

64. See, e.g. *Rust v. Elec. Light Co.*, 124 Ala. 202 (1899); *Capital City Bank v. Hodgin*, 24 F. 1 (S.D. Iowa 1885); 14 C.J.S. *Chattel Mortgages* § 392 n. 64 (1991) (citing cases from both camps).

65. The effect of noncompliance on the right to a deficiency was always the money question in the title-lien debate. Original Article 9-507 took an ambiguous position, providing that wrongful foreclosure gave the debtor “the right to recover from the secured party any loss caused by failure to comply” with statutory requirements. This led to three different approaches. One line of cases held noncompliance was an absolute bar to a deficiency. A second created a rebuttable presumption that compliance with statutory formalities would have yielded enough to satisfy the debt, placing the burden on the creditor to prove otherwise. A third line of cases placed the burden of proving loss

say subterfuge - for dealing with the substantive issues. By the early twentieth century 17 states, primarily on the Eastern seaboard, still clung to the title theory of chattel mortgages, while 23 others, mostly in the South and West, had embraced the lien theory.⁶⁶ One may speculate this was because the title theory was less forgiving to debtors, and Easterners were then lenders to rest of the country.

The title-lien debate was never satisfactorily resolved and was perhaps incapable of definitive resolution.⁶⁷ Original Article 9 did not end the debate so much as moot it.⁶⁸ It replaced the substantive differences between the title and lien theories in the right of redemption and liability for deficiency with a single unified construct that accorded the same rights and remedies regardless of whether title was in the secured party or in the debtor.⁶⁹ One would have thought that this put an end to the title-lien debate, but curiously, for some commercial law commentators it remains alive and well for information security transfers, as we will see.⁷⁰

3. *The Bona Fide Purchaser*

The real property recording acts and the chattel mortgage acts protected against a subsequent *bona fide* purchaser of the collateral. Gilmore rhapsodized that “[t]he triumph of the good faith purchaser has been one of the most dramatic episodes in our legal history.”⁷¹ Essentially, a *bona fide* purchaser is a person who takes an interest in property in good faith, for value and without notice of a prior transfer.⁷² The *bona fide* purchaser is one of the principle parties

from noncompliance on the debtor. See Clark, *supra* n. 45, at ¶ 4.12[5]. Prof. Gilmore argued that creditors should lose the right to collect a deficiency as a sanction for misbehavior. Gilmore, *supra* n. 7, at § 44.9, at 1263-1264. The Drafters of Revised 9 opted instead for the “rebuttable presumption” rule for commercial foreclosures, and a “let the court decide” rule in consumer loans. Their reasoning is described in Donald J. Rapson, *Default and Enforcement of Security Interests under Revised Article 9*, 74 Chi.-Kent L. Rev. 893, 937-940 (1999).

66. See 14 C.J.S. *Chattel Mortgages* § 1 (1991), listing the states in the footnotes.

67. See Gilmore, *supra* n. 7, at § 1.1 at 8-9.

68. *Id.* at § 11.9.

69. See U.C.C. § 9-202 (West 1999); see also Clark, *supra* n. 45, at ¶ 1.02[1] (stating that the “mystical location of ‘title’ no longer determinative”).

70. *Infra* n. 177 and following text

71. See Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 Yale L.J. 1057 (1954); but see Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 Ga. L. Rev. 605, 627 (1981) (Upon reconsideration, noting that many of the concepts in Article 9 with regard to intangible financing, including repudiation of *Benedict v. Radner*, may well have been mistaken).

72. The details of all three ingredients are beyond the scope of this article. For

protected by the policy against secret liens.

The term “*bona fide* purchaser” is a legal term of art that is not limited to a “buyer.”⁷³ It also embraces mortgagees,⁷⁴ pledgees holding liens,⁷⁵ and interests under chattel mortgages.⁷⁶ Under the UCC, by definition a “purchaser” includes a creditor under a mortgage, pledge or lien,⁷⁷ including of course a security interest.⁷⁸ The term does not include general, attaching or lien creditors.⁷⁹ However, judicial creditors who purchase at their own execution sales do qualify for *bona fide* purchaser status.⁸⁰ The distinction between a *bona fide* purchaser and a judicial lien creditor is a matter of utmost importance which we will address repeatedly.

B. Intangible Financing

1. Origins

By the middle of the nineteenth century, real and personal property had developed roughly parallel financing systems in the recording acts and the chattel mortgage acts. Unfortunately, there was a gap — intangible financing. Intangibles encompass a variety of legal interests, including accounts receivable, contract rights, and of course intellectual property. How could they be financed, in a manner consistent with the policy against fraudulent conveyances? The chattel mortgage acts were limited to tangible property, and

further discussion, see Patton & Patton, *supra* n. 43, at § 13 (describing the elements under real property recording acts); Brian A. Blum, *Notice To Holders in Due Course, and Other Bona Fide Purchasers under the Uniform Commercial Code*, 22 B.C. L. Rev. 203 (1981); Grant Gilmore, *supra* n. 71.

73. See Ronald A. Anderson & Lary Lawrence, *Anderson on the Uniform Commercial Code* § 1-201:428 *et seq.* (1999 Rev. ed.).

74. See e.g. *Fed. Deposit Ins. Corp. v. Super. Ct.*, 54 Cal. App. 4th 337, 343 (1997) (holding that a *bona fide* purchaser includes mortgagee or holder of deed of trust); Patton & Patton, *supra* n. 43, at § 12 n. 53 (collecting cases).

75. See e.g. *Ironside v. Levi*, 278 Mass. 18 (1932); *Famous Furniture Co. v. J. Fishman & Son*, 22 N.J. Misc. 368; (1944); 49 C.J. *Pledge* § 64 (Date).

76. See e.g. *People v. One 1941 Buick Coup*, 72 Cal. App. 2d 593 (1946) (chattel mortgagor); *Pac. Fin. Co. v. Hendley*, 103 Cal. App. 335, 338 (1930) (chattel mortgagee); *Central Trust Co. v. Stepanek*, 138 Iowa 131 (1908) (assignee of chattel mortgagee).

77. U.C.C. § 1-201(32) - (33) (defining “purchase” and “purchaser”) (West 1998).

78. *Guy Martin Buick, Inc. v. Colo. Springs Natl. Bank*, 184 Colo. 166 (Colo. 1974); see also Anderson, *supra* n. 73, at § 1-201:434 and cases cited.

79. *Green v. Hanover Ins. Co.*, 700 S. 2d 1354, 1357 (Ala. 1997) (judgment creditors are not *bona fide* purchasers); Patton & Patton, *supra* n. 43, § 12 n. 44 (collecting cases).

80. See e.g. *McClaskey v. Harbison-Walker Refractories Co.*, 138 F.2d 493, 498-499 (3d Cir. 1943) (patents); *Hunter v. Watson*, 12 Cal. 363, 377 (1859) (real property); also 35 C.J.S. *Judicial Sales* § 128 (1997); Patton, *supra* n. 43, at § 12, fn. 55.

therefore were unavailable.⁸¹ Certain types of intangibles represented by a writing, such as negotiable instruments, corporate securities, documents of title and the like, were eventually allowed financing by pledge through the mechanism of turning the document over to the creditor.⁸² However, many intangibles, including intellectual property, could not be so pledged. Periodically certain intangibles were separated out, made the subject of a recording act, and thus allowed an effective method of financing.⁸³ This happened for federal patents and copyrights in 1870 and trademarks in 1905. Before turning to how this worked, let us briefly finish the story of intangible financing up to the general enactment of the UCC, since it will have a bearing on the story later on.

In strict legal theory, “pure” intangibles outside the negotiable instrument variety would need to be financed under the law of assignment.⁸⁴ At early common law, intangibles – choses in action – could not be assigned at all.⁸⁵ Gradually, through a complex dance between the law and equity courts, assignments of intangibles were recognized, including security transfers or “collateral assignments.”⁸⁶ The basic difference between a “true” assignment and a “collateral” assignment was that the latter accorded the debtor a right of redemption while the former did not.⁸⁷ The courts evidently could have developed a refined law of the difference between a collateral assignment and a mortgage, but never seemed inclined to do so.⁸⁸

81. Gilmore, *supra* n. 7, at § 2.8 at 55; 11 C.J. *Chattel Mortgages* § 204. It appears that early on a few chattel mortgage acts could have covered intangibles, but after a few bumps settled down to only tangible property.

82. Gilmore, *supra* n. 7, § 7.1 (“It is in general true that if intangible property can be pledged, it must be pledged; that is to say, no perfected security interest can be created in such property except by its physical delivery to the creditor.”).

83. *Id.* (certain contract rights financed under Uniform Trust Receipts Act, *etc.*)

84. *Id.* at § 2.8, at 55-56.

85. *Id.* at § 7.3, at 200. At common law, patents, trademarks and copyrights were classified as choses in action. See W.R. Warren, *Choses in Action* 2 (Street & Maxwell 1899)

86. See Gilmore, *supra* n. 7, at §§ 7.3-7.5, at 200-210 (describing the process).

87. See *Sheldon v. McFee*, 216 N.Y. 618 (1916) (“The right to redeem is the essential characteristic of a mortgage”); compare 6A C.J.S. *Assignment* § 6 (1975) (assignment not a mortgage because no right of redemption) with 14 C.J.S. *Chattel Mortgages* § 2 (1991) (distinguishing mortgage from assignment).

88. See Gilmore, *supra* n. 7, § 2.8, at 58-60:

Many of the cases which talk about mortgages of intangibles use language which wobbles from mortgage to pledge to assignment, in situations where the applicability of the chattel mortgage act is not in any way involved. . . . The approach of the New York Court of Appeals has been to state expressly that security transfers of intangibles do not fall within the chattel mortgage acts for any

Instead, they simply treated a collateral assignment as a type of mortgage, albeit one not subject to the filing rules under the chattel mortgage acts. Basically, they were saying that when an intangible was assigned for security, the debtor would be accorded the same right of redemption as a mortgagor under the prevalent title or lien theory under applicable state law.

2. Account Financing

An important type of intangible financing involved accounts receivable.⁸⁹ Revised Article 9 has now defined royalties due under information licenses as “accounts.” Thus, it is important to understand pre-Code systems for account financing as a prelude to understanding what Revised 9 does to royalties under information licenses.

By the twentieth century, accounts receivable financing had become big business.⁹⁰ The earliest method was “factoring.” This involved an unconditional assignment or “sale” of accounts to the factor.⁹¹ The account debtor would be instructed to make payment to the factor, after which the factor took the credit risk of default by the account debtor, but also the upside of any increase in value.⁹² Later on, “accounts receivable” or “non-notification” financing came into vogue. In this scheme the financier loaned money against a changing pool of accounts.⁹³ The financier did not notify the account debtors of the financing unless the debtor defaulted. Instead, the debtor was

purpose. Other courts reached what was for all practical purposes the same result by saying that while security transfers of intangibles were mortgages, they were not subject to the filing provisions of the chattel mortgage acts. Theoretically, this type of holding could have led to the development of involved distinctions between the rights of transferees who were ‘mortgagee’s and the rights of those who were ‘assignees.’ There has never been enough litigation of this sort, however, to nourish the growth of such refinements.

89. *Id.* at §§ 8.1 *et seq.*

90. See Dan T. Coenen, *Priorities in Accounts: The Crazy Quilt of Current Law and a Proposal for Reform*, 45 Vand. L. Rev. 1061 (1992); and Thomas E. Plank, *Sacred Cows and Workhorses: The Sale of Accounts and Chattel Paper under the U.C.C. and the Effects of Violating a Fundamental Drafting Principle*, 26 Conn. L. Rev. 397 (1994).

91. Factors were originally agents who sold goods for manufacturers to distant customers. They began by guaranteeing the creditworthiness of their customers, a practice that gradually evolved into buying the receivables directly. See Plank, *supra* n. 90, at 407-408.

92. Coenen, *supra* n. 90, at 1067. Factors could also buy the accounts “with recourse” and take the credit risk, or “without recourse” leaving the debtor with the obligation to buy-back defaulting accounts.

93. Plank, *supra* n. 90, at 408.

required to keep sufficient accounts to secure the loan, typically taking the credit risk of a non-paying account.⁹⁴

Typically, an "account" is a fully matured right to payment. A seller delivers the goods, the buyer pays the price, and an "account" arises. The payment is now property of the seller, and the trick for the lender is to ensure priority in this payment over other creditors of the seller. Since accounts were financed under the law of assignment, there was no filing system, and priority issues were left to the courts to sort out. Three different rules emerged. Under the "American rule," the first security assignment in time prevailed under the *nemo dat* principle.⁹⁵ Under the "English rule," in case of competing security assignments, the first to give notice to the account debtor prevailed.⁹⁶ Finally, Massachusetts adopted a complicated four-factor test from the Restatement of Contracts that became known as the "four horsemen" rule.⁹⁷ For factoring, this caused little problem, since the account debtor was given notice of the assignment, a technique sufficient to perfect under all three rules.

Non-notification account financing was another matter. It came under attack in *Benedict v. Ratner*.⁹⁸ The case involved a non-notification account financing in which the debtor was allowed unfettered ability to control collections. This was a variant on the debtor in possession, raising all the hackles about secret liens. *Benedict* held that the failure of the creditor to exercise dominion over the accounts and so provide notice to third parties of its interest was a "fraud in law" void against the bankruptcy trustee. This holding did not make non-notification account financing impossible, but did confine it to specialists who would exercise appropriate control.⁹⁹

If *Benedict* allowed non-notification financing, at least by the finance companies, there was still a question of how perfection worked. The Supreme Court addressed that in *Corn Exchange National Bank and Trust C. v. Klauder*.¹⁰⁰ It held that in an English rule state, the ability of a second assignee to defeat the first assignee

94. *Id.*; Coenen, *supra* n. 90, at 1068.

95. Coenen, *supra* n. 90, at 1069; Gilmore, *supra* n. 7, at § 8.7. New York was a tenacious proponent of this rule until its enactment of the Uniform Commercial Code.

96. Coenen, *supra* n. 90, at 1069; Gilmore, *supra* n. 7, at § 8.7. The rule originated in *Dearle v. Hall*, 3 Russ. 1 (Ch. 1828). Pennsylvania and California followed this approach.

97. See Coenen, *supra* n. 90, at 1069; Gilmore, *supra* n. 7, at § 8.7.

98. 268 U.S. 353 (1924).

99. See Gilmore, *supra* n. 7, ch. 8.

100. 318 U.S. 434 (1943).

by notice meant that the transfer was not deemed made until perfected against a good faith purchaser for value. Thus, the bankruptcy trustee, who was then treated as a *bona fide* purchaser for voidable preferences, could set aside an account assignment unaccompanied by notice to the account debtor.¹⁰¹ This led to a flurry of state “validation” statutes, the bulk of which codified the American first in time rule.¹⁰²

Original Article 9 dealt this situation in a several ways. First, after contentious debate, the drafters decided that the statute would cover both the sale (“factoring”) and financing of accounts on the theory that there was often little practical difference.¹⁰³ Second, the statute abrogated *Benedict’s* dominion rule by allowing account financing, even though the debtor retained the ability to control and collect.¹⁰⁴ Finally, it reversed the validation statutes by requiring a filing to perfect both for a sale and a financing of accounts.¹⁰⁵ One may think that *Benedict* and the validation statutes are now ancient history. Under Revised 9, think again. For intellectual property Revised Article 9 has evidently reanimated the corpse of *Benedict’s* dominion practice and revived the “secret lien” regime under the validation statutes as well.¹⁰⁶

3. Royalty Financing

A close cousin to account financing is royalty financing. Related though they may be, there is a distinct difference. Accounts typically arise from a fully matured right to payment and royalties from executory contracts. This led to different treatment under original Article 9.¹⁰⁷

The starting point for royalty financing is how to perfect in the underlying asset that gives to the royalty, *i.e.* the debtor’s information rights. Curiously, *Benedict* dealt with that. In support of its fraud in

101. Coenen, *supra* n. 90 at 1071; Gilmore, *supra* n. 7, § 8.7.

102. See Gilmore, *supra* n. 7, § 8.7 and Coenen, *supra* n. 90 at 1071-1073 (discussing *Klauder* and the subsequent validation statutes).

103. For a detailed history of the debate, see Plank, *supra* n. 90, at 410 *et seq.*

104. Article 9-205; see Gilmore *supra* n. 7, § 11.6; see also Clark, *supra* n. 45, ¶ 10.01[4].

105. Gilmore, *supra* n. 7, § 8.7.

106. See Brennan, *supra* n. 9, § III.A - § III.K (reviving validation statutes and *Benedict* policing requirements).

107. Under original Article 9, executory payment rights were treated as “contract rights.” See Gilmore, *supra* n. 7, § 12.5, at 380. The 1972 revision subsumed “contract rights” under “accounts” by re-defining an account as a right to payment *whether or not it has been earned by performance*. See Clark, *supra* n. 45, ¶ 11.01[1].

law rule, *Benedict* cited¹⁰⁸ *In Re Leslie-Judge Co.*¹⁰⁹ The case dealt with a chattel mortgage, duly filed under the New York chattel mortgage act, which covered both a federal copyright and trademark. Under the Copyright Act of 1909¹¹⁰ and the Trademark Act of 1905¹¹¹ it would seem such a mortgage would only be effective against third parties if filed federally. *Leslie Judge*, albeit in summary language, agreed.¹¹² Due its approval in *Benedict*, *Leslie-Judge* emerged as a leading pre-Code authority for the rule that a federal filing was the only way to perfect a security transfer in federal information.¹¹³ Although Article 9 abrogated *Benedict*'s dominion rule for financing accounts under state law, it could not change federal law. Thus, *Benedict*'s endorsement of *Leslie Judge* should remain good law on the necessity of a federal filing to perfect in federal information. This was Gilmore's reading of the situation.¹¹⁴

The next issue involves how to perfect in the royalties. More curiously still, *Klauder* effected that. Some of the state validation statutes enacted in response to *Klauder* covered general intangibles as well as accounts. California's did.¹¹⁵ Indeed, for more than a decade California's version of Article 9 contained a non-uniform provision expressly providing that between *bona fide* assignees of a right to payment under a general intangible, the first one to give notice to the account debtor prevailed.¹¹⁶ The section was eventually removed from

108. *Benedict*, 268 U.S. at 353 n. 2.

109. *In re Leslie-Judge Co.*, 272 F. 886 (2d Cir. 1921), *cert. denied*; *Green v. Felder*, 256 U.S. 704 (1921).

110. *See infra* n. 407 and accompanying text.

111. *See infra* n. 458 and accompanying text.

112. Prof. Gilmore excuses *Leslie-Judge*'s summary invalidation because the chattel mortgage was a "dead duck" on so many grounds. He n.s. that, putting aside the federal filing requirement, under state law it would have been possible to finance the *Leslie-Judge* copyright under the New York law of assignment, which did not require a filing for intangibles. Gilmore, *supra* n. 7, § 13.3, at 415.

113. Patents would also be included since the Patent Act had identical recording rules. *See infra* n. 445 and accompanying text.

114. *See* Gilmore, *supra* n. 7, § 13.3, at 415.

115. Cal. Civ. Code § 3019 [former], *repealed* Stat. 1963 c. 819, at 1997 § 2; *see also* *California Chattel Security and Article Nine of the Uniform Commercial Code*, 8 UCLA L. Rev. 806, 878 (1961).

116. Under California's non-uniform addition of Article 9-302(1)(g), between *bona fide* assignees of a right to payment under a general intangible, the first one to give notice to the account debtor prevailed. The reason given was that "money is often loaned, for example, against a pledge of uncopyrighted literary property or the rights of performance under a contract for a person to appear in a motion picture or television show. No filing or recordation is now required in these transactions, and the Advisory committee believes that because of the peculiar nature of the collateral filing is not necessary to protect subsequent transferees or lenders." *Report by the California State Bar Committee on the*

Article 9¹¹⁷ and left in the state Civil Code where it belonged.¹¹⁸ This is because original Article 9 only covers security interests and “sales of accounts” (factoring).¹¹⁹ An account is a right to payment arising from goods sold or services rendered; royalties from information are not accounts.¹²⁰ Thus, even after adoption of original Article 9, royalties continued to be financed under the state law of assignment,¹²¹ just like pre-Code account financing. One could well distinguish a “sale” assignment or factoring of royalties from a “collateral” or security assignment, putting the royalty “factoring” outside Article 9 but leaving the security financing in. The case law has not seemed particularly interested in this distinction. It treats any assignment of a fully matured right to royalties, whether a “sale” or for security, as outside Article 9.¹²²

When the royalty has been fully earned by performance, it is relatively easy to strip off the royalty from the informational rights and finance it separately. This is similar to what happens with accounts when they appear as matured rights to payment after the goods are sold.¹²³ However there is another way to look at the situation, especially where the royalty obligation is still executory. Some of the commentary argues, reasonably enough, that royalties could be treated as “proceeds” under original Article 9-306(1) since

Uniform Commercial Code, 37 J. St. B. Cal. 119, 211 (1962). By “uncopyrighted” the committee obviously meant works for which federal statutory copyright had not been secured, i.e. common law copyrights, since *Leslie-Judge* required a federal filing for statutory copyrights. This section mirrored California Civil Code 955.1 [1965]. For discussion of the California approach see Peter F. Coogan, *Intangibles as Collateral under the Uniform Commercial Code*, 77 Harv. L. Rev. 997, 1021-1031 (1964).

117. California repealed Article 9-302(1)(g) in 1974. Cal. Stats. 1974, c. 997 § 14101.

118. Cal. Civ. Code § 955.1 (1965). This section has been amended effective July 1, 2001 due to California’s adoption of Revised Article 9.

119. Original Article 9-102(1).

120. Original Article 9-106; *In re SSE Intl. Corp.*, 198 B.R. 667, 670 n.3 (Bankr. W.D. Pa. 1996).

121. See Brennan, *supra* n. 9, § III.D.3(b).

122. Compare e.g. *Morrison v. Helms*, 28 U.C.C. Rep. Serv. 172 (Tenn. App. 1979) (absolute assignment of royalties under music contract outside Article 9) with *Broadcast Music, Inc. v. Hirsch*, 104 F.3d 1163 (9th Cir. 1997) (collateral assignment for security of royalties under music contract outside Article 9).

123. See *Am. Natl. Bank v. Cloud*, 201 Cal. App. 3d 766 (1988) (holding that proceeds from the sale of raisins became an account in which the bank was perfected since it was perfected in the original collateral.). Current Article 9-318(2) allows an assignor and account debtor to modify an assigned contract only so far as the right to payment “has not already become an account.” The idea is that once goods are sold or services rendered, i.e. the payment is earned by performance, the assignee’s rights vest. See Gilmore, *supra* n. 7, § 41.10, at 1114.

they arise from “disposition” of the information.¹²⁴ In that case, Article 9 would cover the transaction, subject, of course, to relevant federal law. Under original Article 9-306(2), a security interest remains perfected in proceeds if the security interest in the original collateral was perfected and the financing statement covering the collateral was filed in the same place one would file to perfect in the proceeds. The copyright cases, led by *In re Peregrine*, have held that one can perfect a security interest in “copyright receivables,” *i.e.* royalty proceeds, by filing in the Copyright Office,¹²⁵ a quite sensible approach. But what if the federal filing conflicts with the state law assignment? Under federal preemption, one would expect the federal filing to prevail. *Broadcast Music, Inc. v. Hirsch*,¹²⁶ addressed this problem in a conflict between an IRS lien, which was deemed recorded in the Copyright Office, and an earlier unrecorded assignment of royalties from a non-exclusive music performance license. Distinguishing *Peregrine*, the *BMI* court said that a party does not finance royalties by filing in the Copyright Office, but under the law of assignment. The reasoning is suspect. The royalties arose from a written nonexclusive license, which under Section 205(f) of the Copyright Act would have had priority over the IRS tax lien even without a recording. In other words, relying on federal law would have given the same result as the court eventually reached using the state law of assignment, and a far better result for financiers of information royalties as well.

4. Anti-assignment Issues

Another piece of the puzzle deals with ensuring priority over

124. See Clark, *supra* n. 45, ¶ 10.01[2][d].

125. See *infra* n. 422 and accompanying text; *MCEG v. Phillips Nizer Benjamin Krim*, 646 N.Y.S.2d 778 (1996) (involving a malpractice action against a law firm for failing to file in the Copyright Office to perfect a security interest in royalty payments under exclusive television distribution agreements. The court said that since *Peregrine* had not been decided when the loans were documented, there was no malpractice in failing to anticipate its “novel theory”). *Peregrine*’s holding is hardly novel, *infra* n. 422. Moreover, the *MCEG* court’s reasoning is questionable. First Bank had a loan against the copyrights in various movies, duly registered in the Copyright Office. The lender in question, Credit du Nord, was in second position. An Interparty Agreement executed by First Bank retained its security interest in the copyright but excluded the television contracts that formed Credit du Nord’s collateral. The court held that since First Bank had retained the *copyright*, that Credit du Nord had no interest in the copyright, only in the royalties. However, under Section 201(d) of the Copyright Act, the exclusive television distribution contracts certainly were copyright ownership interests, and Credit du Nord should have filed in the Copyright Office to perfect its security interest in royalty “proceeds” derived from them.

126. 104 F.3d 1163 (9th Cir. 1997); see *infra* n. 438 and accompanying text.

creditors of the transferee. In factoring, the account is a fully matured right to payment, and the risk of intervening claims by a creditor of the account debtor is slight.¹²⁷ Non-notification financing may involve somewhat greater risk, and financing accounts yet to be earned by performance, as allowed by the 1972 revision to Article 9, would be riskier still.¹²⁸ In royalty financing, however, the license often has multiple on-going obligations on both sides, and is squarely in the area of financing executory contracts. It is therefore quite possible that other creditors of the transferees will have claims against the transferees, including the earnings realized from exploitation of the information, in addition to the transferor.

With regard to the information rights, filing in the appropriate federal register would give the transferor's lender priority over subsequent ownership transferees.¹²⁹ The Copyright Act filing system applies both to ownership transfers (assignments, mortgages and exclusive licenses) and non-exclusive licenses¹³⁰, and so accommodates filing for all transfers. The Patent Act and Lanham Act, however, only apply to ownership transfers (assignments, grants and, as this article maintains for trademarks, mortgages), not licenses. How a secured creditor perfects a security interest in a patent or trademark license therefore depends, for now, on state law.

How does a transferor establish priority in its right to royalties earned by a transferee ahead of a security interest filed against the transferee? In *Septembertide Publishing, B.V. v. Stein and Day, Inc.*,¹³¹ an author granted an exclusive copyright license to book publisher while reserving a large royalty. The publisher subsequently granted a security interest in all "contract rights and rights to payment of moneys" it held. The author's royalty was not recorded, and the secured creditor claimed it had priority in advances collected from licensees that were otherwise payable to the author as royalties. The Court looked to Article 9-318(1)(a), which provides that the rights of an assignee are subject to "all the terms of the contact between the account debtor and assignor and any defense or claim arising therefrom." It concluded that the publisher's lender could only take

127. The risk, however, is not entirely non-existent. See *Octagon Gas Sys., Inc. v. Rimmer*, 995 F.2d 948 (10th Cir. 1993); Brennan, *supra* n. 9, § III.B.

128. See Clark, *supra* n. 45, at ¶ 11.01[1].

129. See *infra* n. 207 and following text.

130. 17 U.S.C.A. § 205 (West 1996). Section 205(a) refers to *transfers*, not merely *transfers of ownership*, and thus allows the filing of nonexclusive licenses. This is confirmed by Section 205(f). N. that 205(f) gives a limited priority to unrecorded nonexclusive licenses over transfers of ownership.

131. 884 F.2d 675, 676 (2d Cir. 1989).

what that publisher had, which was a contract for net collections after the royalty. The court was influenced by the fact that the security interest was taken after the author made the contract, so there was no way for the author to discover it. It was therefore incumbent on the lender to investigate the contract rights it was financing.

An influential commentator, while acknowledging that *Septembertide* makes sense in terms of basic fairness, nevertheless argues the author should have been a mere unsecured creditor with regard to the advances, and hence junior to the secured creditor.¹³² This argument, however, in effect, views the copyright license as no more than a "sale of goods" in which the author lost all residual interest in the *rights* once the license was signed and thereafter only had an *account* for royalties due. From an intellectual property perspective, things look quite different. A licensor who has transferred a copyright interest in exchange for royalties retains a beneficial ownership in the rights for royalties due, giving immediate standing to sue for infringement if the transferee does not act.¹³³ One could therefore view the right to royalties as a beneficial copyright interest that the publisher did not own, so the security interest never attached to it in the first place. Alternatively, one could view the reservation of royalties as an assignment back to author, which, not being an account, would not need a filing to perfect.¹³⁴

A basic question raised by *Septembertide* is finding prior interests. Granted, a secured creditor loaning against information must check chain of title. The question is where. *Septembertide* says,

132. Clark, *supra* n. 45, at ¶ 11.04[3][b] at 11-22. Prof. McDonnell argues that the expanded definition of "account" in Revised Article 9-102(a)(2) has now adopted this view and reversed *Septembertide*, requiring the author to file to perfect against the publisher, "[a] result which might well surprise authors of the world." Coogan, *supra* n. 11, § 2B.07[5], at 2B-50.

133. 17 U.S.C.A. § 501(b) (West 1994); H.R. Rpt. No. 94-1476, at 159 (1976); *Wildlife Intl., Inc. v. Clements*, 591 F. Supp. 69 (S.D. Ohio 1984); Nimmer & Nimmer, *supra* n. 19, at § 12.02[C].

134. An assignment of rights under an executory contract does delegate duties so as to make the assignee liable for their performance except where the assignee assumes the obligations expressly or by implication. Such an implication occurs where the contract is fully executed and the assignee takes the benefits of the contract. See e.g. *Fanning v. Yoland Productions, Inc.*, 150 Cal. App. 2d 444 (1957) (assignee of actor's contract bound to pay guaranteed compensation despite agreement with assignor, unknown to actor, relieving assignor of liability, since actor had rendered full performance to assignee and assignee had the benefits of the contract); *Pecarovich v. Becker*, 113 Cal. App. 2d 309 (1952) (assignee of football coach's contract liable). Under this rule, it is arguable that a collateral assignee, i.e. a creditor under a security interest, of a licensee's rights under a license fully executed by the licensor would take subject to the obligation to pay the licensor's royalties.

in effect, that a secured lender to a transferee takes subject to a royalty obligation in the transferee's transfer agreement, whether or not recorded. An alternative approach would be to follow *Peregrine* and view the royalties as proceeds of an intellectual property license, making the transferee's lender subject only to a royalty obligation disclosed in a properly recorded instrument, at least to the extent of the preemptive filing rules in federal law. Another commentator, familiar with the nuances of intellectual property law, advocates this approach.¹³⁵ Technically, *Septembertide* and *Peregrine* can be reconciled on the ground that *Septembertide* was considering a reservation of royalties, which could be classified as a "true" assignment outside Article 9, while *Peregrine* was speaking of a security assignment of royalties, which would need to be filed for perfection in the Copyright Office.

Other case law is mixed. *South Bay Entertainment v. Miranda Bay Petroleum*¹³⁶ held that an inventor's right to royalties under an unfiled technology license prevailed against creditors of the licensee with a writ of execution returned unsatisfied. *Recorded Picture Co. v. Nelson Entertainment, Inc.*¹³⁷ held that a sublicensee was not liable for royalties its sublicensor owed to its licensor because a sublicensee is not an assignee, and the obligation was not properly disclosed.¹³⁸ *In re*

135. See Moore, *supra* n. 10, at 589-594 (arguing that priorities should be determined based on recording in the Copyright Office). The author conceptualizes the licensor's interest as a termination right allowing the licensor to terminate the license for breach. Where the license is silent, this termination right would arise where the obligation to pay royalties was material. *Id.* at 59, n. 159. This is similar to categorizing the licensor's rights as a beneficial ownership interest giving the licensor standing to sue for unpaid royalties, where the failure to pay is so material as to terminate the licensee's rights and thus make continued use an infringement. *Id.*

136. *S. Bay Enter. v. Miranda Bay Petroleum*, 957 S.W.2d 287 (Ky. App. 1997). For further discussion see Brennan, *supra* n. 9, at § III.C.3(a).

137. 53 Cal. App. 4th 350 (1997).

138. Recorded Picture Co. ("Recorded"), the producer of *The Last Emperor*, licensed exclusive video rights to Hemdale, reserving a royalty of 70% of gross receipts and obligating Hemdale to require sublicensees to make payments directly to Recorded. Hemdale sublicensed to Nelson for 50% of net proceeds, not disclosing Recorded's interest. *Id.* Hemdale declared bankruptcy, and Recorded sued Nelson, claiming it was bound by the terms in the Recorded-Hemdale contract. *Id.* Although an assignee of rights under a contract becomes liable for its obligations when the contract is fully executed and the assignee takes the benefits, the court concluded that Nelson was a licensee, not an assignee, so this rule was inapplicable. *Id.*

Hemdale had taken a protective security interest against Recorded, filing a UCC-1 and a Copyright Mortgage. *Id.* Although both referenced the Recorded-Hemdale license, neither one disclosed the payment obligation. *Id.* This was insufficient to place Nelson on notice, since "[a]bsent suspicious or other circumstances warranting a reasonable investigation, a recorded document does not put a potential purchaser on notice of the content of a referenced, unrecorded document." *Id.* at 366. Instead, looking by analogy to

*DAK Industries, Inc.*¹³⁹ held that pre-petition royalty payments under a nonexclusive software license were junior to secured creditors of a bankrupt licensee. This result is unreliable, however, because the court categorized the license as a “sale of goods,” in effect treating the royalties as an “account” requiring filing a financing statement to perfect.¹⁴⁰

Can a transferor simply prohibit the transferee from assigning its rights for security at all? This requires a somewhat detailed review of the law of assignment that is better conducted in the context of Revised 9.¹⁴¹ Summarizing briefly, pre-Code case law was mixed on the enforceability of restrictions on assigning payment rights.¹⁴² The drafters of original Article 9 opted in favor of limited assignability in Article 9-318(4), which invalidates any term prohibiting “the creation of a security interest in a general intangible for money due or to become due.”¹⁴³

Under Article 9-318(4), a transferor of information could not prohibit the transferee’s creation of a security interest in its *exclusive* rights “for money due or to become due.”¹⁴⁴ Such a security interest could take priority over the transferor’s royalties even under Article 9 if the transferee’s security interest were properly perfected first. *Septembertide* would arguably be inapplicable because, in that case, the security interest was perfected after the transfer was made. A

real estate law, the court found no liability because

[b]etween [the landlord] and . . . [the] sublessees there was neither privity of estate nor privity of contract. . . . [The landlord], therefore, could not sue the undertenants upon the original lessee’s covenant to pay the rent, unless the undertenants had assumed the lease, nor could an action be maintained for the use and occupation of the premises, unless there had been an agreement for the use of the premises express or implied between the lessor and the sublessee.

Id. at 365. In the Digital Millenium Copyright Act 28 U.S.C. § 1040, Congress created a limited statutory privity in providing that a transferee of U.S. rights in a motion picture produced under a collective bargaining agreement takes subject to certain obligations to pay residuals under such labor agreement, subject to various qualifications.

139. 66 F.3d 1091 (9th Cir. 1995).

140. *Id.* at 1093. “Microsoft did not perfect a security interest in any of DAK’s property, which might have protected it against DAK’s failure to pay the entire minimum commitment in the event of bankruptcy.” Brennan, *supra* n. 5 at 558-560 (questioning the reasoning in *DAK*).

141. See Brennan, *supra* n. 9, at § III.F(3)(a).

142. Compare *Allhusen v. Caristo Constr. Co.*, 303 N.Y. 446 (1952) (enforcing an anti-assignment clause) with *Sillman v. Twentieth Century Fox Film Corp.*, 3 N.Y.2d 395 (1957) (holding that where conduct demonstrated waiver, and anti-assignment will not be enforced).

143.

144.

pre-existing floating lien against the transferee would not do the job, however, since the federal system does not recognize floating liens because they do not specifically identify the work, patent or mark. The transferor, or its lender, could thus assure priority by federally recording an instrument covering the reserved royalty with respect to the specific item of information before the transferee's lender did so. However, *nonexclusive* patent and copyright licenses are non-assignable without consent of the licensor as a matter of federal law, preempting state law rules.¹⁴⁵ All federal trademark licenses are not assignable without consent of the trademark owner under federal law.¹⁴⁶ A right to receive royalties is an essential part of the rights accorded by intellectual property law.¹⁴⁷ It seems that federal law would also prevent a transferee's grant of a security interest "for money due or to become" under a nonexclusive license, notwithstanding Article 9-318(4). Revised 9, however, attempts to change this result.¹⁴⁸

This concludes the discussion of information financing under the common law of assignment. We now turn to financing under the federal information acts.

C. The Early Federal Information Acts

1. Origins and Operation

In the 1830s, Congress enacted laws to deal with the assignment of patents and copyrights.¹⁴⁹ They did not mention security transfers as such, perhaps an understandable omission at the time. By the middle of the nineteenth century, however, the Supreme Court had

145. *In re CFLC, Inc.*, 89 F.3d 673, 679 (9th Cir. 1996) (discussing nonassignability of non-exclusive patent licenses); *Harris v. Emus Records Corp.*, 734 F.2d 1329, 1334 (9th Cir. 1984) (discussing non-assignability of non-exclusive copyright licenses).

146. *Super. Bedding Co. v. Serta Assoc., Inc.*, 353 F. Supp. 1143, 1149 (N.D. Ill. 1972).

147. See e.g. *Chemical Found., Inc. v. E.I. Du Pont De Nemours & Co.*, 29 F.2d 597, 600 (D.C. Del. 1928) *aff'd. sub nom. Farberke Vormals Meister Lucius & Bruning v. Chem. Found., Inc.*, 283 U.S. 152 (1930) ("Royalties to accrue and damages and profits for future infringement are incident to and accompany the patent unless separated by express reservation"); *Crom v. Cement Gun Co.*, 46 F. Supp. 402, 405 (D. Del. 1942).

148. See Brennan, *supra* n. 9, at § III.F.

149. Section 6 of the Copyright Act of 1831, 4 Stat. 436, required that assignments of statutory copyright be in writing, but did not mention mortgages. The Patent Act of 1836, 5 Stat. 117, eliminated state law patents and created the national Patent Office. Section 11 made every patent assignable by an instrument in writing and required their recording in the Patent Office, but mortgages also were not mentioned. The purpose was to protect subsequent assignees without knowledge. *Gibson v. Cook*, 10 Fed. Cas. 314, 315 (Cir. C. N.Y. 1850).

faced a series of cases asking how parties could lien a patent or copyright.¹⁵⁰ They highlighted the need for an effective national system for financing federal intellectual property.

In 1870, Congress enacted a comprehensive overhaul of the patent and copyright acts, finally bringing security transfers explicitly within their scope.¹⁵¹ The Act of 1870 required federal recording for a prior “assignment” (copyright) or “assignment, grant or conveyance” (patent) to prevail against “any subsequent purchaser or mortgagee for a valuable consideration, without notice.” The language of the Act of 1870 continues to this day in the Patent Act. The substance also continues in the Copyright Act, albeit with a change in language for technical reasons discussed below. In 1905, Congress followed suit with a modern trademark act that followed the same pattern as the copyright and patent acts.¹⁵²

We will return to the modern details of these acts in a later section. For now, we need merely note that, from their inception the federal intellectual property acts, like the early chattel mortgage acts, have operated like *real property recording acts*. As we will see, this leads to significant differences with the financing model later adopted in original Article 9, including where to file, whom filing effects, and the role of the bankruptcy trustee. Early on, the Court of Claims articulated the crucial differences involved:

This new form of property, the mind-work of the inventor, though its constitutional existence is now well nigh a century old, is still a novelty in the law. The wisdom of the common law give neither maxims nor precedents to guide, and the American cases which deal with it, though numerous enough, run in a narrow, statutory groove. Though the most intangible form of property, it still, in many characteristics, is closer in analogy to real than to personal estate. Unlike personal property, it cannot be lost or found; it is not liable to casualty or destruction; it cannot pass by manual delivery. Like real property, it may be disposed of, territorially, by metes or bounds; it has its system of conveyancing by deed and registration; estates may be created in it, such as for years and in remainder; and the statutory action for infringement bears a much closer relation to an action of trespass than to an action in trover and replevin. It has, too, what the law of real property has, a system of user by license.¹⁵³

More recently, the Federal Circuit observed:

150. See *infra* nn. 249-254 and accompanying text.

151. The Act of July 8, 1870, 16 Stat. 198 § 36 (patents), 203 § 89 (copyrights).

152. See *infra* nn. 458-484 and accompanying text.

153. *A.S. Solomons v. U.S.*, 21 Ct. Cl. 479, 483 (1886), *aff'd* 137 U.S. 342 (1890).

Section 261 [of the Patent Act]. . . adopts the principle of the real property recording acts, and provides that a *bona fide* purchaser for value cuts off the rights of a prior assignee who has failed to record the prior assignment in the Patent and Trademark Office by the dates specified in the statute. Although the statute does not expressly so say, it is clear that the statute is intended to cut off prior *legal* interests, which the common law rule did not.¹⁵⁴

For nearly two centuries the federal courts have been fairly shouting to all who would listen that the federal intellectual property statutes must be treated like real property recording acts.¹⁵⁵ This makes sense, since, like real property, the federal statutes cover both ownership and security transfers, whereas state personal property filing systems are limited to security transfers.

Prof. Gilmore was adamant that the filing system in original Article 9 was incompatible with federal filing requirements:

[I]t seems to be generally assumed that the federal filing systems [for copyrights and patents] are exclusive, and it is surely desirable that they should be; no useful purpose would be served and much confusion would result if it were held to be within the power of a state to require a state filing in addition to the federal filing.¹⁵⁶

This brings us to the seminal decision for intellectual property financing.

2. *The Waterman Case*

The Supreme Court's decision in *Waterman v. MacKenzie*¹⁵⁷ is important on several grounds, not the least of which is its continued misinterpretation by some commercial law commentators. The facts are straightforward. Lewis Waterman obtained a patent on pens, which he assigned to his wife. She granted back an exclusive license to make and vend, but not to use, the patent. She then assigned the patent to Shipman as security for a debt; he, in turn, assigned the patent to Mackenzie. When Mackenzie began manufacturing pens, the Watermans sued for patent infringement. Mackenzie pled lack of standing. The question was whether the Watermans had standing under either instrument.

The Court started with the license. In analyzing this grant, the

154. *Filmtec Corp. v. Allied-Signal, Inc.*, 939 F.2d 1568, 1573-74 (Fed. Cir. 1991) *reh'g denied*, 988 F.2d 129. See also Paul Goldstein, *Copyright* § 4.5.3.4 (2d ed. 1996) (copyright system operates like "real property recording acts").

155. See *Heidelberg Harris, Inc. v. Loebach*, 145 F.3d 1454, 1458 (Fed. Cir. 1998) (patents); *Filmtec Corp.*, 939 F.2d at 1573-74 (patents); *In re AEG Acquisition Corp.*, 127 B.R. 34, fn. 8 (Bankr. C.D. Cal. 1991) (copyrights); *Peregrine*, 116 B.R. at 200 (copyright); *Secombe v. Campbell*, 2 F. 357 (S.D.N.Y. 1880) (patent).

156. Gilmore, *supra* n. 7, § 19.9, at 544-545.

157. 138 U.S. 252 (1891).

Court declared what came to be known as the “indivisibility doctrine”:

[The patent laws grant the patentee] the exclusive right to make, use and vend the invention or discovery throughout the United States and the Territories thereof. . . . The monopoly thus granted is one entire thing, and cannot be divided into parts, except as authorized by those laws. The patentee or his assigns may, by instrument in writing, assign grant and convey either (1st) the whole patent, comprising the exclusive right to make, use and vend the invention throughout the United States; or (2d) an undivided part or share of that exclusive right; or (3d) the exclusive right under the patent within and throughout a specified part of the United States. A transfer of either of these three kinds of interests is an assignment, properly speaking, and vests in the assignee a title in so much of the patent itself, with a right to sue infringers . . . An assignment or transfer short of one of these is a mere license, giving the licensee no title in the patent, and no right to sue at law in his own name for infringement.¹⁵⁸

Since the license only granted the exclusive rights to make and use, but not to vend, the patented invention, it was a license, not an assignment; therefore, Lewis Waterman did not have standing.¹⁵⁹

But there was still Mrs. Waterman to consider. She had granted an “assignment” of the patent as security for a debt. Did she have standing under this instrument? This was a different matter, and the Court treated it accordingly. The first step was to categorize the instrument. The Court said that the assignment “being a conveyance made to secure the payment of a debt . . . was a mortgage in apt terms and legal effect.”¹⁶⁰ The Court was merely saying what every lawyer of the day understood: an assignment of a patent actually given as security would operate under the mortgage rules, especially since the Act of 1870 had validated patent “mortgages.” As Gilmore observes, “since the statute confers on patents ‘the attributes of personal property’ and the recording provision makes an unrecorded assignment void ‘against any subsequent . . . mortgagee,’ there can be no doubt that security transfers of patents are recognized.”¹⁶¹

The next step was to determine who had standing under the mortgage to protect the patent. The Court first noted that earlier holdings had treated a chattel mortgage as a transfer of title.¹⁶² This inclined towards MacKenzie. Then, it remarked that this categorization was changing, with many mortgages being treated as

158. *Id.*

159. *Id.*

160. *Id.* at 258.

161. Gilmore, *supra* n. 7, § 13.4, at 417.

162. *Waterman*, 138 U.S. 257.

liens.¹⁶³ This tilted towards Mrs. Waterman. The Court decided, however, that resolution of the issue lay not in title but in possession:¹⁶⁴

The right of action against a stranger for injury to goods mortgaged, generally, thought not always, depends upon the right of possession. When the right of possession is in the mortgagor, he is usually the proper party to sue. [Citations.] . . . And when the right of possession, as well as the general right of property, is in the mortgagee, the suit must be brought by the mortgagee.”¹⁶⁵

In other words, to find who has standing to protect the patent under a mortgage, examine the instrument to determine who has “possession.” Since Shipman under the terms of the security assignment had title, and since the federal recording confirmed possession,¹⁶⁶ only Shipman could protect the patent. The pragmatic reason for placing standing in one party was to avoid a multiplicity of suits against an infringer.¹⁶⁷ The Court pointedly refused to consider when it would be necessary to join the mortgagor since “no such question is presented on this record.”¹⁶⁸

3. *Post-Waterman Cases*

In *Waterman*, the security assignment was a “title” mortgage.¹⁶⁹ What would happen under a “lien” mortgage where the debtor retained title and possession? The First Circuit faced that issue in *Ormsby v. Conners*.¹⁷⁰ A patent owner made a security transfer, duly recorded in the Patent Office, while retaining the exclusive right to manufacture, sell and license the invention. The court first said that the patent owner had “transferred the patent as collateral security, or as in the way of a mortgage; it makes no difference which.”¹⁷¹ It then concluded that when *Waterman* said the “whole title” was in the

163. *Id.* at 258-259

164. *Id.* at 259-260

165. *Id.*

166. The common legal formulation of the time was that filing of a chattel mortgage was “equivalent to a change of possession.” *Berson v. Nunan*, 63 Cal. 550, 552 (1883). This did not mean the creditor literally had physical control, but that the law deemed “possession” sufficient to satisfy the apparent ownership requirement from *Twyne’s Case*.

167. *Waterman*, 138 U.S. at 260-261. Judge Learned Hand, in *A.L. Smith Iron Co. v. Dickson*, 141 F.2d 3 (2d Cir. 1944), identified avoidance of a multiplicity of suits as the justification for denying standing to a licensee. See Donald S. Chisum, *Chisum on Patents* § 21.03[2], 21-270-21-217 (2000 ed.).

168. *Waterman*, 138 U.S. at 261.

169. The case came up from New York, then the premier title theory state for chattel mortgages. Gilmore, *supra* n. 7, § 1.1 at fn. 11.

170. 133 F. 548 (Cir. Mass. 1904).

171. *Id.* at 549.

mortgagee, it meant the debt instrument had transferred “the general right of property as well as possession.”¹⁷² However, when a mortgagor retains possession the mortgagee does not have the “whole title.” Thus, “as far as the question of title is concerned, the suit may be maintained.”¹⁷³ In other words, where the mortgage instrument left “title” in the mortgagor – the situation under a lien – the mortgagor had standing to sue. Other decisions consistently confirmed the validity of lien patent mortgages leaving title and standing in the mortgagor.¹⁷⁴

As far as intellectual property secured financing goes, *Waterman* and its progeny are, or should be, essentially unremarkable. They hold that patent security transfers, and by extension copyright and trademark security transfers, are valid and recordable in the appropriate federal filing offices. The question of title or lien – current assignment subject to defeasance on paying the debt or conditional assignment subject to forfeiture on condition broken – affects standing to sue, not recording. Gilmore reads *Waterman* this way¹⁷⁵ as have the patent commentators since the case was decided.¹⁷⁶

172. *Id.*

173. *Id.* at 550. After trial, the invention was held unpatentable. See *Connors v. Ormsby*, 148 F. 13 (1st Cir. 1906).

174. See e.g. *Transducer Patents Co. v. Renegotiation Bd.*, 492 F.2d 247 (9th Cir. 1974) (holding that a patent “lien” a valid security interest leaving title in debtor); *Charles Holt v. U.S.*, 13 U.C.C. Rep. Serv. 336 (D.D.C. 1973) (holding that a patent “pledge” was valid under usual “substance over form” rule); *Western Battery & Supply Co. v. Hazelett Storage Battery Co.*, 61 F.2d 220, 231 (8th Cir 1932), *cert. denied*, 288 U.S. 608 (1933) (“one who has transferred a patent by way of pledge, as distinguished from mortgage . . . has been held not to have thereby disabled himself completely from dealing with the patent”); *Westmoreland Specialty Co. v. Hogan*, 167 F. 327 (3d Cir. 1909) (holding that there was an absolute assignment for security that was a “temporary pledge” that did not transfer “title”); *E.F. Hauserman Co. v. Wright Metal, Inc.*, 1 F. Supp. 43 (W.D.N.Y. 1932) (holding that an assignor of patent for benefit of creditors retained sufficient interest to sue); *Curtis et. al. v. U.S.*, 75 Ct. Cl. 286, 307 (1932) (mortgagor in possession could sue because patent mortgage effects an assignment “unless otherwise provided in the mortgage”); *Tuttle v. Blow*, 176 Mo. 158 (1903) (mortgage on patent and trademark validly recorded in PTO). The “pledge” statements in *Holt*, *Western Battery* and *Westmoreland* are obviously loose language, since a patent, as an intangible, could not be pledged. *Western Battery* arose from Missouri, then a lien theory state, so the slip is understandable, especially in light of the earlier decision of the Missouri Supreme Court in *Tuttle* recognizing a patent “lien” mortgage. 14 C.J.S. *Chattel Mortgages* § 1 n. 3 (1991). *Westmoreland* categorized an “absolute assignment” for security as no more than a lien, which left “title” – standing – in the patentee. The point is that a patent security transfer need not entail an immediate assignment of title to be effective or recordable in the PTO. See Gilmore, *supra* n. 7, § 13.4, at 6.

175. See Gilmore, *supra* n. 7, at § 13.4

176. For example, William Edward Baldwin, *Baldwin's Digest, Patent, Copyright Trade Mark Cases* 151 (Banks-Baldwin Co. 1936), discusses *Waterman* extensively in “Chapter XVI Infringement, Actions” under the heading “4.b. Who may maintain action”

Recently, however, a few commercial commentators,¹⁷⁷ and courts,¹⁷⁸ have made the remarkable claim that *Waterman* held only patent “title” mortgages are recordable in the PTO. A patent security interest, they say, not being an immediate “assignment of title,” is perfected by a state UCC filing. This claim is stunningly wrong both as a matter of patent law and Article 9. Since Revised 9 was crafted for federal information generally, let us dispose of it here.

Let us begin with patent law. The argument is that a security interest, since it is neither an “immediate transfer of title,” nor an “assignment,” does not need to be recorded federally. This reasoning is fallacious. *Waterman* held that an immediate assignment for security was a mortgage. It did not hold the converse that every mortgage had to be an immediate assignment. All men are human beings; this does not mean that all human beings are men. The authorities have repeatedly confirmed that patent security transfers leaving title in the debtor subject to forfeiture on condition broken – liens – are valid and recordable in the PTO. In *Littlefield v. Perry*¹⁷⁹ the Supreme Court upheld the validity and recordability of a patent assignment that reserved a lien to cover unpaid royalties while leaving title in the assignee-debtor.¹⁸⁰ In *Ormsby*, a security transfer that left title in the mortgagor was valid and recordable in the Patent

but not at all in “Chapter XVII, Transfer of Patent Rights, Sale Conveyance and license.” Arthur M. Smith, *Patent Law, Cases, Comments and Materials*, 786 (Overbeck Co. 1954) (digests *Waterman* under “Chapter VII – Remedies (B) Who May Sue,” but not under “Chapter IX – Property and Contract Interests in Patents (C) Assignments.”). Prof. Chisum, a leading patent authority today, still digests *Waterman* solely under standing to sue. Chisum, *supra* n. 167, at § 21.03[1][j]. For a perceptive analysis of the patent authorities, see *Ball v. Coker*, 168 F. 304 (C.C.S. Car. 1909).

177. See e.g. William C. Hillman, *Documenting Secured Transactions* 2-19 to 2-20 (1998): “A security interest is not an ‘assignment, grant or conveyance’ of a patent. Patent law adheres to strict concepts of title, in order to protect the ownership of new inventions. It therefore distinguishes ‘assignments’ of patents (of which ‘grants’ and ‘conveyances’ are specific types) from all other transfers (which are called ‘licenses.’” This article suggests that Prof. Hillman has misread the patent cases.

178. See *City Bank & Trust Co. v. Otto Fabric, Inc.*, 83 B.R. 780 (Bankr. D. Kan. 1988); *In re Transp. Design & Tech. Inc.*, 48 B.R. 635 (Bankr. S.D. Cal. 1985); see also *infra* nn. 447-455 and accompanying text.

179. 88 U.S. 205 (1874).

180. *Id.* In *Littlefield*, the patent assignment reserved a royalty that for “the non-payment or other non performance a forfeiture might be enforced as for condition broken.” *Id.* at 579. A reservation of a right of forfeiture on condition broken was the Nineteenth Century formula for creating a lien. 14 C.J.S. *Chattel Mortgages* § 4 (1991). The Court held nonetheless that the instrument, which was duly recorded, was a valid transfer leaving title to the assignee-debtor. See accord *Boesch v. Gräff*, 133 U.S. 679 (1890) (patent assigned subject to reversion on condition broken by non-payment recordable with title in assignee-debtor).

Office.¹⁸¹ The Patent Office has recorded voluntary patent liens for more than a century.¹⁸² Rule 313 of the current Manual of Patent Examining Procedures says patent security interests are “recorded in the public interest in order to give third parties notification of equitable interests or other matters relevant to the ownership of a patent or other application.”¹⁸³ That patent security transfers are routinely filed in the PTO is easily verified.¹⁸⁴

The most dramatic affirmation that lien patent mortgages were recordable is *In Re Leslie-Judge*. It invalidated a copyright chattel mortgage not recorded federally, a result that applied by extension to patents because they had the same statutory filing language. At the time, in 23 states the only way to create a chattel mortgage was by lien. If lien patent mortgages could not be recorded federally, then *Leslie-Judge* would have invalidated patent financing in nearly half the country since, without a federal recording, there was no place to record a lien mortgage to defeat a fraudulent conveyance attack.¹⁸⁵ No court ever invalidated a lien patent mortgage on this ground, for the simple reason that such mortgages are and have been recordable federally.

Let us now turn to Article 9. It assembled all the pre-Code

181. 133 F. at 549; see also *Tuttle v. Blow*, 176 Mo. 158 (1903) (mortgage on patent and trademark validly recorded in PTO). In *Tuttle*, the chattel mortgage in question was made in Missouri, which was then a *lien* theory state. See 14 C.J.S. *Chattel Mortgages* § 1, n. 3 (1991).

182. In *Ex parte Church et al.*, 1898 C.D. 35, 82 (1898) (involving an instrument signed by a receiver for an insolvent patentee), Commissioner Duell said:

When an instrument [of the type referred to in Section 261 of the Patent Act] is offered for record and the fees for the recording are paid, it becomes the duty of the Patent Office to record the same. Such duty is a ministerial one. If in the judgment of the Commissioner of Patents the instruments so offered amount to an assignment, grant, mortgage, lien, incumbrance or license, or affects the title to a patent or invention which is properly identified and accompanied by the proper fee, it should be recorded. (See Rule 199 of the Rules of Practice.)

This reasoning was long embodied in the patent office rules. See e.g. Ridsdale Ellis, *Patent Assignments and Licenses* § 296, at 297 (Baker, Voorhis & Co. 1943).

183. U.S. Dept. of Comm., *Manual of Patent Examining Procedures, Patent and Trademark Office*, Rule 313 (Feb. 1, 2000).

184. See <<http://www.uspto.gov/>> (accessed May 11, 2001).

185. Recall that the chattel mortgage acts did not apply to intangibles. See Glenn, *supra* n. 48, at § 503: “Title or lien theory to the contrary notwithstanding, the underlying rule is that an unrecorded chattel mortgage is nothing as against the mortgagor’s creditors. . . . Both are security devices.” It is no answer that a lien patent mortgage could have been recorded voluntarily, because if a document need not be recorded its recording is ineffective. *Am. Solid Leather Button Co. v. Empire St. Nail Co.*, 47 F. 741, 743 (S.D.N.Y. 1891) (equitable patent assignment).

security devices into a single construct, the security agreement.¹⁸⁶ This included both title and lien theory chattel mortgages. If both a title patent mortgage with an immediate transfer of title and a lien patent mortgage without an immediate transfer were recordable federally before Article 9, then a patent security interest that accommodates both structures is certainly recordable in the PTO today.¹⁸⁷ Gilmore, naturally, reads the statute this way.¹⁸⁸

Indeed, to claim that a security interest does not effect patent ownership because it is not an “immediate transfer of title” reverts to the now discredited title-lien distinction. But the substantive differences between title and lien theories have always concerned the debtor’s rights, not the creditor’s title.¹⁸⁹ Article 9 eliminated these differences by applying the same rights, obligations and remedies, regardless of whether title is in the secured party or the debtor.¹⁹⁰ Security instruments, like lien collateral assignments before them, most definitely effect title since they allow the creditor to take ownership after default – just like a title mortgage.¹⁹¹ This is precisely why the definition of “purchaser” in UCC 1-201(32) – the same “purchaser” identified in the Patent Act – includes a secured creditor.¹⁹² Gilmore, ever elegant, puts it thus:

A security assignment may be made conditionally – that is to take effect on the happening some event, such as the institution of insolvency proceedings against the assignor, his default in performing the contract, his failure to repay the loan and the like. It

186. See U.C.C. § 9-102 (West 1997) (providing that Article 9 applies “to any transaction (regardless of its form) which is intended to create a security interest in personal property”, whether a “pledge, assignment, chattel mortgage . . . other lien or title retention contract . . . intended as security”).

187. *Transducer Patents*, relying on *Littlefield*, held that a patent “lien” leaving title in the debtor was a valid security interest. 492 F.2d 247. *Transducer Patents* does not say whether the patent lien in issue was recorded in the PTO. *Id.* However, the opinion follows the language in *Littlefield* upholding the validity of a patent assignment leaving “title” in the debtor, and in *Littlefield* the assignment was recordable. *Id.* at 252.

188. See Gilmore, *supra* n. 7, § 13.4, at 421 (“*Mackenzie* establishes that patents can be assigned for security and the instrument of assignment recorded under 35 U.S.C. § 261.”); see also *id.* at § 13.3, at 415 (“The phrase ‘may be mortgaged’ in 17 U.S.C. § 28 [the precursor to current 17 U.S.C. § 205] should be read as equivalent to ‘may be transferred for security.’ There is nothing, in the legislative history or common sense, to recommend the idea that the ‘mortgage’ language means that while copyright mortgages must be recorded with the Copyright Office, other security transfers of copyrights need not be so recorded.”).

189. See *supra* n. 64 and accompanying text.

190. See U.C.C. § 9-202 (West 1997).

191. *Id.* at § 9-504(4) (disposition of the collateral after default “transfers to a purchaser for value all of the debtor’s rights therein”); see Clark, *supra* n. 45, ¶ at 4.09[1].

192. Anderson, *supra* n. 73, at § 1-201:434 and cases cited.

seems unnecessary to think of such arrangements as 'conditional' – any more than security transfers of chattels by mortgage or conditional sale are conditional. The mortgagee or conditional vendor is entitled to resort to his security only if the borrower defaults, but no one has ever thought that the security right, because it is in that sense conditional on the happening of a future event, does not attach when the loan is made or that the security agreement remains in some sense imperfect until the condition (default) has occurred. . . . [T]he 'condition' is merely a way of expressing the normal understanding that the assignee is not to enforce the assignment until there has been a default.¹⁹³

The Patent Act records transfers that effect patent ownership. A security interest effects title because on foreclosure the debtor's ownership interest – "title" – is transferred to the creditor free of later interests.¹⁹⁴ This is why a creditor takes property for security interest in the first place. To claim a security interest that does not effect ownership demonstrates an embarrassing misunderstanding of what secured financing is all about.

In summary, we can say that Congress authorized security transfers of federal copyrights and patents in the Act of 1870 and trademarks in the Act of 1905. This insulated copyrights and patents from fraudulent conveyance attack by using national recording systems that operate like real property recording acts, covering both ownership and security transfers. They remain in place to this day, necessarily preempting state filing systems. We now turn to how original Article 9 rewrote the rules for the rest of personal property financing.

D. The Different Financing Models

1. Article 9 "Horizontal" Financing

By the middle of the twentieth century the commercial law structures inherited from the nineteenth century were fraying at the edges. The drafters of the original Uniform Commercial Code ("UCC") set out to change them. The story of their struggle to "unhorse" sales law and its impact on intellectual property licensing is covered elsewhere.¹⁹⁵ Here, we concentrate on secured financing law.

The drafters of the original Article 9 faced a number of problems. The nineteenth century had bequeathed a bewildering

193. Gilmore, *supra* n. 7, § 7.5, at 209.

194. U.C.C. § 9-504(4) (West 1999).

195. Brennan, *supra* n. 5.

array of often overlapping security devices, along with little sympathy for the secured creditor who inadvertently used the wrong one. Many of these devices were wrapped around formalistic concepts of “title” which the drafters felt obscured the real issues involved, something the title-lien debate demonstrated all too clearly. Finally, a chattel mortgage, like its real property analog, was considered “good against the world,” meaning, a validly recorded chattel mortgage would take precedence over any later interest in or transfer of the collateral, regardless how remote.¹⁹⁶ These devices worked, more or less, when the debtor’s assets consisted of heavy machinery and fixed assets that could be readily identified. However, they were ill suited to financing changeable inventory, requiring elaborate mechanisms for identifying and releasing the secured collateral.¹⁹⁷

The drafters of Article 9 decided that they need a new concept, the “floating lien.” As one commentator describes its evolution:

The floating lien has evolved as an accepted financing device because the type of enterprise which is vital to our economic order has changed. When the key enterprises are railroads or steel mills, or even carpet manufacturers, one can get along without a floating lien. These businesses will typically have enough wealth invested in fixed assets, land and equipment, to allow for financing to be tied to specific assets. Once the car dealership, appliance wholesaler, and photo processor became crucial enterprises, legal adaptation is imperative. With these businesses, most of the wealth will be embodied in inventory and receivables. Since the constituent elements of these liquid assets will constantly be changing, an efficient regime of chattel security law is possible only if the creditor can take a lien which floats over the pool of assets of the available collateral.¹⁹⁸

Article 9 does not use the term “floating lien” *per se*. Instead, it establishes five components essential to its effective operation: (i) notice filing, (ii) after-acquired property, (iii) proceeds, (iv) future advances, and (v) overruling *Benedict v. Radner*.¹⁹⁹

Notice filing allows the collateral to be described by category rather than listing individual items, since inventory will change over time. An after-acquired property clause allows the security interest to attach automatically to new inventory as it comes into the debtor’s operation, alleviating the need for filing a new collateral description every time that happens. Covering proceeds means that a security interest perfected in inventory will also be perfected in the accounts

196. Gilmore, *supra* n. 7, at § 11.1.

197. *Id.* at § 11.3.

198. Coogan, *supra* n. 11, at § 7.02[2][b].

199. See Gilmore, *supra* n. 7, at § 11.3; Clark, *supra* n. 45, at ¶ 10.01.

realized from its sale. A future advances provision allows a creditor to provide on-going cash flow financing while still retaining its priority position. Finally, overruling *Benedict* means an elimination of the specialized policing required by prior law, opening up the lending business to a greater pool of lenders, colorfully called the "country banks."

In conceptual terms, we can envision the Article 9 floating lien as a "horizontal" financing model illustrated as follows:

Under this model, although individual items of collateral are sometimes important, by and large what matters is the current stock of the debtor's inventory and resulting receivables as it changes over time. The lien floats "horizontally" over these assets. On default, the creditor takes what is in effect a "snapshot" of the debtor's business as it exists on that date. In this structure, what counts are the ongoing operations of the debtor, not particular items of changeable inventory, and the security interest is accordingly filed against the debtor.

The floating lien requires mechanisms to deal with collateral before it is owned and after it is sold.²⁰⁰ Article 9 handled this with two "super priority" rules. On the pre-purchase side, there is the "purchase money secured creditor." A factory may desire to finance the purchase of a specific piece of machinery, but a financier may be reluctant to extend credit if it knows that its security interest in the machinery becomes subordinate to the debtor's pre-existing floating lien. To solve this, original Article 9 allows a purchase money security interest to become superior to a pre-existing floating lien by compliance with statutory rules.²⁰¹ On the post-sale side, a buyer would not readily purchase goods if the buyer thought a foreclosing creditor of the seller could repossess them. Article 9 therefore

200. See Clark, *supra* n. 45, at ¶ 10.06.

201. U.C.C. § 9-312(3) (West 1999); see also Clark, *supra* n. 45, at ¶ 10.06[2].

recognizes a super priority in a “buyer in the ordinary course” who takes, free of a prior security interest, even if the buyer is fully aware of it.²⁰²

2. Information “Vertical” Financing

Article 9’s adoption of the floating lien makes sense where the assets are tangible goods being bought and sold. A different calculus arises for intellectual property. It requires a “vertical” financing model focused on the asset, not the debtor. Think of an office building that can have many space leases that pay rent (royalties). The owner-operator of the building can use actual or expected rents (royalties) to finance initial construction and on-going operations. For this financing to work, the mortgage lender needs to know that filing against the underlying property also gives it priority over subsequent leases and a consequent right to claim rent payments. It is the same for intellectual property. The work, invention or mark can be subject to multiple licenses. A secured lender wants to ensure that filing against the intellectual property gives priority as to subsequent licensees and the royalty payments due. Like the developer of an office building, the creator of new information needs to give such assurances to obtain financing to create the asset in the first place.

We might visualize this “vertical financing” as follows:

Vertical Financing Model

In this model, by filing against any larger box, the secured lender gains priority over all included (“junior”) boxes. Therefore, a secured creditor loaning against Sublicense A2 needs to determine whether

202. U.C.C. § 9-307(1); see also Clark, *supra* n. 45, at ¶ 10.02[1].

there is a recorded filing for each prior transferee, *i.e.* against License A or the creator of the Intellectual Property. This relies on the rule that a properly perfected security transfer is “good against the world.” Intellectual property has some subtleties in the licensing practice. Subsequent licenses can be exclusive (akin to real estate leases) or non-exclusive (akin to real estate licenses). These require some special handling in the priority rules. However, the basic models are the same. Information is financed on the vertical financing model, like an office building, not on the horizontal model, like a used car.

3. *Chain of Title*

It should be apparent that the horizontal financing model used in Article 9 for tangible goods and the vertical financing model used for intangible information are not reconcilable. The most obvious illustration is the need to search chain of title.

For tangible goods, a searcher needs only search the immediate debtor. This is because UCC Article 2-401(1) provides flatly that “[a]ny retention or reservation of by the seller of title in the goods shipped or delivered to the buyer is limited in effect to reservation of a security interest.”²⁰³ Even if the parties intend to reserve title in the seller, and the agreement so provides, the seller cannot prevent the passage of title to the buyer upon delivery of the goods.²⁰⁴ Any title interest retained by the seller is thus converted to a security interest.²⁰⁵ This means that a financier seeking security in inventory need only search the immediate debtor. Anyone with a prior purported title interest has a security interest which, if it is not recorded against the seller-debtor, is ineffective against a later perfected security interest under Article 9’s “first to file or perfect” rule.²⁰⁶ Even if its is recorded, it is ineffective against a “buyer in the ordinary course” in any case.

The situation is just the opposite for intellectual property. A creditor must search *every* prior transferor in the chain of title, not

203. U.C.C. § 2-401(1) (West 1999).

204. *O'Donnell v. Am. Employers Ins. Co.*, 622 N.E.2d 570, 575 (Ind. App. 1993) (“[Article] 2-401(1) . . . restricts the parties’ contractual freedom to delay passage of title by agreement [and] negates any attempt . . . to forestall passage of title beyond the moment of final delivery.”); *see also Meinhard-Commercial Corp. v. Hargo Woolen Mills*, 300 A.2d 321 (N.H. 1972) (parties’ intent does not govern question of passage of title under 2-401); Anderson, *supra* n. 73, at § 2-401:182.

205. *See O'Donnell*, 622 N.E.2d at 575; Anderson, *supra* n. 73, at § 2-401:182.

206. Revised 9-322(1); current Article § 9-312(5), *see Clark, supra* n. 45, at ¶ 4.09[1].

just the immediate borrower.²⁰⁷ This is because “in patent, trademark, literary property and copyright infringement cases, any member of the distribution chain can be sued as an alleged joint tortfeasor.”²⁰⁸ For intellectual property, like real property, termination of a senior license anywhere in the chain of title terminates all sublicenses deriving from it, making further exploitation by the sublicensee an infringement.²⁰⁹

207. For discussion of the need to search chain of title as required due diligence step in evaluating intellectual property, see e.g. Simensky, *supra* n. 10, at ch. 7: *Proactive Auditing* (describing in detail necessary auditing procedures including checking chain of title); also Paul Edward Geller & Melville B. Nimmer, 1 *International Copyright Law and Practice*, Introduction § 6[3] (determining copyright chain of title worldwide) (2000 ed); Simensky, *supra* n. 6, at § 8.03 (addressing the need to search chain of title when taking intellectual property as security); McCarthy, *supra* n. 16, at § 18.15 (“To acquire title to a trademark and to prove priority of use to an earlier user in the chain of title, a person or company must be able to prove a chain of title extending back to the original user of the mark.”); Moore, *supra* n. 10, at 588-595; Harold R. Weinberg & William J. Woodward, Jr., *Easing Transfer and Security Interest Transactions in Intellectual Property: An Agenda for Reform*, 79 Kentucky L.J. 61, 88-91 (1990); Robert G. Weiss and Alan G. Benjamin, *Feature Film Secured Financing*, 15 U.C.C. L.J. 195, 201 (1983).

208. *Stabilisierungsfonds Fur Wein v. Kaiser, Inc.*, 647 F.2d 200, 207 (D.C. Cir. 1981).

209. For copyrights, see *Stewart v. Abend*, 497 U.S. 207 (1990) (holding that upon termination of license for original work further exploitation of derivative work an infringement); *U.S. v. King Features Enter.*, 843 F.2d 394 (9th Cir. 1988) (holding that where an original license is invalid, a sublicensee is an infringer as well); *Fitzgerald Publ. Co., Inc. v. Baylor Publ. Co., Inc.*, 807 F.2d 1110, 1113 (2d Cir. 1986) (holding that a sublicensee’s reliance on the terms of its license is ineffective where its licensor commits a material breach; intent or knowledge is not an element of infringement); *Costello Publ. Co. v. Rotelle*, 670 F.2d 1035, 1045 (D.C. Cir. 1981) (holding that if a main license is terminated, the sublicensee is also liable for infringement; ignorance is no defense); *Gilliam v. Am. Broad. Co.*, 538 F.2d 14 (2d Cir. 1976) (finding that a sublicensee’s editing of *Monty Python* programs is an infringement, since editing was a material breach of license from show creators to BBC); *The Walt Disney Co. v. Video 47, Inc.*, 972 F. Supp. 595 (S.D. Fla. 1996) (holding that a rental of counterfeit cassettes was an infringement despite purchase of a copy); Nimmer & Nimmer, *supra* n. 19, at § 11.02[B][1][b], § 13.08 and cases cited.

For patents, see *Gen. Talking Pictures Corp. v. W. Elec. Co.*, 304 U.S. 175 (1938) (holding that where supplier of patented invention breached its license, purchaser from supplier is also an infringer); *Straight Side Basket Corp. v. Kull*, 24 F. Supp. 771 (D. Idaho 1938) (stating that a buyer of patented devices from licensee after its license is terminated is an infringer); Chisum, *supra* n. 167, at § 21.03[3] and cases cited.

For trademark, see *Stabilisierungsfonds Fur Wein v. Kaiser, Inc.*, 647 F.2d 200, 207 (D.C. Cir. 1981) (holding that in patent, trademark, literary property and copyright infringement cases, any member of the distribution chain can be sued as an alleged joint tortfeasor); *Major League Baseball Promotion v. Colour-Tex, Inc.*, 729 F. Supp. 1035 (D.N.J. 1990) (finding that where a sublicense is not authorized by license from the trademark owner, the sublicensee is an infringer); *Grocers Baking Co. v. Sigler*, 132 F.2d 498, 502 (6th Cir. 1942) (holding that a distributor that infringed common law trademark is jointly liable with its supplier, since the trademark owner is entitled to protection against innocent as well as malicious infringers); McCarthy, *supra* n. 16, at § 25:30 and cases cited.

For example, in 1950, Cornell Woolrich wrote a short story called *It had to be Murder*. In 1954, Universal Pictures licensed the story as the basis for Alfred Hitchcock's thriller, *Rear Window*. Woolrich died before the copyright renewal term vested, ending the license. When the picture was re-released Woolrich's successor sued for copyright infringement. In *Stewart v. Abend*²¹⁰ the Supreme Court agreed that exploitation of the derivative work (the motion picture) during the renewal term without a license for the underlying work (the short story) was an infringement. The result would have been the same had the license from Woolrich to Universal terminated because of foreclosure of a prior copyright mortgage on the short story.²¹¹ A financier lending Universal money to produce the picture could not rely on merely conducting a search against Universal; it would need to search Woolrich's interest as well.²¹²

For intellectual property, a diligent lender must check all prior ownership transfers, no matter how remote, for possible mortgages whose foreclosure could wipe out the existing interest. Many in the commercial bar complain that it is too difficult to conduct a search in the Copyright Office or the PTO when financing intellectual property. They say a lender should be able to conduct a single search against the immediate debtor, just like for personal property. But unless they are seeking wholesale repeal of the intellectual property laws, a search of the entire chain of title is essential to ensure that the lender does not become an infringer.

4. A Searching Example

For example, assume a producer wants to finance a hypothetical new movie, *Terminator 3*, based on the popular *Terminator* and *Terminator 2* pictures.²¹³ Since *Terminator 3* will be derived from

210. 497 U.S. 207 (1990).

211. 17 U.S.C.A. § 205(d) (West 1996).

212. Section 203(b)(1) of the Copyright Act now provides that the exercise of the statutory termination right will not terminate the right to utilize a derivative work prepared in accordance with the grant.

213. During the past decade, there have been several proposals in Congress to subject intellectual property security interests to state filing systems. I have appeared repeatedly in opposition on behalf of the American Film Marketing Association (AFMA), the trade association for major financial institutions and independent producers engaged in motion picture financing. I have been joined by the Motion Picture Association of America, the Directors Guild of America, the Writers Guild of America and the Screen Actors Guild. For details of AFMA's testimony against the abortive Copyright Reform Act of 1992, see Rotstein, *supra* n. 10, at 175-177. The example in the text is based my testimony before the Subcommittee on Courts and Intellectual Property of the House Judiciary Committee in opposition to H.R. 4351, the so-called "Security Interests in Copyrights Financing

several prior screenplays and movies, a production lender certainly wants to know about all security interests against these works since they would be superior to its lien. Just as for *Rear Window*, a mortgage foreclosure that terminates any of these prior transfers could make exploitation of *Terminator 3* infringing.

Under current practice, a lender can find prior transfers and mortgages with a single search in the Copyright Office. A search is available from private sources for about \$250, free from the Copyright Office. Assume that copyright mortgages are only filed at the state level. We can assume that the Copyright Report lists all the ownership transfers. For *Terminator 3*, I can represent that the Copyright Report will show that, ignoring duplicate entries and transfers that may not affect the new production, there are 94 separate entities to search.²¹⁴

Here are the steps a searcher must undertake to ensure finding all prior liens that might effect the hypothetical *Terminator 3* production loan using only the state filing systems:

Step 1 – Order a Copyright Report: We still need the Copyright Report to identify the prior parties who need to be searched. Cost: \$250.

Step 2 - Locate the Parties: The Copyright Report only identifies who the parties are, not where they are located. So the next step is to determine in what state to search. Of the entities listed, 90 are corporations, and four are individuals (the screenwriters). That means we must search the Secretary of State offices in all fifty states, Puerto Rico, Guam and the District of Columbia to determine where the corporations are located. One major search firm charges \$365 for a national-wide search. (Maybe we can do this cheaper searching the Internet by hand, but that means paying someone an hourly rate to do so.) The cost is 90 parties x \$365 each = \$32,850. To find the individuals, we must use a skip-tracer, for additional fees. Let's assume \$500 each. (Some search firms are cheaper *if* we know the social security numbers or a past address, which the Copyright Report, alas, does not reveal.)

Step 3 - Search the Parties: Now that we know where each party

Preservation Act.” A copy is available on-line at <<http://www.us.gov/judiciary/bren0624.htm>>. For the deficiencies in the “dual filing” scheme in H.R. 4351, see Brennan, *supra* n. 9; Babaian, *supra* n. 10 (commenting on the hearings).

214. Several transfers list multiple transferring parties. For example, a transfer from Hemdale Communications Corp. will include close to 20 subsidiary corporations. Under Article 9, a financing statement must be filed separately for each subsidiary. See *LeFlore v. Grass Harp Prod., Inc.*, 57 Cal. App. 4th 824 (1997). Since any one of them could be a debtor due to an inter-company transfer, we must search them all.

is located, we must search the local UCC filings. For a general intangible, currently twenty-six states only require filing in the Secretary of State, while fourteen others also require an additional county filing.²¹⁵ Since Revised Article 9 eliminates dual state-county filings, let's assume we only need to conduct a single state search. Searching fees vary per state. In California, a UCC search costs \$34. If all of these companies are headquartered in California, and all the individuals are domiciled there, then we must conduct ninety-four UCC searches at a cost of $\$34 \times 94 = \$3,196$.

Step 4 – Order Copies of All UCC-1s: A UCC search only discloses UCC-1s filed against the debtor, not against the copyright in *Terminator* or *Terminator 2*. One transferor alone, Carolco Pictures Inc., had more than 1,000 UCC-1 filed against it. (Each time it produced a picture, the lenders filed a UCC-1 to cover the physical materials. If information security interests were to be covered only by state filings, companies with large libraries would have thousands of filings. How many UCC-1s do you estimate could be filed against Microsoft, or Viacom, or IBM or Procter & Gamble?) To find out which UCC-1s apply to *Terminator* or *Terminator 2* we must examine them all. In California copies cost \$1.25 per page. If we make the conservative assumption that each UCC-1 is only 1 page, and that for all 94 debtors there are only 2,400 UCC-1s in total, this means an additional cost of $\$1.25 \times 2,400 = \$3,000$.

Step 5 - Read All UCC-1s: Now somebody has to read all 2,400 UCC-1s to determine which ones apply to *Terminator* or *Terminator 2*. If a legal professional could read one UCC-1 a minute, it would still take 40 hours to read them all. If were only charged \$100 per hour, that is an additional $40 \times \$100 = \$4,000$.

Step 6 – Search for Judgment Liens: What about judgment liens? This article maintains a judgment creditor should not be able to obtain an involuntary judicial lien on a copyright, federal trademark or patent by levy or attachment,²¹⁶ so that we should not need to search for them. However, the inevitable result of this approach is that the only way to trump the bankruptcy trustee is by filing in the federal registers. Let us see what it would take to search for them.²¹⁷

215. See William D. Hawkland, *Hawkland, Lord & Lewis UCC Series* §§ 9-401 *et seq.* (1997 ed.).

216. See *infra* n. 249 and accompanying text.

217. Even if judgment liens were allowed, they would constitute a "transfer" and hence under Section 205(d) of the Copyright Act would have no effect against a subsequent *bona fide* purchaser unless recorded in the Copyright Office. Thus, the Copyright Report would be sufficient to disclose all prior judgment liens. The same would not apply, unfortunately, for patents or trademarks, not due to statutory language, but

Copyrights, as intangibles, have no fixed *situs*. An action can be filed against a copyright owner anywhere a creditor can obtain *in personam* jurisdiction.²¹⁸ Thus, a judgment and resulting lien could be filed in any local courthouse nationwide.²¹⁹ Since any such pre-existing lien would trump a copyright security interest under Article 9-301(1)(a), all locations must be searched. One search firm estimates there are 6,400 local filing locations; another more than 8,000. There is no central filing system; most local courthouses must be searched by hand. This requires examining all 94 parties in at least 6,400 locations at \$49 per search - for the staggering sum of \$29,478,400.

The following table compares the estimated costs of finding all prior security interests and liens that might apply to a *Terminator 3* production loan by searching in the Copyright Office and under the state UCC filing systems.

due to judicial misinterpretations.

218. See e.g. *Keeton v. Hustler Mag., Inc.*, 465 U.S. 770 (1984) (holding that a New York resident could obtain personal jurisdiction against an Ohio corporate defendant for libel suit filed in New Hampshire, based on distribution of magazine there). “[The defendant] produces a national publication aimed at a nationwide audience. There is no unfairness in calling it to answer for the contents of the publication where ever a substantial number of copies are regularly sold and distributed.” *Id.* See generally *Nimmer & Nimmer*, *supra* n. 19, at § 12.01[C]; *McCarthy*, *supra* n. 16, at § 32:38.

219. *In re Cone*, 11 B.R. 925, 929 (M.D. Fla. 1981), considered the identical problem when a creditor maintained that a lien filed only with a local sheriff trumped a federally recorded aircraft lien:

The whole purpose of systems of recordation of ownership and security interests... is to provide a ready means for prospective financiers or purchasers of the property to search for competing interests. The Florida judgment recordation provisions apply to property located in the county in which the judgment or writ of execution is recorded. Airplanes are uniquely mobile, and the Federal Aviation Act provides for a uniform national means of registering aircraft ownership and security interests. To fully protect itself under Cooper's theory, Sun Bank would have to examine the execution docket of every sheriff and marshal in the state where the plane might be 'located,' not to mention other states.

	Copyright Office		State UCC Registers	
	Documents	Cost	Documents	Cost
Federal Search	1	\$250	1	\$250
Corp. Location Searches	0	0	90	\$32,850
Skip Tracer Reports	0	0	4	\$2,000
State UCC Searches	0	0	94	\$3,196
Copies of State UCC filings	0	0	2,400	\$3,000
Review of UCC filings	0	0		\$4,000
Judgment Lien Searches	0	0	601,600	\$29,478,400
Total (w/o Judgment Liens)	1	\$250	2,589	\$45,296
Total (w/ Judgment Liens)	1	\$250	604,189	\$29,523,696

Search Cost Comparison for *Terminator 3* (Estimates)

Of course, we could get lucky. We could find all necessary information after searching only a few locations. But we cannot guarantee it, and the law must anticipate worst-case scenarios. Since copyrights, patents and trademarks are national assets, a remote transferee must be prepared to search public records on a national scale. For such a search, even without the judgment liens, the costs can easily run in excess of \$45,000 or 18,000% more than the cost of a Copyright Search. Including judgment liens this brings the costs to insane levels.

Commercial finance lawyers advocating the use of the state UCC filing systems for federal information invariably assume it is only necessary to make *one* search. They make claims like “[t]he recordation [of a UCC-1] enables a prospective lender to search the UCC files of any state by borrower name in order to see whether its property is already encumbered by another party’s security interest.”²²⁰ This is tragically wrong. It only applies in the rare case where the lender has absolute surety the debtor is the sole creator of a stand-alone work, invention or mark. For the myriad of creations built on pre-existing creations, and for all assignees and licensees, professional due diligence demands searching the entire chain of title

220. Haemerli, *supra* n. 11, at 1658-1659; Healt, *supra* n. 11, at 135 (assuming only a single search required); *but see* Rostein, *supra* n. 10, at 175-177 (criticizing this error).

of the intellectual property.²²¹ For nationwide assets like federal information, the most efficient approach is a single search in the federal filing offices.

E. Competing Creditors

1. The Lien Creditor

The previous sections have addressed how to file. This section discusses from whom a filing protects. As discussed above, the federal intellectual property systems, like the real property recording acts, protect against later *bona fide* purchasers.²²² Article 9, however, protects against later lien creditors.²²³ A *bona fide* purchaser and a lien creditor are not the same.²²⁴ It is crucial to understand why this difference exists since Revised Article 9 now makes it the acid test for determining where a creditor must file to perfect a security interest.²²⁵

For tangible personal property, general creditors are ordinarily subordinate to a secured party regardless of whether the security interest is perfected.²²⁶ This follows from original Article 9-201, which provides that a security interest is effective between the parties, against purchasers of the collateral and against creditors unless otherwise provided in Article 9.²²⁷ This means a security interest need not be perfected to take priority over a later general creditor.²²⁸ The priority fight starts with the lien creditor. Under original Article 9-301(3), a "lien creditor" means "a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for the benefit of creditors from the time of the assignment,

221. See Simensky, *supra* n. 10, at § 15.3:

It is particularly important to investigate possible existing rights in a trademark or trade name, copyrights, or patents before making a substantial business investment in creating, using, or acquiring intellectual property. This inquiry is comparable to the necessity of a title search when dealing in real estate. The expense and possible delay entailed is usually well worth the investment and may be essential to ensure that rights can be lawfully created or acquired.

222. *Filmtec Corp.*, 939 F.2d at 1573-74 (patents); *In re AEG Acquisition Corp.*, 127 B.R. at 34, n. 8 (copyrights).

223. See U.C.C. § 9-301 (West 1999); Hawkland, *supra* n. 212, at § 9:301:4.

224. See generally Miller & Starr, *California Real Estate Law* 2d § 8:104 (1989).

225. See Brennan, *supra* n. 9, § III.C.

226. See Anderson, *supra* n. 73, at § 9-301:12 and cases cites.

227. Article 9-201; see 9 Anderson, *supra* n. 73, at § 9-201:5. Revised 9-201(a) continues the rule.

228. Anderson *supra*, n. 73, at § 9-301:11.

and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of the appointment.” The definition continues unchanged in Revised 9-102(a)(52). Basically, a lien creditor is a person with a money judgment who obtains a lien by attaching or levying upon personal property of the debtor.²²⁹ This involves taking physical possession of the debtor’s chattels. The possession establishes an apparent ownership that prevails over an unperfected security transfers under the policy against fraudulent conveyances.²³⁰

Article 9 does not define when and how a general creditor becomes a lien creditor; it leaves that to state law. The mechanisms for doing this are “complex and convoluted,” varying from state to state.²³¹ Not all mechanisms for enforcing a judgment create a lien; not all parties who obtain a judicial lien are lien creditors; and not all parties who become lien creditors do so at the same time. The available mechanisms also differ depending on the type of property involved. The crucial inquiries in each case are: (i) can the judgment creditor get a lien on the particular property at all, (ii) if so, will the judicial lien qualify the creditor as a lien creditor, and (iii) if so, at what point will this happen? It is to state enforcement of judgment law we must go to unmask the lien creditor for intellectual property.

2. *Lien Enforcement Procedures*

At common law, the entry of a money judgment did not itself create a lien.²³² The judgment creditor was required to execute on the judgment by requesting the court to issue one of the common law writs available for that purpose.²³³ The basic writ for executing on a money judgment was the *fieri facias*, which ordered the sheriff to seize and sell the debtor’s tangible personal property to the extent needed to satisfy the judgment.²³⁴ Execution of the writ proceeded in

229. *Id.* at § 9-301:14.

230. *See* Glenn, *supra* n. 48, at § 18 (“Actual seizure, followed by continued possession on the sheriff’s part, is very necessary, because otherwise a man who purchases the chattels from the judgment debtor, in good faith and without notice of the levy, will get the title by estoppel which will prevail over the judgment creditor’s rights.”); *see also* 51 Am. Jur. 2d *Liens* § 21 (“The right to a common-law lien is based entirely on the idea of possession, and it is indispensable that the one claiming it have an independent and exclusive possession of the property. Such a lien arises only when possession is obtained, and exists only so long as it is retained.”).

231. *See* Coogan, *supra* n. 11, at § 7E.04.

232. 46 Am. Jur. 2d *Judgments* § 361 (Year) and cases cited.

233. *Id.* at § 43. An “execution” means the formal document or “writ” issued by the court authorizing the sheriff to levy upon the property of the judgment debtor.

234. *Id.* at § 14. A related writ of *scire facias* was used to enforce execution of some

two steps, “the levy, or taking of property into the possession of the sheriff for sale, and the [actual] execution sale itself.”²³⁵ An “attachment” is similar to a levy, although it is available before the judgment is entered; a “garnishment” is a related attachment procedure for impounding debts due to a defendant pending judgment.²³⁶

The states differ on when during the enforcement of judgment process a lien arises. In some states a judgment lien arises when the judgment is rendered;²³⁷ in others, by filing with the Secretary of State;²³⁸ in “order of delivery states,” upon delivery of the writ to the sheriff;²³⁹ and in “order of levy” states not until the sheriff actually levies on the property.²⁴⁰ The difference between the last two derives from an ancient problem in issuance of the *feri facias*. Initially, it related back to the beginning of the court’s term, a harsh result for good faith transferees after the term began. The Statute of Frauds in 1676 alleviated this result, providing that the writ took effect on delivery to the sheriff.²⁴¹ The “order of delivery” states follow this older approach. The “order of levy” states instead say no lien arises until the sheriff takes possession by levy.²⁴² Three “order of levy” states allow a notice filing as an alternative to seizure for creating a lien.²⁴³

matter of record by giving notice to the defendant that the creditor sought to apply for an execution. *Id.* at § 15. For other common law writs, *see id.* at § 58. *See also* Coogan, *supra* n. 11, at § 7E.03[1].

235. 64 Am. Jur. 2d *Judgments* § 213.

236. 7 C.J.S. *Attachment* § 2.b (1980).

237. These states are Alabama, Georgia and Mississippi. *See* William J. Woodward, Jr., *New Judgment Liens on Personal Property: Does “Efficient” Mean “Better”?*, 27 Harv. J. on Legis. 1, 4 n. 9 (1990).

238. *See id.* discussing procedures in California, Connecticut and Maine.

239. Coogan, *supra* n. 11, at § 7E.04[1][d]. The editors of *Collier* identify the following as order of delivery states: Arkansas, Colorado, District of Columbia, Florida, Illinois, Indiana, Kentucky, New Jersey and New York. Lawrence P. King, 5 *Collier on Bankruptcy* ¶ 5.44.06, 544-11 n. 1 (15th rev. ed. 2000).

240. Coogan, *supra* n. 11, at § 7E.04[1][b]. The editors of *Collier* identify the following as the order of levy states: Alaska, California, Delaware, Idaho, Iowa, Kansas, Louisiana, Maryland, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Texas, Utah, Virginia, Washington, Wisconsin and Wyoming. King, *supra* n. 239, ¶ 5.44.06, at 544-11 n. 1.

241. *See* Coogan, *supra* n. 11, at § 7E.04[1][a]; also D.E. Murray, *Execution Lien Creditors versus Bona Fide Purchasers, Lenders and Other Creditors: Charles II and the Uniform Commercial Code*, 85 Comm. L. J. 485 (1980) (extensive history of issue).

242. *See* 46 Am. Jur. 2d *Judgments* § 361; Coogan, *supra* n. 11, at § 7E.04[1][a].

243. The states are New Hampshire, Vermont and Maine. *See* Coogan, *supra* n. 11, at § 7E.04[1][c].

Since Article 9 defines a lien creditor as someone who has acquired a lien “by attachment, levy or the like,” judgment creditors who acquire a judgment lien merely upon docketing the judgment or filing with the Secretary of State are not lien creditors.²⁴⁴ Similarly, in “order of delivery states,” a judgment creditor who merely delivers the writ to the sheriff is not a lien creditor.²⁴⁵ Such a creditor has an execution lien, to be sure, but not a lien by attachment, levy or the like, which requires some seizure of the debtor’s property. Delivery of the writ only creates a general lien that remains inchoate until the writ is returned. If the levy is successful, priority relates back to the date of delivery; if unsuccessful, the lien expires unless revived by a later writ.²⁴⁶ The bottom line is that a judgment creditor must perfect the lien by ensuring that the sheriff takes possession of personal property, or the creditor will not become a lien creditor who prevails against an unperfected security interest.²⁴⁷

3. *Non-Lien Enforcement Procedures*

Not all personal property is subject to these rules. At common law, the *fieri facias* only reached tangible personal property.²⁴⁸ In 1852, the Supreme Court made the obvious point that since intangibles are incapable of physical seizure, copyrights are not subject to levy or attachment at law.²⁴⁹ Numerous decisions confirmed that intellectual property interests were not subject to levy or attachment at law.²⁵⁰ A recent confirmation was the millennial year

244. See *id.* at § 7E.03[2]. In Georgia filing a judgment in the general execution docket creates a lien. But the judgment creditor does not become a lien creditor for purposes of Article 9 until the creditor secures an attachment or levy. See *Crossroads Bank of Ga. v. Corim, Inc.*, 262 Ga. 364 n. 5 (1992); also Coogan, *supra* n. 11, at § 7E.03[2] n. 8. Similarly, in California a judgment creditor can lien tangible personal property by a filing in the Secretary of State, but California Commercial Code § 9301(3) provides that a creditor so doing is not a lien creditor. Cal. Comm. Code Ann. § 9301(3) (West 1990).

245. Coogan, *supra* n. 11, at § 7E.04[1][d][iii].

246. See *id.* at § 7E.04[1][d][i].

247. E.g. *In re Baird*, 55 B.R. 316 (Bankr. W.D. Ky. 1985); *In re Wilson*, 38 B.R. 940 (Bankr. W.D. Ky. 1984); 33 C.J.S. *Executions* § 145 ([T]he lien of an execution ceases on return of the writ *nulla bona* or on return the return day of the writ unless there is an actual levy); see also Coogan, *supra* n. 11, at § 7E.04[1][d][iv].

248. 30 Am. Jur. 2d *Executions and Enforcement of Judgments* § 152 (Date); 53 C.J.S. *Liens* §§ 31, 33 (1987) (levy liens only allowed on tangible property).

249. *Stephens v. Cady*, 55 U.S. 528 (1852).

250. For copyrights see *Stevens v. Gladding*, 58 U.S. 447 (1855) (map); *Dart v. Woodhouse*, 40 Mich. 399 (1879) (title abstracts); *Banker v. Caldwell*, 3 Minn. 94 (1859); cf. *Washington Bank of Walla Walla v. Fidelity Abstract & Sec. Co.*, 15 Wash. 487 (1896) (common law copyright in title abstracts subject to judicial foreclosure of voluntary chattel mortgage).

For patents see *Ager v. Murray*, 105 U.S. 126 (1882); *Chem. Found. v. Gen. Aniline*

decision of the Virginia Supreme Court in *Network Solutions, Inc. v. Umbro International, Inc.*²⁵¹ It concluded that since intangibles were not subject to levy, the right to a domain name was not subject to garnishment. In procedural terms, this means the *fieri facias* (writ of execution) is returned *nulla bona* (unsatisfied).²⁵² A return of the writ unsatisfied extinguishes whatever lien there was in any case.²⁵³

How could a judgment creditor reach intellectual property? In *Ager v. Murray*²⁵⁴ the Supreme Court said the only way was through a creditor's bill in equity after legal remedies were exhausted, *i.e.* after a *fieri facias* was returned *nulla bona*.²⁵⁵ This basically required a

Works, Inc., 99 F.2d 276 (3d Cir. 1938), *cert. denied*, 305 U.S. 654 (1938) (mere conception of an invention before patent applied for cannot be seized on execution); *Rosenthal v. Goldstein*, 112 Misc. 606, 611 (1920) (or on supplemental proceeding); *Jewett v. Atwood Suspender Co.*, 100 F. 647 (C.C.D. Vt. 1900); *Coldren v. Am. Milling Research & Dev. Co.*, 177 Ind. App. 134 (1978); *Rubens v. Bowers*, 136 F.2d 887 (9th Cir. 1943) (Nev. law); *Newton v. Buck*, 77 F. 614 (2d Cir. 1896) (N.Y. law); *Wilson v. Martin-Wilson Automatic Fire Alarm Co.*, 149 Mass. 24 (1889); *Barton v. White*, 144 Mass. 281 (1887); *Peterson v. Sheriff*, 115 Cal. 211 (1896). *But see McClaskey v. Harbison-Walker Refractories Co.*, 138 F.2d 493, 498-99 (3d Cir. 1943) which asserted that Pennsylvania had changed its statute to allow a *fieri facias* to reach a patent by conferring on the judgment debtor "relief of the same kind which he would have received under a creditor's bill." A stinging dissent questioned the result in light of *Ager v. Murray*, asserting the judgment creditor should have proceeded by equitable execution. *Id.* at 500.

For trademarks see *Marshak v. Green*, 746 F.2d 927 (2d Cir. 1984) (N.Y. law); *Jacobs, Bell & Baumol v. Curtis*, 232 N.J. Super. 155 (1989); *Stutzman v. C.A. Nash & Son, Inc.*, 189 Va. 438, 466 (1949); *Ward-Chandler Bld. Co. v. Caldwell*, 8 Cal. App. 2d 375 (1935). Although *Ward* states the general rule that a trademark is not subject to attachment or levy at law, in that case a receiver was appointed and the trademark assigned by equitable proceeding. The assignment to the receiver was invalid because it was detached from the goodwill of the business, not because it occurred through levy or attachment.

For franchises see *Gue v. The Tide Water Canal Co.*, 65 U.S. 257, 263 (1860) ("The franchise, being an incorporeal hereditament, cannot, upon the settled principles of the common law, be seized under a *fieri facias*."); *Hart v. Seacoast Credit Corp.*, 115 N.J. 28, 169 (1933) *aff'd*, 116 N.J. Eg. 573 (1934); *Gulf Refining Co. v. Cleveland Trust Co.*, 166 Miss. 759 (1926) (corporate franchise);

For domain names see *Network Solutions, Inc. v. Umbro Intl., Inc.*, 259 Va. 759 (2000) (domain name not subject to garnishment under Virginia law, citing *Ager*, *Stevens* and *Gue*).

See generally 30 Am. Jur. 2d *Executions and Enforcement of Judgments* § 159 (patents and copyrights), § 160 (trademarks), § 161 (franchises); 33 C.J.S. *Executions* §§ 28, 30 (1998).

251. *Network Solutions, Inc.*, 259 Va. at 759.

252. 30 Am. Jur. 2d *Executions and Enforcement of Judgments* § 306.

253. See *e.g. So. Bay Enter. v. Miranda Bay Petroleum*, 957 S.W.2d 287 (Ky. App. 1997); *Illi, Inc. v. Margolis*, 296 A.2d 412 (Md. 1972); *Baird*, 55 B.R. 316; *Wilson*, 38 B.R. 940; 33 C.J.S. *Executions* § 145 (1998) ("[T]he lien of an execution ceases on return of the writ *nulla bona* or on return the return day of the writ unless there is an actual levy.").

254. 105 U.S. 126 (1882). *Ager* relied on an earlier suggestion in *Stevens v. Gladding*, 58 U.S. 447, 452 (1855) that this was the only proper method for a judgment creditor to reach a copyright. See *accord Pacific Bank v. Robinson*, 57 Cal. 520 (1881) (patent).

255. See generally Coogan, *supra* n. 11, at § 7E.04[1][a] (describing procedure); see

judgment creditor to petition a court in equity to appoint a receiver to execute a transfer if the intellectual property owner refused to act.²⁵⁶ Not all states recognized this procedure. In those that did not, intellectual property was simply unavailable to a judgment creditor.²⁵⁷ In those that did, this was the only available execution vehicle.²⁵⁸ In modern practice, some states now provide by statute that a writ of execution can reach certain classes of intangible property, primarily bank deposits and shares of corporate stock. But many continue the common law rule that the writ does not reach intangibles, meaning the creditor must resort to equitable proceedings.

A significant question is whether a judicial creditor resorting to a creditor's bill is a lien creditor under Article 9. The answer is no. A creditor's bill did give rise to what is loosely called a "lien," but this did not create an apparent ownership effective against third parties. It was merely an equitable lien to establish a priority among competing judgment creditors based on diligence.²⁵⁹ It arose simply by filing and not as a result of an attachment,²⁶⁰ and thus was subject to all pre-existing legal and equitable interests.²⁶¹ Although the creditor's bill usually had no effect on later parties without notice of the proceedings, where the bill described specific property, in some cases it operated as a *lis pendens* which was effective against

also 21 Am. Jur. 2d *Creditor's Bill* § 61 ("The limited scope of the common-law writs of execution created the need for the creditor's bill in equity, which is a lawsuit brought to enforce the payment of a debt out of property of a debtor under circumstances which impede or render impossible the collection of a debt by the ordinary process of execution.").

256. See generally 21 Am. Jur. 2d *Creditor's Bills* § 2 (A creditor's bill "is an equitable remedy available to a creditor who seeks to enforce the payments of debts out of assets that cannot be reached by traditional means of execution on a judgment established in a suit at law.").

257. See e.g. *Coldren v. Am. Milling Research & Dev. Co.*, 378 N.E.2d 870 (patent case, noting that Indiana did not recognize creditor's bill).

258. See e.g. *Wilson v. Martin-Wilson Automatic Fire Alarm Co.*, 149 Mass. 24 (1889) (patent); *Peterson v. Sheriff*, 115 Cal. 211 (1896) (patent).

259. See Coogan, *supra* n. 11, at § 7E.04[3][c][i]; see also *Ex parte Roddey*, 171 S.C. 489 (1934) (no specific lien arising from creditor's bill; it merely establishes priority among competing judgment creditors); *Right of Creditor Who Institutes Supplementary Proceedings to Priority over Other Creditors in Respect of Property Disclosed Thereby*, 92 A.L.R. 1435 (1935) (hereinafter "Right of Creditor").

260. *Hull v. Vaughn*, 107 S.W.2d 219 (1937); see also 21 C.J.S. *Creditor and Debtor* § 105 (1990).

261. *N.M. Uri & Co. v. McCroskey*, 205 S.W. 976 (1918) (lien of creditor's bill does not take priority over prior *bona fide* lien, even if unrecorded); *Colyear v. Super. Ct.*, 40 Cal. App. 462 (1919) (judgment creditor instituting supplemental proceeding could not take priority over prior warehouseman's lien); 21 C.J.S. *Creditor and Debtor* § 105 (1990).

subsequent interests.²⁶² However, perfecting the bill against prior legal interests required appointment of receiver and a transfer to the creditor.²⁶³ An example is *Adams Apple Distributing Co. v. Papeleras Reunidas*.²⁶⁴ A U.S. trademark licensee obtained a judgment against its Spanish licensor, who was in bankruptcy in Spain.²⁶⁵ The court affirmed imposing an equitable lien on the U.S. trademark since without it, the debtor's tangible assets might be sold independently, thus invalidating the mark.²⁶⁶ However, the lien was only intended to give the U.S. judgment debtor status as a creditor in the Spanish bankruptcy court, not more favorable rights against other creditors in Spain.²⁶⁷

With the merger of law and equity, most states have replaced the creditor's bill with the supplemental proceeding.²⁶⁸ This operates differently. It is a summary proceeding directed at discovery of assets and turning over those found.²⁶⁹ Whether the creditor must first obtain an execution returned unsatisfied depends on the statute,²⁷⁰ but resort to the proceeding invariably requires notice to the debtor and a chance to be heard.²⁷¹ Although in a few states a lien arises on commencement of the procedure, in most states a supplemental proceeding does not produce a lien at all. Instead, the remedy for unauthorized transfer is a contempt citation against the debtor.²⁷² Where a lien is provided, the statutes usually provide that it has no effect on a prior or subsequent *bona fide* purchaser without notice.²⁷³ Illinois is a good illustration. A fierce debate raged whether its citation to discover assets procedure created a lien, the better view

262. See Coogan, *supra* n. 11, at § 7E.04[3][c][ii]. Prof. McDonnell argues that if the judgment debtor conveyed to a secured party without notice of the creditor's bill, by reason of Article 2-403(1) the secured party could also claim it was a "good faith purchaser for value" who prevailed over any lien. *Id.*

263. See 33 C.J.S. *Executions* § 410 (1998) (service on the judgment debtor of an order for examination can create an equitable lien on the assets of the debtor, but the lien is inchoate and is not perfected until an order to deliver or pay over the property is made or a receiver is appointed or such other steps are taken as required by the statutes).

264. 775 F.2d 925 (7th Cir. 1985).

265. *Id.*

266. *Id.* at 931.

267. *Id.* at 931-932.

268. See Coogan, *supra* n. 11, at § 7E.04[3][c][i]; 23 C.J.S. *Executions* § 57 (1998).

269. See Coogan, *supra* n. 11, at § 7E.04[3][d]

270. 33 C.J.S. *Executions* §§ 957, 960 (1998).

271. *Id.* at §§ 361, 376.

272. *Id.* at §§ 379, 413.

273. See e.g. *Farm Credit Bank of St. Louis v. Swartz*, 18 F.3d 413 (7th Cir. 1994); 33 C.J.S. *Executions* § 411 (1998).

being it did not.²⁷⁴ The Illinois legislature eventually amended the statute to provide that the procedure did create a lien but that it did not effect *bona fide* purchasers without notice of proceedings.²⁷⁵ The next section contains a compendium of the state laws on this subject.

This procedural goo raises an important issue for security interests in intellectual property. If the state follows the typical rule that an intangible can only be reached in a supplemental proceeding, and the supplemental proceeding does not create a lien, then a judicial creditor pursuing supplemental proceedings is not a lien creditor. That means that the secured creditor need not file to perfect against a subsequent judicial creditor commencing supplemental proceedings. Moreover, where the statute provides that a supplemental proceeding does not effect a *bona fide* purchaser without notice, since a secured creditor is by definition a "purchaser," a secured creditor need not file to perfect against a prior pending supplemental proceeding of which it is unaware.²⁷⁶ In other words, under Article 9-201 a lender typically need not file to perfect an information security interest against a prior supplemental proceeding of which it is unaware or any subsequent supplemental proceeding.

The problem arises when the judicial creditor perfects its interest by obtaining a court ordered transfer. At that point, the judgment creditor becomes a judicial sale purchaser entitled to the protection of any applicable registry acts, the same as a *bona fide* purchaser.²⁷⁷

274. After a scholarly review of the conflicting case law, *In re Jaffee*, 111 B.R. 701 (Bankr. N.D. Ill. 1990), concluded that the citation procedure did not create a lien. *Water Tech. Corp. v. Calco Ltd.*, 132 F.R.D. 670 (N.D. Ill. 1990), followed *Jaffee* in a case involving a citation issued with regard to a patent license.

275. The legislation is digested in Coogan, *supra* n. 11, at § 7E.04[3][c][ii].

276. See e.g. *Farm Credit Bank*, 18 F.3d at 413 (although Illinois amended its citation procedure to provide lien, the lien does not effect a third party not served with citation); see also *Right of Creditor*, *supra* n. 259, at 1435.

277. For real property see e.g. *McNitt v. Turner*, 83 U.S. 352 (1873) (land patent); *Riley v. Martinelli*, 97 Cal. 575 (1893); *Hansen v. G&G Trucking Co.*, 236 Cal. App. 2d 481, 496 (1965).

For personal property see *LeFlore*, 57 Cal. App. 4th at 834 (judicial sale purchaser of film negative took free of unperfected security interest); *Teater v. Good Hope Dev. Corp.*, 55 Cal. App. 2d 459 (1942) (chattel mortgage); *M & J. Fin. Corp. v. Hodges*, 230 N.C. 580 (1949) (chattel mortgage). See generally 47 Am. Jur. 2d *Judicial Sales* §§ 163, 241 (1995) (although a judicial sale is typically subject to *caveat emptor*, so that the purchaser only takes the title of the debtor, a purchasing judgment creditor is nonetheless entitled to the protection of any applicable registry acts, the same as a *bona fide* purchaser); 50A C.J.S. *Judicial Sales* § 59 (1997) ("A purchaser at a judicial sale is a 'purchaser' within the meaning of the registry acts and is entitled to their protection."); 5A Words & Phrases, *Bona Fide Purchaser* and vol. 35A, *Purchaser for Value*. But see *Natl. Shawmut Bank of Boston v. Vera*, 223 N.E. 2d 515 (Mass. 1967) (holding that a judgment creditor purchasing an automobile from a consumer for personal use at an execution sale did not

Under pre-Code law there was a split of authority whether release of antecedent debt by bidding in the amount of the unpaid judgment was good consideration for the purchase of a chattel.²⁷⁸ Under the Code, it now definitely is.²⁷⁹ This means that, where information is concerned, an execution sale purchaser without notice can seek the protection of the federal information acts to trump prior unrecorded security interests. This is precisely what happened in *CMS Industries, Inc. v. L.P.S. International, Ltd.*²⁸⁰ It held that an unrecorded patent assignment was void against a purchasing judgement creditor without knowledge under Section 261 of the Patent Act.²⁸¹ Similarly, under Article 9-301(1)(d), a security interest in a general intangible must be perfected to prevail against a later *transferee* for value and without notice, including a judicial sale purchaser.

To sum up, under the enforcement of judgment laws in most states, a creditor need not file to perfect a *bona fide* security interest in intellectual property against a judicial creditor who merely institutes supplemental proceedings of which the secured creditor has no notice. Such a judicial creditor is neither a lien creditor nor a transferee. Therefore, an unfiled security interest has priority against such a creditor under original Article 9-201. A filing is required, however, to perfect against a judicial creditor who completes the

become a *buyer in the ordinary course* sufficient to prime an unrecorded security interest perfected without recording. Such standing was required for a consumer automobile under the state automobile certificate of title statute. While there is some overlap, a buyer in the ordinary course is different from, and has greater avoidance powers than, a *bona fide* purchaser.). See Anderson, *supra* n. 73, at § 1:201.50.

278. See W.C. Crais III, *Right to Follow Chattel into Hands of Purchaser Who Took in Payment of Preexisting Debt*, 11 A.L.R. 3d 1028 § 2b (West 2000). Two California courts of appeal, *20th Century Plumbing Co. v. Sfregola*, 126 Cal. App. 3d 851 (1981) (real property), and *City of Torrance v. Castner*, 46 Cal. App. 3d 76, 82 (1975) (personal property), have asserted that the credit bid of an execution purchaser is not “for value.” However, these cases confuse the holder of a judgment *lien* with a judicial sale *purchaser*, and the results are unsound. Moreover, in *20th Century*, the statements about credit bids were gratuitous since the court relied on the prior recording of the deed of trust to defeat *bona fide* purchaser status. Similarly in *Castner*, despite statements about the credit bid, the court relied on the fact that the execution purchaser was not “without notice.” *Castner* cited *Sargent v. Sturm*, 23 Cal. 359 (1863), for the proposition that a credit bid is not “for value” under the antecedent debt rule. But in *Sturm*, the defendant evidently did not release the antecedent debt; moreover, the property levied on was procured by fraud, and a true owner could always prove the purchaser’s title void due to fraud. Later cases in California held that release of antecedent debt was valuable consideration. See e.g. *Adolph Ramish, Inc. v. Woodruff*, 2 Cal.2d 190, 203 (1934); *Duff v. Randall*, 116 Cal. 226, 231 (1897) (real property); *Va. Timber & Lumber Co. v. Glenwood Lumber Co.*, 5 Cal. App. 256, 261 (1907) (chattel).

279. U.C.C. § 1-201(44)(a) (West 1996).

280. 643 F.2d 289 (5th Cir. 1981).

281. *Id.* at 292.

proceedings and obtains a court ordered transfer. Such a creditor, however, is not a lien creditor but is now a *bona fide* purchaser, and a filing is now required to perfect under Article 9-301(1)(d) or applicable federal law.

4. *State Insolvency Representatives*

The definition of lien creditor in current Article 9-301(3) is not limited to judgment creditors by attachment or levy. It also includes insolvency representatives: the bankruptcy trustee from the time the petition is filed; a receiver in equity from the time of appointment; and an assignee for the benefit of creditors from the time of the assignment. There are really two issues buried in the definition: *who* is a lien creditor and *when* does one become a lien creditor. To understand how Article 9 deals insolvency representatives, we need to have another look at pre-Code law:

In nineteenth century theory, an insolvency representative was viewed as a mere successor to the debtor who only took the actual title of the debtor, not the apparent interest. This meant, at least initially, that title was subject to all existing security interests, whether or not recorded.²⁸² In case of a fraudulent conveyance, however, the debtor was conceived as retaining an “equitable title” allowing avoidance of such a conveyance, and the insolvency representative, as successor to the debtor’s “equitable tile,” could use that right to avoid a secret lien.²⁸³ Although this started as an exception to the general rule, gradually the insolvency representative was conceived more as a representative of creditors than a mere successor to the debtor, and therefore was allowed to take advantage of various statutory avoidance powers the law gave to creditors. Congress gave the bankruptcy trustee a “strong arm” power equal to the maximum lien avoidance power available to any creditor under applicable non-bankruptcy law, a matter considered below. Here we focus on state receivers and assignees for the benefit of creditors.

Receivers: A receiver is appointed by a court under either its equitable powers or by virtue of statutory authority.²⁸⁴ A receiver is now generally conceived as a representative of creditors, but not a

282. For bankruptcy trustee *see infra*, discussion in § III.F.(2). For receiver *see* 66 Am. Jur. 2d *Receivers* § 160; 6A C.J.S. *Assignment for the Benefit of Creditors* § 63 (Dates).

283. *See e.g. Credit Managers Assoc. v. Natl. Indep. Bus. Alliance*, 162 Cal. App. 3d 1166, 1170-71 (1984) (assignee for benefit of creditors); 66 Am. Jur. 2d *Receivers* § 143.

284. *See generally* Ralph Ewing Clark, *A Treatise on the Law and Practice of Receivers* (3d ed. 1959); 66 Am. Jur. 2d *Receivers* §§ 1 *et seq.*

bona fide purchaser.²⁸⁵ A receiver only takes charge of property directly involved in the litigation in which the receiver is appointed.²⁸⁶ Under the general rule that a receiver merely gets the debtor's title, a receiver takes subject to all existing liens, whether or not recorded, unless a statute provides otherwise.²⁸⁷ Pre-Code case law, under a rainbow of theories, allowed receivers in various situations to set aside an unrecorded chattel mortgage for the benefit of creditors.²⁸⁸ Article 9-301(3) resolved the different approaches by giving a receiver that same lien avoidance power as a levying creditor. Article 9-301(3) also resolved the issue of when the receiver's power arose by deciding that it related back to the time of appointment.²⁸⁹ The receiver's power, of course, only applies for the benefit of other creditors; as between the receiver and the debtor, the security interest, even if unperfected, remains good.²⁹⁰

Although Article 9 establishes the avoidance power of a receiver (the same as a levying creditor) and when it arises for priority purposes (time of appointment) it does not decide how property becomes subject to the receivership to begin with. State law does that. "The general rule is that the appointment of a receiver does not in itself operate to change any title, right, or interest, or to vest any title or estate in the receiver; on the contrary, the title to the property in receivership continues in the defendant, debtor, insolvent or other person whose property is in receivership, until he is divested of it by receiver's sale, or act of his own."²⁹¹ Thus, the mere appointment of a receiver did not in itself set aside a prior unrecorded chattel mortgage; the receiver had merely an "equitable title" (lien avoidance power), and the chattel mortgage remained good until the receiver took action to set it aside.²⁹² Put another way, the

285. 66 Am. Jur. 2d *Receivers* § 139 (representative capacity); § 142 (but not a *bona fide* purchaser).

286. *Id.* at § 155.

287. *Id.* at § 166.

288. See e.g. *Shooters Island Shipyard Co. v. Howden*, 293 F. 706, 716 (3rd Cir. 1923); *In re K-T Sandwich Shoppe*, 34 F.2d 962 (E.D. Ohio 1929); *Camerer v. Cal. Sav. & Com. Bank*, 4 Cal. 2d 159, 170 (1935). See *Right of Receiver of Conditional Vendee to Avail Himself of Defect in Execution, or Filing, or Failure to File, Contract*, 61 A.L.R. 975, for an interesting discussion of receiver's avoidance status under pre-Code case law, such a representative of creditors, subsequent purchaser, judgment creditor, lien creditor, etc.

289. For discussion of different theories under pre-Code law, see 66 Am. Jur. 2d *Receivers* § 151.

290. *Morse Elec. Prod. v. Beneficial Indus. Loan Co.*, 90 Wash. 2d 195 (1978).

291. 66 Am. Jur. 2d *Receivers* § 155.

292. *Id.* at § 160; *Stevens v. Meriden Britannia Co.*, 160 N.Y. 178 (1899); *Ward v. Petrie*, 157 N.Y. 301 (1898). See also *E. Turgeon Constr. Co. v. Elhatton Plumbing & Heating Co.*,

appointment of a receiver is merely a “constructive possession,” not an actual one,²⁹³ and the receiver does not perfect an interest in personal property against prior unrecorded interests until the receiver takes actual possession, allowing the apparent ownership rule to come into play.²⁹⁴

This rule has particular application to intellectual property. As discussed below, the federal intellectual property statutes require a signed writing to transfer an interest in federal information. Thus, *Inventions Corp. v. Hobbs*,²⁹⁵ applying well-settled law, held that the mere appointment of a receiver does not in itself vest title to a patent in the receiver; vesting only occurs when a court in equity orders the patent owner to execute an assignment to the party entitled.²⁹⁶ The resulting receiver’s sale is treated as a judicial sale, in contradistinction to a sheriff’s or execution sale.²⁹⁷ For Article 9 purposes, this means that the receiver is a lien creditor from the date of appointment, but the receiver’s “lien” is inchoate until perfected by a receiver’s “sale,” (court ordered assignment). Although in principle the sale only conveys the actual title of the debtor,²⁹⁸ as noted above, the receiver or third party purchaser is entitled to the protection of any applicable recording acts.²⁹⁹ Thus, an unrecorded security interest in federal information, should remain good against a

292 A.2d 230 (R.I. 1972) (incidental assignee of accounts, exempted from filing requirements under U.C.C. § 9-302(1)(e), prevailed over subsequent receiver of debtor, since receiver had no power to set it aside.).

293. 66 Am. Jur. 2d *Receivers* § 161 (Date).

294. See e.g. *Bank of Woodland v. Heron*, 120 Cal. 614, 620 (1898) (receiver who did not take possession of real property could not set aside later crop mortgage); *Miller v. Super. Ct.*, 63 Cal. App. 1 (1923) (receiver appointed after sheriff took possession could not claim property).

295. 244 F. 430 (2d Cir. 1917).

296. *Id.* at 444; *accord Ager v. Murray*, 105 U.S. 131 (mere appointment of receiver does not transfer patent right absent court order); *Ball*, 168 F. at 304; *Waterman*, 55 F. at 986; *Gillett v. Bates*, 86 N.Y. 87 (1881); *Pac. Bank v. Robinson*, 57 Cal. 520 (1881); *Finnegan v. Finnegan*, 64 Cal. App. 2d 109, 112 (1944); 75 C.J.S. *Receivers* § 106 (1952) (assignment order necessary to convey legal title); Clark, *supra* n. 284, at §§ 244, 256. Apparently, English practice does not allow receivers for a patent at all. *Id.* See also *Jewett v. Atwood Suspender Co.*, 100 F. 647, 648 (1900) (mere assignment of patent by state court in insolvency proceeding without proceeding to compel patent owner to assign did not convey any right in patent).

297. 66 Am. Jur. 2d *Receivers* § 402.

298. *Id.* at § 416.

299. *First Natl. Bank of Green River v. Ennis*, 44 Wyo. 497, 512-513 (1932) (assignee of *chose in action* at receiver’s sale took free of undisclosed prior interest); 50A C.J.S. *Judicial Sales* § 59 (1997) (“A purchaser at a judicial sale is a ‘purchaser’ within the meaning of the registry acts and is entitled to their protection.”); 75 C.J.S. *Receivers* § 258 (1952) (purchaser of *chose in action* at receiver’s sale without notice takes free of latent equities); see *supra* n. 277 and accompanying text.

receiver until the receiver's interest is perfected by court ordered sale and recorded federally.³⁰⁰ This is exactly the way it works for real property. A receiver takes subject to any pre-existing mortgage on the real property, whether or not recorded, but the purchaser from a receiver's sale is entitled to the protection of the recording acts.³⁰¹

Assignee for the Benefit of Creditors: The common law rule was that an assignee for the benefit of creditors merely succeeded to the title of the assignor.³⁰² The assignee was neither a purchaser nor a creditor, and not within the protection of the statutes that allowed creditors to attack an unrecorded conditional sales contract or chattel mortgage.³⁰³ Article 9-301(3) changed that, giving the assignee the status of a lien creditor as of the time of the assignment. Once again, although Article 9 establishes the avoidance power (same as a levying creditor) and the priority date (time of assignment) it does not decide when and how property becomes subject to the assignee. State law does that. And there is considerable variation.

Many states have statutes that regulate, to a greater or lesser degree, assignments for the benefit of creditors. At common law a partial assignment was permissible, but many states now make partial assignments either void or treat them as general assignments.³⁰⁴ Since the assignment is often seen as a common law alternative to bankruptcy, the assignor can usually withhold exempt property.³⁰⁵ Many states impose formalities for the assignment to be effective, such recording in a local court, filing a schedule of assigned property, or posting a bond.³⁰⁶ If the statute is regulatory, then common law assignments may be allowed independent of the statute; if mandatory, then failure to comply with statutory formalities can

300. For state information, the judicial sale purchaser would be a "transferee" under Article 9-301(1)(d), and, if without notice, entitled to priority over an unrecorded security interest.

301. See e.g. *Moore v. Schneider*, 196 Cal. 380 (1925); Clark, *supra* n. 284, at § 491.

302. See 6 Am. Jur. 2d *Assignments for the Benefit of Creditors* § 73 (Date).

303. See e.g. *Intl. Harvester Co. v. Poduska*, 232 N.W. 67, 71 (1930); *Chicago Sugar-Refining Co. v. Jackson Brewing Co.*, 48 S.W. 275 (Tenn. 1898); Anno., *Assignees for Creditors as Within Protection of Statute Requiring Filing or Recording of Conditional-sale Contract or Chattel Mortgage*, 71 A.L.R. 981 (Date); 6A C.J.S. *Assignment for the Benefit of Creditors* § 73 (1975).

304. See 6 Am. Jur. 2d *Assignments for the Benefit of Creditors* § 33 (different state practices).

305. See, e.g. Cal. Civ. Proc. Code § 1800.1 (Date) (property exempt from assignment); Ohio Rev. Code Ann. § 1313.17 (Date) (assignment shall not include "property exempt from levy or sale on execution"); 6 Am. Jur. 2d *Assignments for the Benefit of Creditors* § 126 (Date).

306. See 6 Am. Jur. 2d *Assignments for the Benefit of Creditors* § 4 (statutory overview), § 28 (recording), § 31 (schedules) § 102 (bond).

make the assignment ineffective.³⁰⁷ Where recording is required, failure to record either renders the assignment void³⁰⁸ or ineffective against *bona fide* purchasers and encumbrancers without notice.³⁰⁹ In the latter case, the assignee has a lien as of the date of the assignment, as provided in Article 9, but the lien is inchoate until perfected by complying with the statutory recording requirements.³¹⁰

Only creditors who consent to the assignment may share in the distribution of assets the extent of their proportional share.³¹¹ Non consenting creditors retain their claims against the debtor but may not share in the distribution.³¹² In some states, the consent must be express; in others, it is presumed where the assignment is general and not prejudicial to the creditor.³¹³ Under Article 9 the assignee has the same power as a lien creditor to attack unperfected security interests.³¹⁴ For perfected ones, there are four different rules as to

307. *Id.* at § 4.

308. See e.g. Ala. Code § 35-4-57 (1991) (deeds of assignment for benefit of creditors must be recorded in probate court of county where property is located to be valid against creditors); Ariz. Rev. Stat. Ann. § 44-1034 (same); Ohio Rev. Ann. Code § 1313.02 (Date) (assignment effective only from time of delivery to probate judge). *J.F. Sanson & Sons Co. v. Weltman*, 58 Ohio App. 2d 1 (1978) (since assignment is not effective until recorded in probate court, assignee was junior to judgment lien after assignment but before recording).

309. See e.g. Ariz. Rev. Stat. Ann. § 44-1041.

310. See *Metro Burak, Inc. v. Rosenthal & Rosenthal, Inc.*, 380 N.Y.S.2d 758 (1976) (all procedures under Debtor and Creditor law must be complied with before the assignment takes effect); *In re Fed. Wholesale Meats & Frozen Foods, Inc.*, 43 Wis. 2d 21 (1969) (assignee for benefit of creditors has no right to debtor's property until assignment filed, but on so doing assignee has priority over secured creditor in accounts that failed to file); *Borges v. Acme Oil Tool Co.*, 306 P.2d 704 (Okla. 1956) (although under Oklahoma law an unrecorded assignment for the benefit of creditors is void against non-assenting creditors and *bona fide* purchasers and encumbrancers without knowledge, recording is a condition subsequent, so the assignee has an inchoate lien until recording which is good against parties with knowledge); 6A C.J.S. *Assignment for the Benefit of Creditors* § 63 (1975) (recording requirements); 6 Am. Jur. 2d *Assignment for the Benefit of Creditors* § 28 (same). In *Century Factors v. Everything New, Inc.*, 468 N.Y.S. 2d 987 (1983), interpreting a "novel question" under the New York Debtor and Creditor Law, held that although an assignment is not effective against third parties until recording, upon recording the assignee's interest relates back to the appointment. Thus, a restraining order served after the assignment was ineffective where the assignment was duly recorded one day later.

311. 6 Am. Jur. 2d *Assignments for the Benefit of Creditors* § 34.

312. *Id.*; see e.g. *Southwest Research Corp. v. Caliendo*, 24 Ariz. App. 560 (1975) (procedure under Arizona law).

313. See *Meador v. Larned Feed Lot, Inc.*, 197 Kan. 334 (1966) (assignment for benefit of creditors that did not comply with statutory requirements could not be enforced against unwilling creditor); 6 Am. Jur. 2d *Assignments for the Benefit of Creditors* §§ 34, 35.

314. 6 Am. Jur. 2d *Assignment for the Benefit of Creditors* § 83.

how the secured creditor may proceed.³¹⁵ The secured creditor has the choice of exhausting the security and proving the balance the claim, or surrendering the security and proving up the entire claim. The different rules affect dividends arising from the security.³¹⁶ In New York, secured property does not become part of the assigned estate until after a charging order is issued determining its value.³¹⁷

One issue for which there is sparse authority is what happens in a conflict between an unrecorded purchaser of federal information and an assignee for the benefit of creditors. It seems necessary to analyze the issue on first principles. Assume the debtor assigns a patent for security to a lender that fails to record in the PTO, then assigns the patent as part of an assignment for the benefit of creditors. Although the Patent Act requires a signed writing for a patent assignment, because state law requires the assignment to be in writing³¹⁸ this requirement will be satisfied. Section 261 of the Patent Act says the security assignment is “void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office . . . prior to such subsequent purchase or mortgage.”³¹⁹ The assignee for creditors is not a purchaser or mortgagor within Section 261. Thus, the first lender, despite the later assignment, can obtain priority if it records first in the PTO, whatever state law may say, so the assignee’s interest is not really perfected against the prior lender. However, the assignee’s duty is to proceed promptly to convert the property into money any pay the creditors.³²⁰ A transferee from the assignee does qualify as a “subsequent purchaser” and, if in good faith and without notice, could take priority over the unrecorded security assignment by recording first in the PTO. This is the same result as for other lien creditors: effective perfection against prior unrecorded interests requires a transfer and recording in the federal registers.

An example of this result for real property is *Moore v. Schneider*.³²¹ A debtor transferred real property to a *bona fide* purchaser, and then made an assignment for the benefit of creditors. The purchaser, who was unaware of the assignment, then recorded

315. *Id.*; 42 Am. Jur. 2d *Insolvency* § 52.

316. 6 Am. Jur. 2d *Assignment for the Benefit of Creditors* § 83; 42 Am. Jur. 2d *Insolvency* § 52.

317. See *Gen. Motors Acceptance Corp. v. Kalkstein*, 474 N.Y.S.2d 493 (1984); *Cherno v. Bank of Babylon*, 282 N.Y.S.2d 114 (1967).

318. 6 Am. Jur. 2d *Assignment for the Benefit of Creditors* § 27.

319. *Id.*

320. *Id.* at § 92.

321. 196 Cal. 380 (1925).

the deed. The assignee sued to set aside the deed. The court held that the assignee was subject to the recording law like any other party. Since the assignment was not recorded, and since the purchaser was without notice, the prior deed prevailed over the later assignment for the benefit of creditors.³²²

5. State Law Compendium

The following chart summarizes enforcement of judgment procedures in various states.

STATE	Writ of Attachment	Writ of Execution	Creditor's Bill in Equity	Supplement Proceeding
Alabama	Not on information	No levy on information		No lien
Alaska	Not on information?	Not levy on information?		No lien
Arizona	Not on information	No levy on information		No lien
Arkansas	Not on information	No levy on information		Lien - not against BFP
California	Not on information	Lien? - not against BFP	Lien - not against BFP	Lien - not against BFP
Colorado	Not on information?	No levy on information?		No lien
Connecticut	No lien on federal info?	No levy on federal info?		No lien
District of Columbia	Not on information?	No levy on information?		No lien
Florida	Not on information	No levy on information	Lien - not against BFP	No lien
Georgia	Not on information?	No levy on information	N/A	No lien
Illinois	Not on information?	No levy on information		Lien - not against BFP
Iowa	Allowed on information	Allowed on information	Lien - not against BFP	No lien
Michigan	Not on information?	No levy on information		No lien
Minnesota	Allowed on information?	Allowed on information?		Lien - not against BFP
Missouri	Not on information	No levy on information		No lien
Nebraska	Not on information?	Not on information		No lien
Nevada	Allowed on information?	Allowed on information?		No lien
New Hampshire	Not on information	Not on information	Lien on later interests	

322. *Id.* at 390.

New Jersey	Allowed on assignable information?	Allowed on assignable information?		No lien
Ohio	Not on information	Not on information		No lien
Oklahoma	Not on information	Not on information		No lien
Texas	Not on information?	Not on information?		No lien
Virginia	Not on BFPs until filing	Lien - not against BFP		No lien

Chart of Selected State Enforcement of Judgment Laws³²³

323. Where a statute does not expressly create a lien, I have assumed there is none. Where the statute does not authorize a procedure, *e.g.* a creditor's bill, I have assumed there is none. A "BFP" means a "*bona fide* purchaser," *i.e.* a third party who takes in good faith, for value and without notice. I have translated "choses in action," the traditional formula for intangibles, as "information." For example, Alabama does not allow a writ of execution on "choses in action," so I have represented this under Writ of Execution as "Not on Information." Similarly, several states provide that and execution only applies to "goods and chattels," which in the traditional usage did not include intangibles. For consistency, I have also reflected these as "Not on Information," but I have followed it by a "?" where statutory language or judicial decisions may indicate a different result. Blank entries indicate that the procedure is unavailable, or at least that I was unable to find it readily. Following this chart is a selected commentary of the relevant statutes. Due to space limitations I have not included receivers or assignees for the benefit of creditors in the chart, although they are often discussed in the notes. Chart relied on extensive annotation in Hon. James J. Brown, *Judgment Enforcement* § 4.01 (2d ed. 2000), as well as additional research of my own.

Alabama: *Attachment:* Ala. Code § 6-6-70 (date), lien Ala. Code § 6-6-76; *Execution:* *id.* at § 6-6-70, lien *id.* at § 6-6-90; *Supplemental Proceeding:* *id.* at § 6-6-183, no lien; *Assignee for Creditors:* *id.* at § 35-4-57. For an attachment, under Ala. Code § 6-6-70 a sheriff must take possession "where practicable," which requires dominion by notorious act. *Landers v. Moore*, 21 Ala. App. 12 (1925). Registration of a judgment in a local courthouse creates a judgment lien on personal property "subject to levy," but not on choses in action. Ala. Code § 6-9-211. *See also Canterbury & Gilder v. Marengo Abstract Co.*, 166 Ala. 231 (1910). Execution creates a lien from the time of levy. Ala. Code § 6-9-60. Execution may be levied on personal property except "things in action." Ala. Code § 6-9-40(2); *see also In re Head*, 204 B.R. 1022 (Bankr. N.D. Ala. 1997) (allowing no lien on proceeds from sale of treasury note since Alabama does not allow levy on chose in action); *In re Flair*, 28 B.R. 160 (Bankr. M.D. Ala. 1983) (same). No lien is provided by statute in a supplemental proceeding. Deed of assignment for creditors must be recorded to be valid. Ala. Code § 35-4-57.

Alaska: *Attachment:* Alaska Stat. §§ 09.40.010 *et seq.* (Date). *Execution:* *id.* at § 09.30.010 *et seq.*, lien *id.* at § 09.35.110; *Supplemental Proceeding:* Civil Rule 69(b) - no lien; *Receiver:* Alaska Stat. 09.40.240. A writ of execution extends to "all goods, chattels, money or other property, both real and personal" of the judgment debtor. Alaska Stat. § 09.30.070. However, this does not extend to corporate franchises. *See Stevens v. Lathrop*, 4 Alaska 407 (1911). Attachment may be had on all property "not exempt from execution." Alaska Stat. § 09.40.030. Mere appointment of a receiver does not transfer intangibles without a court order. *See Wood v. Noyes*, 279 F. 321 (9th Cir. 1922), *cert. denied*, 260 U.S. 732 (1922).

Arizona: *Attachment:* Ariz. Rev. Stat. Ann. § 12-1521 (date); lien *id.* at § 12-1532; *Execution:* *id.* at §§ 12-1551 - 12-1558; *Supplemental Proceeding:* *id.* at §§ 12-1631-1635;

Receiver: Fed. R. Civ. P. 66; *Assignee for Creditors*: Ariz. Rev. Stat. Ann. §§ 44-1031 *et seq.* (Date). For an attachment, § 12-1532 creates a lien only on "property in the custody of the attaching officer." *Id.* at § 12-1532. Choses in action can be "levied on and sold on execution." *Id.* at § 1558. However, the statute contains no mechanism for so doing. Since 1931 Arizona courts have held that a chose in action is not subject to levy, but must be reached by garnishment. *See Hill v. Favour*, 52 Ariz. 561 (1938); *Haigler v. Burson*, 38 Ariz. 192, 195 (1931). Since the Legislature has reenacted the statutes in substantially similar form in light of *Hill* and *Haigler*, it is presumed to agree. *Cage v. Butcher*, 118 Ariz. 122, n. 2 (1978). The Arizona garnishment proceeding does not create a lien, merely a *lis pendens*. *In re McCoy*, 46 B.R. 9, 11 (Bankr. D. Ariz. 1984). The supplemental proceeding does not create a lien. The assignee for creditors may not recover property conveyed to a good faith purchaser for value. Ariz. Rev. Stat. Ann. § 44-1041.

Arkansas: *Attachment*: Ark. Code Ann. §§ 16-110-101 *et seq.* (1997), lien *id.* at § 16-110-115; *Execution*: *id.* at §§ 16-66-101 *et seq.*, lien *id.* at § 16-66-112; *Supplemental Proceeding*: *id.* at §§ 16-66-418 & 16-66-419; *Receiver*: *id.* at §§ 16-117-201 *et seq.*; *Assignee for Creditors*: Ark. Code Ann. § 16-117-401 *et seq.* Under section 16-66-201, the writ of execution only extends to "goods and chattels." Ark. Code Ann. § 16-66-201. *See also In re Frazier*, 136 B.R. 199 (Bankr. W.D. Ark. 1991) (noting that Arkansas follows the common law rule that choses in action and other equitable property interests are not subject to execution except to the extent modified by statute). The Legislature has made some, but not all, such interests subject to execution. The supplemental proceeding does create a lien, but it is ineffective against third parties without notice. Ark. Code Ann. § 66-419; *see also N.M. Uri & Co. v. McCroskey*, 135 Ark. 537 (1918). The lien of an attachment only binds the defendant's property "which may be seized under an execution." Ark. Code Ann. § 16-160-115. The assignee must file in a local court for the assignment to be effective. *Id.* at § 16-117-401.

California: *Attachment*: Cal. Civ. Proc. Code §§ 481.010 *et seq.* (date). *Judgment Lien*: *id.* at § 697.510; *Execution*: *id.* at § 699.710; *Supplemental Proceeding*: *id.* at § 708.110 - lien; *Creditor's Bill*: *id.* at § 708.210 - lien; *Receiver*: *id.* at § 708.610; *Assignment Order*: *id.* at § 708.510. The California statutes are discussed in detail in the companion article. *See Brennan, supra* n. 9, at § II.C.3.b.

Colorado: *Attachment*: Colo. R. Civ. P. 102; *Execution*: Colo. Rev. Stat. Ann. §§ 13-52-101 *et seq.* - lien *id.* at § 13-52-11; *Supplemental Proceeding*: Colo. R. Civ. P. 69 - no lien; *Receiver*: *id.* at 66; *Assignee for Creditors*: Colo. Rev. Stat. Ann. § 6-10-101 *et seq.* Under Colorado Rules of Civil Procedure, personal property can only be attached by "taking it into custody." Under Colorado Revised Statutes Annotated section 13-52-102(1), levy may be had on "goods and chattels." This apparently excludes intangibles. *See First Natl. Bank of Denver v. Dist. Ct.*, 652 P.2d 613 (Colo. 1982) (holding that partnership interests not subject to levy on execution). The supplemental proceeding in Rule 69 is available for such purpose. Colo. R. Civ. P. 67. Although it does not expressly create a lien, the prior creditor's bill it replaced did create an equitable lien. *Shuck v. Quackenbush*, 75 Colo. 592 (1924). The "property" subject to an assignment for the benefit of creditors includes "choses in action." Colo. Rev. Stat. Ann. § 6-10-101(2). The assignment vests, in the assignee, all property of the debtor except property "by law not subject to levy and sale under execution" and "subject to all valid and subsisting liens." *Id.* at § 6-10-102.

Connecticut: *Attachment*: Conn. Gen. Stat. Ann. §§ 52-279 *et seq.* (Date); *Judgment lien*: *id.* at § 52-355a; *Execution*: *id.* at § 52-350f; *Supplemental Proceeding*: *id.* at § 52-397 - no lien; *Receiver*: *id.* at §§ 52-504 *et seq.* (Date). A writ of attachment is authorized in all cases "containing a money demand against the estate of the defendant, both real and personal." *Id.* at § 52-279. While the writ is authorized in such cases, there is no procedure to attach information. Section 52-355a allows judgment liens on personal property to be filed with the Secretary of State, but the lien applies to personal property "on which a security interest could be perfected by filing in the office of the Secretary of State." *Id.* at

§ 52-355a. Since perfecting a security interest in a federal information requires a federal filing, at least as to *bona fide* purchasers, it is questionable whether this section applies. Connecticut General Statute Annotated section 52-350f provides that a money judgment may be enforced against all property of the judgment debtor unless “exempt . . . under federal law.” *Id.* at § 52-3504. By “exempt,” the statutes usually means the exemptions allowed under bankruptcy law for personal effects, homestead exemptions and the like. Whether this would include federal information which has traditionally been held not subject to execution at law due to the writing requirement is undecided.

District of Columbia: *Attachment:* D.C. Code §§ 16-501 *et seq.* (Date). *Execution:* *id.* at § 15-311, lien - *id.* at § 15-307; *Supplemental Procedure:* *id.* at 15-320 - no lien; *Receiver:* *id.* at § 16-518, Fed. R. Civ. P. 66; *Assignee for Creditors:* D.C. Code §§ 28-2101 *et seq.* The “writ of *feiri facias* may be levied on all goods and chattels of the debtor not exempt from execution.” D.C. Code § 15-311. A writ of attachment only reaches “the debtor’s goods, chattels and credits,” and the *feiri facias* only applies to “goods and chattels.” *Id.* at §§ 16-544, 15-311; *see Rowe v. Colpoys*, 137 F.2d 249 (D.C. Cir. 1943) (noting that “goods and chattels” was the common law formula to describe property subject to levy under a writ *scire facias*, opined that the term has a “broader and inclusive meaning” in modern practice). *Rowe* decided that “goods and chattels” in District law would allow levy on a liquor license, concluding “that the rule of the common law which forbids a levy upon licenses, was confined, and should be confined, to non-transferable licenses.” *Id.* at 251. *Rowe* was talking about a business permit, and relied on the fact that the licensing board had the authority to transfer the license. This is not necessarily the same as a private license of intellectual property, where there are limits on involuntary transfers without consent of the owner. The lien of an execution only extends to “the equitable interest of the judgment defendant in goods and chattels in his possession.” D.C. Code § 15-307. An assignment for creditors is invalid unless recorded. *Id.* at § 28-2103.

Florida: *Execution:* Fla. Stat. Ann. §§ 56.01 *et seq.* (Date); *Supplemental Proceeding:* *id.* at § 56.29 - no lien; *Creditor’s Bill:* *id.* at § 68.05 - lien; *Receiver:* R. of Civ. P. 1.620; *Assignee for Creditors:* Fla. Stat. Ann. §§ 727.101 *et seq.* The writ of execution extends to “goods and chattels” but not contractual rights or choses in action. *Id.* at § 56.061; *see also Willard v. Petruska*, 402 Fla. 2d 756 (1968). The supplemental proceeding in section 56.29 does not create a lien, although the creditor’s bill under section 68.05 does. Fla. Stat. Ann. § 56.29.6805. However, *Salina Mfg. Co. v. Diner’s Club, Inc.*, 382 S.2d 1309 (Fla. App. 1980), held the Florida creditor’s bill only creates equitable lien as between two competing judgment creditors, so it would not apply to third parties without notice. Creditors with liens prevail over an assignee for creditors to the extent their liens are “duly perfected pursuant to applicable law.” Fla. Stat. Ann. § 727.114.

Georgia: *Attachment:* Ga. Code Ann. (1998) §§ 18-3-1 *et seq.* (1998); *Judgment lien:* *id.* at § 9-12-80; *Execution:* *id.* at §§ 9-13-50 *et seq.*; *Supplemental Proceeding:* *id.* at § 9-11-69 examination procedure - no lien; *Receiver:* *id.* at §§ 9-8-1 *et seq.*; *Assignee for Creditors:* *id.* at §§ 18-2-40 *et seq.* Georgia creates a judgment lien on personal property by mere entry of a judgment. *Id.* at § 9-12-80. Nonetheless, a judgment creditor does not become a lien creditor until attachment or levy. *Crossroads Bank v. Corim, Inc.*, 262 Ga. 364, n. 5 (1992). A writ of execution does not extend to “choses in action.” Ga. Code Ann. § 9-13-57. The examination procedure in section 9-11-69 does not create a lien. *Id.* at § 9-11-67. Under section 18-3-74, the lien of an attachment is only created by a levy, but O.C.G.A. § 18-3-72, says that a judgment obtained in an attachment may only be levied “in the same manner as executions issuing at common law.” *Id.* at §§ 18-3-74, 18-3-72. No procedure is provided for a levy by attachment on a chose in action. An assignment for creditors includes choses in action. *Id.* at § 18-2-45. The assignee succeeds to the interest of the assignor but has any power the assignor had to attack a fraudulent conveyance. *Id.* at § 18-2-54.

Illinois: *Attachment:* 5 Ill. Comp. Stat. Ann. § 4-101 *et seq.* (Date); *Execution:* *id.* at § 12-

101 *et seq.*; *Supplemental Proceeding: id.* at § 2-1402 – lien *id.* at § 2-1402(m). Attachment applies to all property subject to execution, which may mean choses in action are not covered. See *Christison v. Jones*, 83 Ill. App. 3d 344 (1980) (malpractice action not attachable). Only “goods and chattels” are subject to levy on execution which does not include intangibles. 5 Ill. Comp. Stat. Ann. § 12-112; see *Rochford v. Laser*, 91 Ill. App. 3d 769 (1980). In Illinois, a lien on intangibles may only be created through the creditor’s bills or citation procedures. *Rochford*, Ill. App. 3d at 769. Originally the Illinois citation procedure did not create a lien. *In re Jaffee*, 111 B.R. 701 (Bankr. N.D. Ill. 1990). The Legislature amended the statute to create one, but provided that the lien did not extend to “*bona fide* purchasers or lenders without notice of the citation.” 5 Ill. Comp. Stat. Ann. § 2-1402(m).

Iowa: *Attachment:* Iowa Code Ann. §§ 639.1 *et seq.* (Date); *Execution: id.* at §§ 626.1 *et seq.*; *Supplemental Proceeding: id.* at §§ 630.1 *et seq.* – no lien; *Creditor’s Bill: id.* at §§ 630.16 *et seq.*, lien – § 630.18; *Receiver: id.* at § 630.7; *Assignee for Creditors: id.* at §§ 681.1 *et seq.* Choses in action may be attached, and may be levied on. *Id.* at §§ 639.23, 626.21. The Supplemental Proceeding evidently does not create a lien. The Creditor’s Bill procedure does create one from the time of notice.

Michigan: *Attachment:* Mich. Comp. Laws §§ 600.40001 *et seq.* (Date); *Execution: id.* at § 600.6017, lien – *id.* at § 600.6012; *Supplemental Proceeding: id.* at §§ 600.6101 – 600.6143; *Receiver: id.* at § 600.6104(4); *Assignee for Creditors: id.* at §§ 600.5201 *et seq.* An attachment binds “goods and chattels from the time they were attached.” *Id.* at § 600.4035. No mention is made of choses in action. Execution may only be had on personal property of the judgment debtor that “is liable to execution at common law.” *Id.* at § 600.6017. In *Dart v. Woodhouse*, 40 Mich. 399 (1879), the state supreme court held that common law copyrights were not subject to levy on execution at law in Michigan. Section 600.6017(1) now specifically provides that the *abstract books* themselves (copies) are subject to levy on execution, but does not indicate that the intangible copyright interest to use the books is subject to levy. *Id.* at § 600.6017(1). Sections 600.6119 and 600.6122 allow a subpoena on a third party who owes money to a judgment debtor, and provides that transfer of the property is thereafter subject to the rights of the judgment creditor except against a *bona fide* purchaser for value and without notice. *Id.* at §§ 600.6119, 600.6122. Assignments for the benefit of creditors are void unless duly recorded. *Id.* at § 600.5201.

Minnesota: *Attachment:* Minn. Stat. Ann. §§ 570.01 *et seq.* (Date); *Execution: id.* at § 550.10; *Supplemental Proceeding: id.* at §§ 575.01 *et seq.*; *Receiver: id.* at §§ 576.01 *et seq.*; *Assignee for Creditors: id.* at §§ 577.01 *et seq.* Personal property is attached in the same manner as provided for levy by execution. *Id.* at § 570.061(sub. 3). Section 550.10 allows a lien on property “subject to levy and execution.” *Id.* at § 550.10. The general method for levy on “property capable of manual delivery” for the sheriff to take custody. *Id.* at § 550.12. In *Banker v. Caldwell*, 3 Minn. 94 (1859), the state supreme court held that a sheriff’s levy on a common law copyright in unpublished title abstracts was improper. However, section 550.135(sub. 2) now says that for personal property “not covered elsewhere” a sheriff may levy by leaving a writ of execution and notice specifying the property levied on “with the person holding it.” *Id.* at § 550.135(sub. 2). Although the statute does not say so expressly, early case law has held that the commence of a supplemental proceeding creates an equitable lien on the property of the debtor, but it is ineffective against prior creditors without notice. *LaFleur v. Schiff*, 239 Minn. 206 (1953) (lien of supplemental proceeding junior to prior unrecorded attorney’s lien on case without notice). Incorporeal property is only transferred to a receiver after a noticed hearing. Minn. Stat. Ann. § 576.11. An assignment for the benefit of creditors must be recorded to be valid. *Id.* at § 577.01.

Missouri: *Attachment:* Mo. Rev. Stat. Ann. § 513.090(a) (date); *Execution: id.* at §§ 513.010 *et seq.*; *Supplemental Proceeding: id.* at § 513.380 – no lien; *Receiver: id.* at § 515.240; *Assignee for Creditors: id.* at §§ 426.010 *et seq.* An execution lien only arises on

levy. *Id.* at § 513.085. An attachment or execution only reaches “goods and chattels” and certain specifically described intangibles such as corporate stock. *Id.* at § 513.090(a). Intangibles may be garnished by serving notice on the account debtor, the traditional method. *In re Riverfront Food & Beverage Corp.*, 29 B.R. 846 (Bankr. 1983). Mere appointment of a receiver transfers no title. *Jennings Sewer Dist. v. Pitcairn*, 230 Mo. App. 704 (1945). An assignee for creditors has the right as “an attachment or execution creditor with a writ levied on such property could prosecute or make.” Mo. Rev. Stat. Ann. § 426.410.

Nebraska: *Attachment:* Neb. Rev. Stat. Ann. §§ 25-1001 *et seq.* (Date); *Execution:* *id.* at §§ 25-1501 *et seq.*; *Supplemental Proceeding:* *id.* at § 25-1564 - no lien; *Receiver:* *id.* at § 25-1573; Execution applies to “goods and chattels.” *Id.* at § 25-1503. Apparently, this excludes intangibles, since section 25-1564 says the supplemental proceeding applies to “choses in action.” *Id.* at § 25-1564. The supplemental proceeding does not create a lien, but is enforced by a court order of transfer, punishable by contempt for non-compliance. *Id.* at § 25-1577. A receiver can be appointed in aid of the supplemental proceeding. An attachment applies to “goods, chattels, stocks . . . , rights, and effects of defendant” in the county. *Id.* at § 25-1004.

Nevada: *Attachment:* Nev. Rev. Stat. Ann. §§ 31.010 *et seq.* (Date); *Execution:* *id.* at §§ 21.010 *et seq.*; *Supplemental Proceeding:* *id.* at § 21.270 - no lien. Execution applies to “goods and chattels.” *Id.* at § 25-1503. *Sportsco. Enter. v. Morris*, 112 Nev. 625 (1996) (holding that under section 21.080, a debtor’s interest in a sports box, whether deemed an interest in real estate or an intangible license, was subject to levy on execution); *see also* Nev. Rev. Stat. Ann. § 21.080. It relied on the “general rule” that “when property is saleable it is seizable . . . upon execution.” 30 Am. Jur. 2d *Executions and Enforcement of Judgments* § 165. This “general rule” was stated with regard to real property. The “general rule” does not apply to patents, copyrights or trademarks. *Id.* at § 159-60. All property of the defendant “in this state” is subject to attachment pursuant to the order of attachment, but personal property must be attached “by taking it into immediate custody” or appointing “a keeper in charge of a going business where property is located.” Nev. Rev. Stat. Ann. §§ 31050, 31060. The supplemental proceeding allows the judge to order property transferred to the judgment creditor, and is enforced by contempt. *Id.* at § 21320.

New Hampshire: *Attachment:* N.H. Rev. Stat. Ann. § 511:1 (date); *Execution:* *id.* at § 527:6; *Creditor’s Bill:* *id.* at § 498:8; *Receiver:* *id.* at § 512:30; *Assignee for Creditors:* *id.* at §§ 568:1 *et seq.* Only property “which is liable to be taken in execution” may be attached. *Id.* at § 511:1. Chapter 528 has procedures to levy on money, goods, corporate franchises and corporate shares, but not intellectual property. Under (former) section 527:12, the form of the execution directs the sheriff to levy on the “goods, chattels or lands of said debtor in your precinct.” Effective January 1, 2001, section 527:12 amended the form of the writ to cover “money, goods, chattels, land, personal estate, property interest, right or credit of the said debtor in your precinct.” Whether this extends the sheriff’s authority to levy on information intangibles in light of the failure to amend Chapter 528 to provide a procedure for so doing is unclear. It appears that the proper procedure to reach information is the creditor’s bill for property “that cannot be reached by execution.” *Id.* at § 498:8. Recording the creditor’s bill in the local court creates a lien on property described in the bill but only against “after-acquired rights.” *Id.* at 498:14. This is the traditional *lis pendens* approach. An assignment for creditors assign “all property which might be taken on execution.” *Id.* at § 568:6.

New Jersey: *Attachment:* N.J. Stat. Ann. (Date); *Execution:* *id.* at § 2A:17-18; *Supplemental Proceeding:* *id.* at § 2A:17-65; *Receiver:* *id.* at § 2A:17-66; *Assignee for Creditors:* *id.* at §§ 2A:19-1 *et seq.* Section 2A:17-18 allows levy on “proprietary rights and credits.” *Id.* at § 2A:17-18. *McCray v. Chrucky*, 68 N.J. Super. 533 (1961) (following *Rowe v. Colpoys*, 137 F.2d 299 (D.C. 1993) discussed under District of Columbia), held that a

license related to personal character or skill is not transferrable and hence not subject to levy, but a taxicab permit which the statute expressly made assignable was subject to sale on execution with permission of the taxicab authority. The receiver appointed in aid of supplemental proceedings is vested with title of the debtor upon appointment. N.J. Stat. Ann. § 2A:17-67.

Ohio: *Attachment:* Ohio Rev. Code § 2751.01; *Receiver:* *id.* at § 2715.20 (in attachment), 2735.05. *Execution:* *id.* at § 2329.01; *Supplemental Proceeding:* *id.* at § 2333.01; *Assignee for Creditors:* *id.* at § 1310.2. Although attachment against “property, other than personal earnings, of a defendant,” is allowed, the attachment levy only applies to “goods, chattels, rights.” *Id.* at § 2715.05. Courts have held attachment does not apply to choses in action. *Haines v. Public Fin. Corp.*, 7 Ohio App. 2d 89 (1968). For property not in possession of a person, the sheriff serves a written notice to appear in court. Ohio Rev. Code § 2715.091. On a hearing the court can order a written transfer or appoint a receiver to do so. *Id.* at § 2715.29. Execution applies to “goods and chattels.” *Id.* at § 2329.01. The supplemental proceeding in section 2333.01 covers “choses in action,” but no lien arises on choses in action until a bill filed for charging order. *See Douglass v. Huston*, 6 Ohio St. 156; *Bowry & Sons Co. v. Odell & Bro.*, 4 Ohio St. 623 (1855).

Oklahoma: *Attachment:* Okla. Stat. Ann. §§ 12-1151 *et seq.* (Date); *Execution:* *id.* at §§ 12-731 *et seq.* - lien *id.* at § 12-734; *Supplemental Proceeding:* *id.* at §§ 12-841 *et seq.*; *Receiver:* *id.* at § 12-852; *Assignee for Creditors:* *id.* at §§ 24-31 *et seq.* Only “goods, chattels, stocks, rights, credits, money and effects” are subject to attachment. *Id.* at § 12-1154. Only “goods and chattels” are subject to levy, and section 12-751 only provides procedures for sale of goods and realty under levy. *Id.* at §§ 12-733, 12-751. “Any property” of the debtor, including “equitable interests” can be reached by a supplemental proceeding that appears to codify prior rules for creditor’s bill. *Id.* at § 12-841. The supplemental proceeding does not create a lien but is enforceable by contempt. *Id.* at § 12-842. A receiver may be appointed, but property is only transferred by a receiver’s sale. *Id.* at §§ 12-852, 12-853. An assignment for creditors is void unless duly signed and recorded. *Id.* at §§ 24-35, 24-36.

Texas: *Attachment:* Tex. Civ. Prac. & Rem. Code Ann. § 61.041 (Date); *Execution:* R. of Civ. P. § 621; *Supplemental Proceeding:* Tex. Civ. Prac. & Rem. Code Ann. § 31.002 (Date); *Receiver:* *id.* at § 64.001; *Assignee for creditors:* Tex. Bus. & Comm. Code § 23.01 *et seq.* In attachment may only be had on property subject to levy under a writ of execution. Tex. Civ. Prac. & Rem. Code Ann. § 61.041. Texas Rules of Civil Procedure § 621 *et seq.* gives procedures for execution; but no procedures are provided for intangibles. Section 31.002 of the civil practice code allows a turnover order on noticed hearing for property that “cannot readily be attached or levied by ordinary legal process.” Tex. Civ. Prac. & Rem. Code Ann. § 31.002. No lien is created. A receiver has no title, only temporary possession, of property. *Durham v. Scrivener*, 259 S.W. 606 (Tex. App. 1923). An assignment for the benefit of creditors must be recorded to be valid. Tex. Bus. & Comm. Code § 23.08(a)(2). It is not effective against a prior innocent purchaser for value. *Id.* at § 23.09(b).

Virginia: *Attachment:* Va. Code Ann. § 8.01-557 (Date); *Execution:* *id.* at § 8.01-501; *Supplemental Proceeding:* *id.* at § 8.01-506 - no lien. Section 8.01-557 allows attachment lien on personal property in actual or constructive possession of defendant and on third parties by service of writ. *Id.* at § 8.01-557. An attachment lien is ineffective against third parties without notice unless and until recorded a *lis pendens* in appropriate courthouse. *Id.* at § 8.01-268. This also applies to personal property. *In re Hart*, 24 B.R. 821, 824 (Bankr. E.D. Va. 1982). One can create a lien on intangible property by delivery of a writ of *fieri facias* to the judgment debtor, but the lien is ineffective against an assignee for valuable consideration without notice. Va. Code Ann. § 8.01-501. The lien is in effect an equitable lien with priority over later execution liens, *In re Acorn Elec. Supply, Inc.*, 348 F. Supp. 277 (E.D. Va. 1972), but is “inchoate and unperfected as against third parties”

So what's the point? As discussed in the companion article,³²⁴ Revised Article 9 requires a creditor to file a security interest in the state where the debtor is "located." Revised 9-307(c) says that a debtor is "located" in a state if the state requires filing to perfect against a *lien creditor* with regard to the collateral; otherwise, the debtor is located in the District of Columbia. As this chart indicates, as to whether the collateral is intangible information, state law falls into three general categories:

- *No lien states:* Many states do not require a filing where the collateral is information for the simple reason that they do not authorize a judgment creditor to lien information by attachment, levy, or the like. Alabama, for example, does not allow an attachment or levy on "choses in action" at all. The supplemental proceeding is available for information, but does not create a lien. Therefore, a secured creditor need not file in Alabama to gain priority over a *lien creditor* for information, but must file to gain priority over the *bona fide purchaser* who emerges from the judicial sale after the supplemental proceeding.
- *Equitable Lien States:* Some states allow the creation of the equivalent of an equitable lien on information, but provide the lien has no effect on *bona fide* purchasers, including prior secured creditors without notice. California is an example.³²⁵ It allows a lien on intangibles by execution (possibly), creditor's bill, and supplemental proceeding. However, the lien is effectively used to allocate priorities among competing judicial creditors and has no effect on a *bona fide* purchaser. A creditor with such an equitable lien is not a "lien creditor" for Article 9 purposes. No filing is required by a prior *bona fide* encumbrancer without notice while the lien remains inchoate. However, a filing is required under Article 9-301(1)(d) to gain priority over a judicial sale purchaser.
- *Legal lien states:* Finally, some states do provide that an execution can reach "all property of the debtor," which would include information, or specifically allow levy on choses in action. However, the statutes often fail to provide a procedure for levy on information, and there is scant judicial

acquiring prior or subsequent liens without notice, in particular the IRS under a tax lien. *In re Dulaney*, 29 B.R. 79 (Bankr. 1982). The supplemental proceeding in section. 8.01-506 does not create a lien. Va. Code Ann. § 8.01-506.

324. See Brennan, *supra* n. 9, § III.C.

325. See Brennan, *supra* n. 9, § III.C(3) for extensive analysis of California rules.

authority interpreting how the statutes would operate in such a case. It is also questionable whether states could even allow an involuntary levy on federal information due to the restrictions discussed in the next section

As a result, under Revised 9 many debtors will be "located" in the District of Columbia where information collateral is concerned. The companion article explores the implications of this result in greater detail.

6. *Federal Information – No Lien Creditors*

There is another reason why federal intellectual property is not subject to involuntary judicial lien. The Copyright Act, Patent Act and Lanham Act all require a signed writing to make an ownership transfer.³²⁶ Since a levy only acts *in rem*, a judgment creditor cannot lien federal information by attachment or levy since there is no signed transfer.³²⁷ The writing requirement is not some abstract formality. As *Konigsberg International v. Rice*³²⁸ explained:

Although Section 204 is often referred to as the "copyright statute of frauds," it actually differs materially from state statutes of frauds. . . . State statutes of frauds serve a purely evidentiary function – to prevent enforcement through fraud or perjury of fictitious agreements. . . . By contrast, a transfer of copyright [ownership] is simply "not valid" without a writing. . . . Section 204's writing requirement not only protects authors from fraudulent claims, but also "enhances predictability and certainty of ownership – 'Congress's paramount goal' when it revised the Act in 1976." [Citations omitted].³²⁹

The writing requirement addresses two basic problems arising from a forced sale, one practical, and the other juridical. Prof. Vaver, after an extensive review of English, Canadian and American authorities limiting execution on intangibles,³³⁰ elucidates the practical problem: valuation.

A sheriff should be able to make a rough assessment of the value of what is being seized so as not to deprive the debtor of more than is necessary to satisfy the judgment debt and the cost of seizure. How

326. 17 U.S.C.A. § 204(a) (West 1996); 35 U.S.C.A. § 261 (West 1984); Lanham Act, 15 U.S.C.A. § 1060(a) (West 1997).

327. See e.g. *Ball*, 168 F. 304; *Jewett v. Atwood Suspender Co.*, 100 F. 647 (D.C. 1900) (holding that a levy on a patent was invalid).

328. 16 F.3d 355 (9th Cir. 1994).

329. *Id.* at 357.

330. See David Vaver, *Can Intellectual Property be Taken to Satisfy a Judgment Debt?* 6 B.F. L. Rev. 255 (1991). The author argues that the signature requirement is a reflection of a fundamental policy of protecting creators from indiscriminate seizure of the fruits of their labors.

is a sheriff to do that with intellectual property? Assume trademarks or trade names are made seizable. . . . How does a sheriff estimate the value of goodwill when even professional trustees have difficulty with it? As for a copyright, 'unlike real property and other forms of personal property, it is by its very nature incapable of accurate monetary evaluation prior to its exploitation.³³¹

As a result of these practical difficulties, legislatures are often reluctant to subject intellectual property to forced sale. In California, for example, an intellectual property owner has the right to prior notice and a hearing before any forced judicial sale.³³² If the court finds a forced sale will not realize full value of the intellectual property, it instead orders an assignment of royalties to satisfy the judgment.³³³

A juridical problem arises from the fact that a sheriff's authority reaches no further than the county borders.³³⁴ As the Supreme Court observed in *Stevens v. Gladding*:³³⁵

These incorporeal rights [copyrights] do not exist in any particular State or district; they are coextensive with the United States. There is nothing in any act of congress, or in the nature of the rights themselves, to give them locality anywhere so as to subject them to the process of courts having jurisdiction limited by the lines of States and districts. That an execution out of the court of common pleas for the county of Bristol, in the State of Massachusetts, can be levied on an incorporeal right subsisting in Rhode Island, or New York, will hardly be pretended. That by the levy of such an execution, the entire right could be divided, and so much of it as might be exercised within the County of Bristol, sold, would be a position subject to much difficulty.³³⁶

Allowing levy by a local sheriff on nationwide federal information raises significant jurisdictional problems. How could a sheriff whose authority is limited to County A transfer property in County B? What if sheriffs in different states hold conflicting sales? What if different states establish different priority dates for when the

331. *Id.* at 284.

332. Cal. Civ. Proc. Code § 701.520 (1982).

333. *Id.* As the California Law Revision Commission explained:

By restricting the assignment of payments to the amounts necessary to satisfy the judgment, the assignment order procedure (in conjunction with proposed restrictions on the sale of certain obligations) is designed to avoid cases where valuable or potentially valuable obligations are purchased by the judgment creditor or a third person on a speculative basis, perhaps resulting in a large windfall to the purchaser.

16 Cal. Law Revision Comm. Rep. (Dec. 1982) at 1137-1138.

334. 33 C.J.S. *Executions* § 140 (1998).

335. 58 U.S. 447 (1855).

336. *Id.* at 451.

sale if effective? No state need recognize the priority of a security interest filed in another state against a local creditor.³³⁷

This was another reason why *Stevens* held that a copyright is not subject to levy and execution at law. To reach federal information requires an equitable execution under court supervision. The resulting transfer on behalf of the information owner then necessarily applies nationwide. This is one of the reasons Congress established the national information filing systems to give a single nationwide location to record such transfers.

7. Real Property Compared

It is instructive to compare the execution procedures for intellectual property with those for real property. At common law, a judgment did not create a lien on the defendant's real property.³³⁸ In a few states, by statute, a judgment can create a lien on real property when the judgment is docketed.³³⁹ In other states, a judgment creditor can record an abstract of judgment in the county recorder's office to create a lien that makes transfers after the recording subject to the judgment.³⁴⁰ However, in all cases a judgment lien only attaches to the actual interest of the debtor in the realty, not the apparent interest, meaning it is subject to all prior interests, known or unknown, recorded or unrecorded.³⁴¹ This follows from the *nemo dat* principle; since the debtor has already conveyed to a mortgagee, even if unrecorded, there is nothing left for the judgment creditor to take. To prevail against prior interests, a judgment creditor must proceed to judicial sale. The judicial sale purchaser is then entitled to record the deed and seek the protection of the real property recording acts, the same as a *bona fide* purchaser.³⁴²

The enforcement procedures for intellectual property operate similarly. Since one cannot take physical possession of an intangible,

337. See e.g. *Atha v. Brockius*, 39 Cal.2d 635 (1952); 33 C.J.S. *Executions* § 140 (1998). However, states can recognize out of state priorities as a matter of comity. See Brennan; *supra* n. 9, III.C.

338. See 46 Am. Jur. 2d *Judgments* § 371; 50 C.J.S. *Judgement*, § 551 (1997) ("At common law, no lien on lands of a judgment debtor is acquired under a judgment against him.").

339. See 46 Am. Jur. 2d *Judgments* § 371; 50 C.J.S. *Judgement*, § 551 (1997).

340. *Id.*

341. *Id.*; see Miller & Starr, *supra* n. 224, at § 8:103.

342. See e.g. *Riley v. Martinelli*, 97 Cal. 575, 582 (1893); *Foorman v. Wallace*, 75 Cal. 552 (1888); *Hansen v. G&G Trucking Co.*, 236 Cal. App. 2d 481, 496 (1965). Under pre-Code law there was a split of authority whether release of antecedent debt was good consideration for the purchase of a chattel. See Anno. 11 A.L. Rev. 3d 1028. Under the Code, it now definitely is. U.C.C. § 1-201(44)(a) (West 1996).

the apparent ownership rule from *Twyne's Case* does not apply. Even if a creditor's bill or supplemental proceeding creates a lien, it is ineffective against prior unrecorded interests in any case, just like for real property.³⁴³ To assure perfection against third parties without notice, the creditor must proceed to judicial sale, in which case, just like real property, the judicial sale purchaser can qualify as a *bona fide* purchaser under federal law.³⁴⁴

Thus, for intellectual property, a secured creditor often need not file to perfect against a subsequent lien creditor by attachment or levy, because such a lien creditor will not exist. A secured creditor must file in the property tract register, however, to trump a judgement creditor who proceeds to sale because that creditor can become a *bona fide* purchaser by recording. This is exactly like real property. A mortgagee need not file to protect itself against a later creditor by attachment or levy, but must file to protect against a subsequent *bona fide* purchaser by reason of judicial sale. This is a fundamental difference between lien creditors and *bona fide* purchasers. A lien creditor primes an unrecorded security interest in tangible personal property at the levy stage due to the apparent ownership rule. A *bona fide* purchaser only primes an unrecorded real property mortgage after judicial sale and recording due to the actual ownership rule.

And here, Article 9 and federal information law irretrievably part company. Article 9 does not protect a perfected security interest against a "buyer in the ordinary course." Why? Because no buyer would drive a car off a dealer's lot if the buyer thought the car could be repossessed because the dealer did not pay its lender.³⁴⁵ Practical inventory financing requires Article 9 to provide a super priority to the buyer in the ordinary course, who is a variant on the theme of the *bona fide* purchaser.³⁴⁶ Such a buyer takes free of a security interest created by a seller even though it is perfected and the buyer knows about it.³⁴⁷ There is no analogous concept of a "licensee in the ordinary course" for intellectual property.³⁴⁸ Under the federal information recording acts, a subsequent transferee who knows about a prior security interest cannot be a *bona fide* purchaser by definition and certainly cannot prevail over a prior patent or copyright

343. See e.g. *S. Bay Enter.*, 957 S.W.2d at 287.

344. *CMS Indus., Inc. v. L.P.S. Intl., Ltd.*, 643 F.2d 289 (5th Cir. 1981).

345. See Gilmore, *supra* n. 7, at § 26.1; Clark, *supra* n. 45, at ¶ 3.04.

346. Clark, *supra* n. 45, at ¶ 3.04.

347. See U.C.C. § 9-307(1) (1998).

348. See Brennan, *supra* n. 9, § III.F.

mortgage.³⁴⁹

This is a fundamental difference between the real property and intellectual property recording acts, on the one hand, and the Article 9 personal property filing scheme on the other. It brings us to the most powerful opponent any secured creditor ever faces.

F. The Bankruptcy Trustee

1. The Strong Arm Power

Surely the gut question for any financier is how to trump the bankruptcy trustee. For information, this will require a filing. For tangible personal property, the trustee is treated as a lien creditor, so filing under Article 9 is an appropriate way to perfect. For real property, the trustee has the status of a *bona fide* purchaser, and the real property track registers are the place to file. So where should a creditor file for information — in the federal track registers, or the state filing systems? Since the federal information acts operate like real property recording acts, it would seem that a federal filing is necessary. And so it is. The reason derives from a third status the trustee has under the Bankruptcy Code, one often overlooked but of long standing import where information is concerned: the unsatisfied execution creditor.

The trustee's lien avoidance powers derive from the "strong arm" powers in Section 544(a) of the Bankruptcy Code:³⁵⁰

Section 544

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by —

(1) a creditor that extends credit to the debtor at the time of commencement of the case, and obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained a judicial lien, whether or not such creditor exists;

349. See 17 U.S.C. § 205(d); *In re AEG Acquisition Corp.*, 127 B.R. 34, n. 8 (Bankr. C.D. Cal. 1991) (copyrights); 35 U.S.C. § 261; *Filmtec Corp.*, 939 F.2d at 1573-74 (patents).

350. 11 U.S.C.A. § 544(a) (West). Under Section 541, commencement of a case creates an estate vested with all property of the debtor subject to the jurisdiction of the bankruptcy court. The estate property is limited to the extent it would be in the hands of the debtor. Collier, *supra* n. 239, at ¶ 541.04. Under Section 70a of the prior Bankruptcy Act, the trustee also took title subject to all pre-existing obligations of the debtor. *In re Pubs, Inc.*, 618 F.2d 432, 441 (7th Cir. 1980). Under Section 541, the estate is not a *bona fide* purchaser.

(2) a creditor that extends credit to the debtor at the time of commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such creditor exists; or

(3) a *bona fide* purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a *bona fide* purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

Under Section 544(a)(1), the trustee is a lien claimant, in Article 9 terms a "lien creditor," who has obtained a lien on the collateral by attachment or levy. Under Section 544(a)(2), however, the trustee is an unsatisfied execution creditor, that is, a creditor who does not have a lien. The editors of Collier describe what this means:

Section 544(a)(2) of the Bankruptcy Code provides that the trustee has the right of a creditor with a lien return unsatisfied. . . . The effect of the trustee having a writ of execution returned unsatisfied is not to give the trustee any kind of lien, but to vest the trustee with the equitable rights of a hypothetical creditor with a writ of execution unsatisfied, that is a creditor who has exhausted its legal remedies.³⁵¹

Numerous decisions say that under Section 544(a) the trustee is merely a lien creditor under applicable state law. This, however, is only an approximation of the truth. The correct rule is that Section 544(a) gives the trustee all lien avoidance powers available to any creditor under applicable non-bankruptcy law. "All lien avoidance power" means that the trustee can exercise all available powers to avoid secret liens. For example, where applicable law gives a judgment lien on docketing the judgment, or an execution lien on delivery of the *fieri facias* to the sheriff, that alone is insufficient to perfect the lien against prior unrecorded security interests. To perfect the lien requires a levy, so the trustee is deemed to be a creditor who has proceeded to levy.³⁵² If applicable law gives a creditor the avoidance power of a *bona fide* purchaser, then the trustee is a *bona fide* purchaser.³⁵³ The "available to any creditor" test means that the

351. King, *supra* n. 239, ¶ 5.44.06, at 544-10-11.

352. See *infra* n. 360 and cited cases.

353. See *Am. Soda Fountain Co. v. Parsons*, 32 F.2d 737 (1st Cir. 1929) (holding that under Massachusetts law, judgment creditor had avoidance power of *bona fide* purchaser, so trustee has such power as well); *In re Chappell*, 77 F. Supp. 573 (D. Ore. 1948) (same under Oregon law). These cases were decided under the earlier Bankruptcy Act of 1898. I have not researched Massachusetts or Oregon law to determine whether the statutes have changed. Perhaps they have. The point remains, however, that if applicable law allows a creditor the avoidance power of a *bona fide* purchaser, then the trustee has such power as well.

trustee also has all the powers of equitable execution given to an unsatisfied execution creditor, including the power to commence and conclude a creditor's bill or supplemental proceeding as necessary to defeat a secret lien. Finally, the trustee's powers arise not merely under state law, but rather under non-bankruptcy law, which includes cases where another federal statute applies.³⁵⁴

Intellectual property in general, and federal intellectual property in particular, is precisely the situation contemplated by Section 544(a)(2). A judgment creditor reaches intellectual property through equitable proceedings after an execution has been returned unsatisfied.³⁵⁵ For federal information, this procedure is mandatory due to the statutory signature requirements.³⁵⁶ Congress enacted Section 544(a)(2) specifically to give the trustee the lien avoidance powers of an unsatisfied execution creditor in such a case.³⁵⁷

As an unsatisfied execution creditor, the trustee is deemed to have taken all steps necessary to perfect against all prior interests. To do so via a creditor's bill, supplemental proceeding, or appointment of a receiver, the creditor must proceed to judicial sale.³⁵⁸ The trustee, as, the ideal creditor, irreproachable and without notice,³⁵⁹ must be deemed to have done so.³⁶⁰ The next question is whether the trustee should be deemed to have recorded in any appropriate register. *In re Peregrine* held that the trustee was deemed to have recorded in the Copyright Office since this was necessary to prevail over a prior copyright security interest only recorded in the state records. *Peregrine* relied on *Sampsell v. Straub*³⁶¹ which held, under the prior Bankruptcy Act, that the trustee was deemed to have recorded an abstract of judgment since this was necessary to trump a homestead declaration, even though recording was voluntary under state law.

354. King, *supra* n. 239, at ¶ 544.02 n. 7 and cases cited.

355. See *supra* n. 249 and accompanying text.

356. See *supra* n. 328 and accompanying text; see also Bramson, *supra* n. 11, at 1597.

357. See King, *supra* n. 239, ¶ 544.02 at 544-12.

358. See *supra* n. 254 and accompanying text.

359. *Matter of Feldman*, 54 B.R. 659, 660 (Bankr. D. N.J. 1985).

360. *Peregrine*, 116 B.R. at 194, n. 19 (holding that under § 544(a) trustee deemed to have exercised rights in their entirety); *Matter of Spain*, 55 B.R. 849, 855 (Bankr. N.D. Ala. 1985) (involving a trustee as execution creditor who has proceeded to levy and sale); *Matter of Feldman*, 54 B.R. at 660 (holding that a trustee, as executing creditor under 544(a)(2), prevails over unexecuting creditors); see also former Bankruptcy Act § 70(a)(5) (vesting the trustee with "... all property which [the bankrupt] could by any means have transferred or which might have been levied upon and sold under judicial process against him" (Emphasis added)).

361. *Sampsell v. Straub*, 194 F.2d 228, 231 (9th Cir. 1952), *cert. denied*, 343 U.S. 927 (1952).

Indeed, under prior law, the trustee was deemed superior to a copyright mortgage not recorded in the Copyright Office, even though it was recorded in the state filing system.³⁶²

*In re AEG Acquisition Corp.*³⁶³ noted that Section 544(a)(3) gives the trustee the status of a *bona fide* purchaser for real property because “under state recording acts such a purchaser cannot defeat the interests of a prior perfected interest holder in the property.”³⁶⁴ On the other hand, the Bankruptcy Code does not give such status for personal property because a buyer in the ordinary course, which includes a *bona fide* purchaser, can defeat a perfected security interest in personal property.³⁶⁵ Concluding that under the Copyright Act, like real property, a *bona fide* purchaser cannot prime a perfected copyright security interest, *AEG* concluded that Section 544(a) “gives statutory satisfaction to the trustee,” *i.e.* treats the trustee as a recording transferee for value and without knowledge under Section 205 of the Copyright Act.³⁶⁶

Section 544 gives the trustee all the avoidance powers of an ideal unsatisfied creditor under applicable law, and where that law gives such a creditor the avoidance power of a *bona fide* purchaser, then the trustee has that power as well.³⁶⁷ The federal information statutes are such laws. In *Filmtec Corp. v. Allied-Signal, Inc.*,³⁶⁸ the Federal Circuit held that section 261 of the Patent “adopts the principle of the real property recording acts” and, “[a]lthough the statute does not expressly so say, it is clear that the statute is intended to cut off prior *legal* interests, which the common law rule did not.”³⁶⁹ That the federal statutes protection execution sale purchasers was affirmed in *CMS Industries, Inc. v. L.P.S. International, Ltd.*³⁷⁰ If a judgment creditor can avoid an unrecorded patent interest by proceeding to

362. See *In re Leslie-Judge Co.*, 272 F. 886 (2d Cir. 1921), *cert. denied sub nom.*; *Green v. Felder*, 256 U.S. 704 (1921); see *Gilmore*, *supra* n. 7, § 13.3. at 412.

363. 127 B.R. 34 (Bankr. C.D. Cal. 1991), *aff'd*, 161 B.R. 50 (Bankr. 9th Cir. 1993).

364. *Id.* at 43.

365. *Id.* at 43. Technically, Article 9 gives priority to a “buyer in the ordinary course.” While they are not the same, since a *bona fide* purchaser is without notice, a *bona fide* purchaser can certainly be a buyer in the ordinary course.

366. *Id.*; accord *In re Avalon Software, Inc.*, 209 B.R. 517, 520-521 (Bankr. Ariz. 1997) (holding that the Copyright Act preempts state law for perfecting security interest in copyrighted works).

367. See *supra* n. 353 and cited cases.

368. 939 F.2d 1568, 1573-1574 (Fed. Cir. 1991), *reh'g denied*, 988 F.2d 129; see also Paul Goldstein, *Copyright* § 4.5.3.4 (2d ed. 1996) (copyright system operates like “real property recording acts”).

369. *Filmtec Corp.*, 939 F.2d at 1573-1574.

370. 643 F.2d 289 (5th Cir. 1981).

judicial sale and recording, the trustee should be deemed to have done so. This was the pre-Code rule as well.³⁷¹

Under Section 544(a)(2) the trustee has the status of an unsatisfied execution creditor whether or not such creditor exists. Federal information, as a national intangible, can be reached wherever the judgment creditor can obtain *in personam* jurisdiction.³⁷² Assume a lender files a financing statement in California covering the information of a California debtor. The debtor then licenses the information for use in Michigan, *e.g.* its copyrighted movie, or its patented snowplow, or its trademarked fishing gear. Assume further that a Michigan creditor could obtain personal jurisdiction over the debtor and a judgment there. Michigan does not allow execution on an intangible; it requires use of a supplemental proceeding that does not produce a lien. Such a Michigan creditor could only trump the prior security interest in federal information by proceeding to judicial sale and recording in the *federal* registers. Under Section 544(a)(2), if such a Michigan creditor can exist, and in an age of long-arm jurisdiction such a creditor certainly can, then the trustee must be deemed to be that creditor and to have so acted.

What this all means is that a creditor taking a security interest in a copyright, patent or federal trademark should prevail against the strong arm power of the bankruptcy trustee under Section 544(a)(2) only by recording in the appropriate federal filing office.

2. *Some Bankruptcy History*

This result is consistent with historic bankruptcy practice. The Bankruptcy Act of 1867 vested the trustee with all copyrights and patents of the debtor.³⁷³ The trustee's interest prevailed over a later recording *bona fide* purchaser.³⁷⁴ Under section 70a of the Bankruptcy Act of 1898, the trustee was vested with all rights of the bankrupt to "interests in patents, patent rights, copyrights and trademarks."³⁷⁵ In addition, section 70(a)(5) vested the trustee with "... all property which he [the bankrupt] could by any means have

371. See *supra* n. 109 and accompanying text regarding *In re Leslie-Judge*.

372. See *supra* n. 218 and cases cited.

373. Bankr. Act of 1867, Pub. L. No. 176, § 14, 14 Stat. 517 (1867), reprinted in *Collier on Bankruptcy* 1753 (14th ed.).

374. See *Prime v. Brandon Mfg. Co.*, 19 Fed. Cases 1324, 1326 (D.C. Vt. 1879) (holding that a trustee prevails over post-petition recorded patent assignment).

375. Bankr. Act of 1898, Pub. L. No. 541, § 70, 30 Stat. 544 (1898) reprinted in *Collier, supra* n. 373, at 1824.

transferred or which might have been levied upon and sold under judicial process against him.”³⁷⁶

Under section 70(a)(5), the trustee took only the title of the debtor. However, in the case of a fraudulent conveyance, the debtor retained an equitable title that a creditor could attach and use to avoid a secret lien.³⁷⁷ The courts looked to non-bankruptcy law to determine the extent of this avoidance power. *York Manufacturing Co. v. Cassell*³⁷⁸ held that the trustee could not invoke an Ohio statute that invalidated an unrecorded conditional sales contract only against lien creditors, since the trustee did not have such a lien.³⁷⁹ However, *Security Warehousing Co. v. Hand*³⁸⁰ held that the trustee could rely on a Wisconsin statute that invalidated an undelivered pledge against all creditors, and *Knapp v. Milwaukee Trust Co.*³⁸¹ also allowed the trustee the benefit of a similar law making an unrecorded chattel mortgage void against all creditors.

Since the laws of many states only invalidated secret liens against creditors who obtained a lien on personal property by attachment or levy,³⁸² in 1910 Congress added Section 47a(2), the “strong arm” provision, to the Bankrupt Act. It gave the trustee the avoidance powers of a creditor holding a lien by legal or equitable proceedings or having an execution returned unsatisfied.³⁸³ In 1938, the Chandler

376. See also *Children's Bootery v. Sutker*, 91 Fla. 60 (1926) (holding that trade names also passed to the trustee under the principle of *ejusdem generis*.)

377. See generally Collier, *supra* n.373, at 583-586.

378. 201 U.S. 344 (1906).

379. The Ohio statute provided that an unrecorded conditional sales contract was void against “subsequent purchasers and mortgagees in good faith, and creditors.” See *York*, 201 U.S. at 344, n. 1 (setting out the terms of the statute). The *York* court, looking to an off-hand remark of the Ohio Supreme Court in interpreting this statute, said that the term “creditor” meant someone who had “fastened upon the property” by some specific lien. The Court held that the mere filing of bankruptcy did not create a specific lien by attachment, and the trustee was not vested with title to the estate as a *bona fide* purchaser, so the Ohio statute was inapplicable. It was apparent that the Court was straining to protect a rather naïve vendor under the conditional sales contract against some sharp practices that had led to the vendee’s bankruptcy. Had the Court read the Ohio statute as applying to any “creditor,” as it said on its face, then the trustee, as a “creditor” under Section 70a(5), would have prevailed.

380. 206 U.S. 415 (1907).

381. 216 U.S. 545 (1910).

382. See Gilmore, *supra* n. 7, § 15.1 at 465 (“Without exception all filing statutes provide that unfiled interests are void against good faith purchasers of the collateral. There is no such unanimity in the treatment of which types of creditors, under various statutory formulas, are entitled to prevail over unfiled interests.”).

383. See Collier, *supra* n. 373, at 564-566. As the statutory drafters explained: “[A]s to property not in the custody of the bankruptcy court, the trustee should stand in the position of a judgment creditor holding an execution returned unsatisfied, thus entitling

Act moved Section 47a(2) to Section 70c with minor clarifications.³⁸⁴ It also added Section 60a, treating the trustee as a *bona fide* purchaser for voidable preferences. This caused considerable heartburn due to the *Klauder* decision,³⁸⁵ so a 1950 amendment changed the trustee's status in Section 60a to a lien creditor.³⁸⁶ In light of this change, Congress decided to make the trustee a lien creditor for all of the bankrupt's property, and thus removed the part of Section 70c treating the trustee as an unsatisfied execution creditor.³⁸⁷ Due to criticism,³⁸⁸ the trustee's status as an unsatisfied execution creditor was restored in 1966.³⁸⁹ Section 70c is the basis for Section 544 of the current Bankruptcy Code.

From its inception, the strong arm power gave the trustee the ability of any creditor to attack "the evil of secret liens."³⁹⁰ This was deemed both necessary and fair, since other creditors of the debtor were prohibited from acting on their own due to the automatic stay.³⁹¹ Since a judgment creditor could only reach intellectual property by equitable execution after legal remedies were exhausted, and since such a creditor only trumped prior secret liens by proceeding to judicial sale, it is appropriate to treat the trustee as a recording execution sale purchaser where intellectual property is concerned.

Such treatment makes all parts of Section 544 consistent. A lien creditor obtains apparent ownership of tangible personal property by taking possession through attachment or levy, thereby perfecting the creditor's rights against prior unrecorded interests. An unsatisfied execution creditor acquires actual ownership of intellectual property by obtaining a court ordered transfer and recording,³⁹² thereby

him to proceed precisely as an individual creditor might have done to subject assets. In this way, in effect, proceedings in bankruptcy will give to creditors the same rights that creditors under the state law would have had if there had been no bankruptcy, and from which they are debarred by the bankruptcy." *Id.* at 567 n. 6.

384. *Id.* at 564-566.

385. *See supra* n. 100 and accompanying text.

386. Collier, *supra* n.373, ¶ 70.47[3] at 569.

387. *Id.* at 569.

388. *Id.* at 566-567. Frank R. Kennedy, *The Bankruptcy Amendments of 1966*, 1 Ga. L. Rev. 149, 169 (1967); James Wm. Moore and Philip W. Tone, *Proposed Bankruptcy Amendments: Improvement of Retrogression*, 57 Yale L. Rev. 683, n. 33 (1948).

389. *See* Collier, *supra* n.373, ¶¶ 70.47[5] at 577-581.

390. *Id.* at 567, n. 6.

391. *Id.*

392. Technically, the Copyright Act requires that a later *bona fide* transferee record in order to trump a prior unrecorded transfer. It is a race-notice statute. However the Patent Act and the Lanham Act provide that even an unrecorded later *bona fide* purchaser or assignee trumps a prior unrecorded transfer. They are notice statutes. For discussion of the difference, *see supra* n. 45 and accompanying text.

perfecting the creditor's rights against prior unrecorded interests. In both cases the Bankruptcy Code perfects the trustee's interest by providing either apparent ownership, § 544(a)(1), or actual ownership, § 544(a)(2).³⁹³ Indeed, since federal law does not allow apparent ownership of intellectual property, a creditor must obtain actual ownership. This also makes section 544(a)(2) consistent with section 544(a)(3). Section 544(a)(3) treats the trustee as a *bona fide* purchaser for real property, *i.e.*, as a creditor who has proceeded to judicial sale and recording, as this is the only way for a judgment creditor to trump prior unrecorded real estate liens. Since the federal information acts operate like real property recording acts, this means section 544(a)(2) operates like section 544(a)(3) where federal information is concerned.³⁹⁴

Indeed, failure to treat the trustee as a recording execution sale purchaser under section 544(a)(2), and hence a *bona fide* purchaser under the federal information acts, deprives the trustee of any ability to protect general creditors against secret liens of federal information. A general creditor cannot avoid a prior unfiled security interest by attachment or levy, because for federal information such remedies are unavailable. A general creditor cannot void a prior secret lien by merely initiating a creditor's bill or supplemental proceeding, since in most states such proceedings do not create a lien; where they do, the lien is ineffective against prior interests without notice in any case. The only way a general creditor can be assured of trumping a prior secret lien on federal information is to proceed to judicial sale and recording in the federal registers. As the ideal creditor, the trustee must be deemed to have done so.

G. Why State Filing Is Worthless or A Fraud

Earlier this article suggested that using a state filing to perfect a security interest in federal information was either commercially worthless or a fraud on creditors. We can now explain why.

393. Does this mean that the trustee is also an unsatisfied execution sale purchaser for tangible personal property? Yes, but it makes no difference. An execution sale purchaser is not a "buyer in the ordinary course" who would take free of a prior perfected security interest. See Anderson, *supra* n. 73, § 1-201:129 (relying on *Natl. Shawmut Bank* discussed *supra* n. 277). Treating the trustee as an execution purchaser for tangible personal property gives the trustee no greater lien avoidance power than lien creditor status. But intangible information is another matter.

394. I suggest that the same reading should apply to recording in the state trademark registers. But that means evaluating whether enactment of original or Revised Article 9 was intended to supercede the state trademark laws. This is a matter of state law that would need to be decided state by state.

Advocates of state filing concede that the federal statutes require filing transfers of "title." But they argue a state filing is sufficient because a security interest is not a "transfer of title."³⁹⁵ However, secured financing comes down to one question: on foreclosure, who owns the collateral? That is fundamentally a title question. Rigorous application of the priority rules to the "no transfer of title" hypothesis leads to absurd results, justifying its rejection.

To take a concrete example, assume a Creditor takes a security interest in federal information, such as a patent, filing only a UCC-1. The Debtor declares bankruptcy after any preference period. The Secured Creditor now seeks relief from the automatic stay to foreclose. Who owns the information, the Creditor, the Estate or the Trustee?

There are three basic priority rules. First is the "first in time, first in right" or *nemo dat* rule. Second is the *bona fide* purchaser exception to the *nemo dat* rule. Third is the "relation back" rule that on foreclosure a creditor's interest relates back to whatever was granted at the attachment date. Apply these rules to determine ownership.

Under Bankruptcy Code 541(a)³⁹⁶ upon filing the petition the Debtor's interest in the information vested in the bankruptcy Estate. The Estate is neither the Trustee nor the pre-petition Debtor but a separate legal entity.³⁹⁷ The Estate is a purchaser, but not a *bona fide* purchaser, so it may not use the second rule to trump the Creditor. On foreclosure the Creditor's security interest should relate back to the attachment date and take priority over the Estate (but not the Trustee) under the *nemo dat* rule in what was conveyed as collateral.

But by hypothesis the collateral under the security interest was not a transfer of title. Hence, the Estate owns the *title* to the information subject to whatever the security interest was. Since it was not a transfer of title (collateral assignment) it must be a license. Such a "security license" must be non-exclusive, because an exclusive license is a transfer of title³⁹⁸ which by hypothesis the security interest

395. E.g. William C. Hillman, Documenting Secured Transactions 2-19 to 2-20 (1998): "A security interest is not an 'assignment, grant or conveyance' of a patent. Patent law . . . distinguishes 'assignments' of patents (of which 'grants' and 'conveyances' are specific types) from all other transfers (which are called 'licenses')." As discussed above, this reasoning is incorrect under Article 9 in any case. See *supra* n. 177 and accompanying text.

396 11 U.S.C.A. 541(a).

397 *In re Lazar*, 200 B.R. 358, 371 (Bkrtcy. C.D. Cal. 1996).

398 Copyrights: 17 U.S.C. § 101 (definition of transfer of ownership); Patent Act: 35

is not. This means the Estate can grant other non-exclusive licenses, or transfer title, subject to the security license, it keeps all the income due to Bankruptcy Code § 522³⁹⁹ A non-exclusive information license is not transferable without consent of the information owner under federal law, so the the Creditor may not be able to foreclose its “security license” absent the Estate’s consent.⁴⁰⁰ Finally, the “security license” would be an executory contract deemed rejected by the Trustee.⁴⁰¹ The Creditor can either treat the “security license” as terminated in which case it become an unsecured creditor, or keep it in force but waive any right to further payment by the Estate.⁴⁰²

Such a non-exclusive, non-transferrable, non-paying “security license” is to all intents and purposes commercially worthless.⁴⁰³

It would not help the Creditor to argue that on foreclosure its security interest was a transfer of title. Under Article 9-504(4), a foreclosing Creditor takes the “all of the *debtor’s* rights” in the collateral.” But on the foreclosure date the Debtor owns nothing in the information. Its rights have transferred to the Estate, a separate legal entity. Under Article 9-306(2), a security interest continues in collateral notwithstanding its disposition. This means the Estate takes the collateral – title to the information – subject to what the security interest was when it attached, which is not a transfer of title.

The only way the Creditor can prevail against the Estate is to argue that although its security interest was not a transfer of title when it attached, it transmorgified into one on foreclosure that related back to become a transfer of title as of the attachment date.

U.S.C. § 261.

399. 11 U.S.C.A. § 522. A security interest only attaches to post-petition proceeds of pre-petition collateral. Since the pre-petition security interest did not attach to the title, the Creditor is not entitled to the Estate’s proceeds from licensing its title interest. See Revised 9 Financing, *supra* n. 9, § II.H.1.e.

400. E.g. *In re Catapult Entertainment, Inc.* 165 F3d 747, 750 (9th Cir. 1999) (patent). See Revised 9 Financing, *supra* n. 9, § II.H.1.a. If the security interest authorized a foreclosure sale, this could be conducted, but the sale purchaser could not make a further transfer.

401. 11 U.S.C.A. § 365(d)(1). Since the security interest requires on-going obligations by the Debtor, e.g. paying the secured debt, protecting the collateral, it is executory. See *In re Qintex Entertainment, Inc.*, 950 F.2d 1492, 1495 (9th Cir. 1991).

402. 11 U.S.C.A. § 365(n)(1)(A) (license terminated) & § 365(n)(2)(C) (license in effect).

403. A “security license” in a patent or trademark need not be recorded federally, since the Patent Act and the Lanham Act do not cover licenses. So the Creditor will have priority over the Trustee, i.e. the Trustee cannot use the “strong arm” power to set aside the “security license.” So what? A *bona fide* assignee takes subject to pre-existing licenses anyway. *Why Corp. v. Super Ironer Corp.*, 128 F.2d 539, 541 (6th Cir. 1942). The “security license” is still no more than that.

Not only is it contradictory to argue that a security interest both is and is not a transfer of title, but such a relation back rule defrauds the public.

As discussed above, intellectual property infringement is a strict liability tort.⁴⁰⁴ The public user therefore needs to find out who owns the information in order to obtain a use authorization to avoid an infringement claim. This is precisely why *Waterman v. McKenzie* held it essential to determine whether the mortgagor or mortgagee has “possession” - so the public user knows where to get a license.⁴⁰⁵ A public user searches the title ownership records in the federal tract record to find out who owns and administers the information. If the security instrument says the creditor has “possession” - administers the information - then the public user must obtain a license from the creditor, but knows that if debt is repaid, the license remains good since the debtor consented to the creditor’s administration. This is precisely what *Waterman* held. Alternatively, if the debtor administers the information, then on foreclosure the creditor takes subject to licenses made by the debtor since the creditor consented to the administration by the debtor. It is a simple, pragmatic approach that protects the public.

If a security interest relates back and becomes as transfer of title as of the attachment date, then this wipes out the Estate’s interest under the *nemo dat* rule. But it also wipes out all licenses and transfers made by the Debtor after the attachment date too, including those to public users who took their licenses from the Debtor in reliance on the federal filings. It means the public cannot rely on the federal system for accurate data about who owns the information, defrauding the public user who relies on that data and opening the door for whipsaw infringement claims.

It cannot be both ways. If a secured creditor wants to have priority over later transferees of title to the information, then the secured creditor must enter the priority line-up with everyone else by recording its claim to that title in the federal system. Trying to justify perfecting an information security interest against later creditors on the grounds that it is not a “transfer of title” either makes the security interest worthless or defrauds the public. A security interest in federal information must be recorded in the federal system to gain priority over subsequent creditors, including a bankruptcy trustee.

Unfortunately, the case law on this point has become hopelessly

404. See *supra* n. 208 and accompanying text.

405. *Waterman*, 138 U.S. at 260-261. See *supra* n. 167 and accompanying text.

confused with different results in the copyright, patent and trademark cases. This has become something of a judicial embarrassment, since all three statutes use comparable filing language and recording systems. This brings us to the concluding section of this long history, an examination of the financing procedures under the current federal information acts.

H. Current Federal Statutory Structure

It will help to compare the structure of the Copyright Act, the Patent Act and the Lanham Act, and then contrast them with state secured financing law reflected in original Article 9.

1. Copyright Act

The recording provisions in the Copyright Act have remained consistent since their initial enactment in the Act of 1870. The original provision read:

The Act of 1870:

Sec. 89. *And be it further enacted*, That copyrights shall be assignable in law, by any instrument in writing, and such assignment shall be recorded in the office of the librarian of Congress within sixty days after its execution, in default of which it shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice.⁴⁰⁶

This provision continued in the 1909 Act without significant change:

Copyright Act of 1909:

Sec. 44: Every assignment of copyright shall be recorded in the copyright office within three calendar months after its execution in the United States or within six calendar months after its execution without the limits of the United States, in default of which it shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, whose assignment has been duly recorded.⁴⁰⁷

An amendment in 1947 renumbered this as Section 30. Section 42 was amended to add "or mortgagee" to the rules regarding assignments of copyrights to indicate that they included mortgages, although this was merely considered a restatement of existing law.⁴⁰⁸

The 1976 Act changed the language, but not the substance, of these provisions in Section 205 of the current Copyright Act. It provides:

406. Act of July 8, 1870, 16 Stat. 198 § 89 (emphasis added).

407. This provision was section 42 of the original 1909, but was renumbered without change to section 30 in the Act of July 30, 1947, ch. 391, 61 Stat. 660.

408. *Republic Pictures Corp. v. Security-First Natl. Bank*, 197 F.2d 767 (9th Cir. 1952).

Copyright Act of 1976 Act, Section 205:

(d) As between two conflicting transfers, the one first executed prevails if it is recorded, in the manner required to give constructive notice under subsection (c), within one month after its execution in the United States or within two months after its execution outside the United States, or any time before recordation in such manner of the later transfer. Otherwise, the later transfer prevails if recorded first in such manner and if taken in good faith, for valuable consideration or on the basis of a binding promise to pay royalties, and without notice of the earlier transfer.

(e) A nonexclusive license, whether recorded or not, prevails over a conflicting transfer of copyright ownership if the license is evidenced by a written instrument signed by the owner of the rights licensed or such owner's duly authorized agent, and if

- (1) the license was taken before execution of the transfer; or
- (2) the license was taken in good faith before recordation of the transfer and without notice of it.

There is some belief that Section 205 makes security transfers in the current Copyright Act "more comprehensive" than the companion provisions in the Patent Act and the Lanham Act. This is alleged because the Copyright Act mentions "hypothecation," whereas the Patent Act does not, and "mortgage" whereas the Lanham does not. Functionally, however, all three statutes, at least as Congress wrote them, operate identically. The changed language in the Copyright Act had nothing to do with the mortgage provisions. It was directed at an entirely different problem: the indivisibility doctrine.

Under *Waterman*, a patent, and by extension a copyright due to the similarity in statutory language, was considered indivisible, so that an assignment of less than the entire bundle of rights was only a license.⁴⁰⁹ Unlike patents, however, before 1978 copyrights were covered by a dual system of state common law and federal statutory copyright. The indivisibility doctrine caused a numerous problems under this dual system.⁴¹⁰ In 1976 Act, Congress eliminated it for copyrights.⁴¹¹ Since the basic purpose of the doctrine was to determine standing to sue, its elimination meant that both assignees and exclusive licensee could sue for infringement of their rights.⁴¹² A new term was needed to cover both such parties, so Congress added

409. Nimmer & Nimmer, *supra* n. 19, at § 10.01[A].

410. *Id.* at §§ 10.01[A], 10.0[C].

411. See 17 U.S.C. § 201(d)(2); Nimmer & Nimmer, *supra* n. 19, at § 10.01[B]; Harold R. Weinberg and William J. Woodward, Jr., *Legislative Process and Commercial Law: Lessons from the Copyright Act of 1976 And the Uniform Commercial Code*, 48 Bus. Law. 437 (1993).

412. See 17 U.S.C. § 201(d)(2); Nimmer & Nimmer, *supra* n. 19, at § 10.02[A].

“transfer of copyright ownership” to the Act. It means “an assignment, mortgage, exclusive license, or any other conveyance, alienation or hypothecation of a copyright of any of the exclusive rights comprised in a copyright.”⁴¹³ A copyright ownership transfer is now broader than a patent ownership transfer (assignment or grant) in the sense that it covers exclusive licenses, which its patent cousin does not. But the rule for mortgages is the same as those in the 1909 Act.⁴¹⁴

Under the 1909 Act, recording in the Copyright Office was the only way to perfect a mortgage in a statutory – federal – copyright.⁴¹⁵ When the 1978 act replaced all state common law copyright with a federal statutory copyright,⁴¹⁶ Congress had no need to make the mortgage recording and priority provisions “more comprehensive” since they already preempted state law filing schemes for statutory copyrights.⁴¹⁷ So why was “hypothecation” included? It means, “to pledge property as security for a debt.”⁴¹⁸ Under the 1909 Act, it was doubtful whether it was even possible to make an effective security transfer of a common law copyright.⁴¹⁹ An influential article suggested trying a pledge, although acknowledging that intangibles could not really be “pledged.”⁴²⁰ The reason Congress included “hypothecation” in the 1978 Copyright Act was to extend federal validation even to doubtful state security constructs,⁴²¹ not to remove existing support for traditional copyright mortgages — and patent or

413. See 17 U.S.C. § 101; Nimmer & Nimmer, *supra* n. 19, at § 10.02

414. See Nimmer & Nimmer, *supra* n. 19, at §§ 10.05[A], 10.07[A] (current act applies to “a subsequent transferees (including a mortgagee)”), 10.07[A][1][b] (both acts “similar in broad strokes” with only technical differences); Paul Goldstein, *Copyright* § 4.5.3.4 (2d ed. 1996) (Section 205 of the Copyright Act acts “like real property recording acts;” substance unchanged from prior law).

415. See *In re Leslie-Judge Co.*, 272 F. 886 (2d Cir. 1921) *cert. denied sub nom. Green v. Felder*, 256 U.S. 704 (1921); Nimmer & Nimmer, *supra* n. 19, at § 10.05[A].

416. See 17 U.S.C. § 301(a); Nimmer & Nimmer, *supra* n. 19, at § 101[B]

417. Nimmer & Nimmer, *supra* n. 19, at § 10.05[A].

418. See *Peregrine*, 116 B.R. at 199.

419. Nimmer & Nimmer, *supra* n. 19, at § 10.05[B].

420. See Leon Kaplan, *Literary and Artistic Property (Including Copyright) as Security: Problems Facing the Lender*, 19 L. & Contemp. Probs. 254, 271-273 (1954); Gilmore, *supra* n. 7, at § 19.8.

421. For a history, see Weinberg & Woodward, *supra* n. 411, at 463-464. “Hypothecation” was suggested by Edward A. Sargoy and adopted by the Registrar of Copyrights. At that time, the states were having some difficulty in dealing with security transfers of common law copyrights, experimenting with pledges and trust instruments. Hypothecation was added to dispel any doubts that all state security transfers were included in a “transfer of copyright ownership.” Technically, of course, the only proper method of financing an information intangible was through a collateral assignment operating as a “mortgage,” not by a “pledge.”

trademark mortgages to boot.

In *Peregrine*⁴²² Judge Kozinski gave a masterful elucidation of why copyright security interests must be perfected by filing in the Copyright Office. The copyright law ensures predictability and certainty of copyright ownership, promotes national uniformity, and avoids the practical difficulties of determining and enforcing author's rights under various state laws.⁴²³ For such a system to work, the priority line-up must be established in a single place because copyrights, unlike industrial goods, have a chain of title. This is why dual filing systems are "scarce as hen's teeth."⁴²⁴ Can you imagine the fistfights if there were two separate lines to buy the same ticket to the Super Bowl? *Peregrine* also held that "because a copyright entitles the holder to receive all income derived from the display of a creative work, an agreement creating a security interest in copyright receivables generated by a copyright may also be recorded in the Copyright Office."⁴²⁵ This follows directly from original Article 9-306(3), which says that a security interest in proceeds is continually perfected if the security interest in the original collateral was perfected. Since a proper recording in the Copyright Office perfects in the copyright, it must then perfect in the royalties – proceeds – from its disposition by licensing.

*In re AEG Acquisition Corp.*⁴²⁶ reached the same result, holding that a filing in the Copyright Office was necessary for both U.S. and Berne Convention works in order for a security interest to defeat U.S. the bankruptcy trustee. *In re Avalon Software*⁴²⁷ also held that a federal filing is necessary to perfect a security interest in a copyright and its proceeds. What if the work is not registered in the Copyright Office? In that case, due to Section 205(c) of the Copyright Act, the filing does not impart constructive notice. Does that mean that a secured creditor can perfect a security interest in an unregistered work under state law? *Avalon* correctly held not. "A product which is entitled to be registered in the U.S. Copyright Office, but is not," said the *Avalon* court, "does not carry a different 'label' or become something different because it was not registered in the Copyright

422. *Peregrine*, 116 B.R. at 194, n. 19.

423. *Id.* at 194.

424. *Id.* at 195; see also Brennan, *supra* n. 9 (discussing problems with dual filing systems).

425. *Peregrine*, 116 B.R. at 194.

426. 127 B.R. 34.

427. *Avalon Software*, 209 B.R. 517.

Office.”⁴²⁸ If a secured creditor wants to perfect a security interest in an unregistered work, the creditor must take the simple steps of ensuring that the work is registered and its security interest property recorded.

Peregrine, *AEG* and *Avalon* establish a consistent and straightforward system for perfecting security interests in copyrights, copyright licenses, and their royalties: register the work and record in the Copyright Office. Certainly, this has been the practice of sophisticated financiers in the motion picture industry for decades. For the four factors discussed above, this single filing system provides a cost-effective and efficient system for financing national assets like copyrights. Recently, however, two decisions have unfortunately reached questionable results — one with regard to unregistered copyrights, the other for royalties under nonexclusive licenses.

*Aerocon Engineering, Inc. v. Silicon Valley Bank (In re World Auxiliary Power Co.)*⁴²⁹ held that a security interest in an unregistered copyright could be perfected against a bankruptcy trustee merely by filing a UCC financing statement. This case is plainly wrong: a creditor cannot perfect a security interest in an unregistered copyright. At least since *Leslie-Judge*, the only way to perfect a security interest in a statutory (federal) copyright is to file federally. As *Avalon* holds, there is no distinction between registered and unregistered works. When the U.S. adhered to the Berne Convention, Congress eliminated registration as a condition to copyright protection.⁴³⁰ However, Congress was concerned that elimination altogether could have deleterious effects. First, it could reduce the incentive to deposit works in the Library of Congress.⁴³¹ Second, it could enable unscrupulous parties without cognizable claims of copyright to forego registration and exploit a presumption of copyright ownership to the disadvantage of legitimate business and the public.⁴³² Congress therefore retained registration as a condition to certain remedies as an incentive to register. Retaining it for perfecting a security interest serves a similar function, ensuring that

428. *Id.* at 521.

429. As of this writing, the decision is on appeal before the Ninth Circuit.

430. This was required as a condition of adherence, since the Convention prohibits the imposition of any formalities to secure copyright protection. *See Nimmer & Nimmer, supra* n. 19, at § 7.16[B][1]b).

431. *See* Sen. Rpt. 352, 100th Cong., 21 (1988).

432. *See* H.R. Rpt. 609, 100th Cong. (1988) (fearing that without incentives to register claimants without a cognizable claim to copyright could nonetheless exploit discovery and other legal processes to extract settlements and cause financial harm to legitimate competition and ultimately the public).

works are deposited with the Library and that copyright owners indicate to the public legitimate claims of copyright ownership.

In fact, the holding in *Aercon Engineering* arguably allows fraud on creditors and the public. Section 544(a) of the Bankruptcy Code gives the trustee all powers of any creditor to avoid secret liens. As *Peregrine* held, this means the trustee is deemed a “transferee” under the Copyright Act⁴³³ who has duly recorded since this is necessary to perfect. If registration is necessary to make the recording effective, then the trustee must be deemed to have registered as well, especially since Section 408(a) of the Copyright Act would authorize the trustee to do so. *Aercon Engineering* is therefore holding, in effect, that a copyright security interest that is not recorded in the Copyright Office nonetheless trumps a subsequent ownership transfer that is recorded. Allowing unrecorded transfers priority over later recorded ones works the very fraud on creditors and the public that the federal filing system is intended to eradicate.

Some lenders claim that nonetheless it is “too burdensome” to register a copyright.⁴³⁴ One complaint is that their borrowers refuse to register. However, under Section 408(a) of the Copyright Act, any “owner” of a copyright or any of the exclusive rights, which includes a mortgagee, can effect a registration.⁴³⁵ They also complain that, in the case of software, a developer is constantly making new upgrades, all of which would need to be registered. But as *Avalon* noted, incremental upgrades are valueless without the right to exploit the underlying work.⁴³⁶ Moreover, the court recognized a limited “relation-back” for security interests duly filed against an underlying work for derivative works.⁴³⁷ The copyright laws are not written for the convenience of lenders. Copyright serves a public function, and the public has an interest in knowing whether a copyright is subject to a security interest. Registration is essential for effective public notice

433. *Peregrine* said the trustee obtained this status as a lien creditor since the definition of “hypothecation” in the Copyright Act would include lienors. As suggested in the text starting at n. 360, *supra*, in fact the trustee obtains this status as an unsatisfied execution creditor who has proceeded to judicial sale. Same result, different reason.

434. See e.g. Reiley, *supra* n. 11, § 16.11 at 16-20: “With respect to unregistered copyrights, *Peregrine* is an example of a judicial decision out of touch with industry realities.” The author proceeds to list the “difficulties” discussed in the text.

435. A registration usually requires a deposit of a “best edition” of a work. A lender should be allowed to obtain a copy of the collateral under the loan agreement. Moreover, the Copyright Office has a procedure allowing a registrant to waive the deposit provided it is made available on request. The other alternative, of course, is simply not to include the copyright in the collateral base.

436. *Avalon Software*, 209 B.R. at 519.

437. *Id.* at 520.

of the financing and thus part of the price for making the loan. There is no public policy in favor of relieving lenders of the minimal burden necessary to achieve this.

Turning to the question of royalties, a case that reaches the right result, but for the wrong reasons, is *Broadcast Music, Inc. v. Hirsch*.⁴³⁸ Miller, a songwriter, was entitled to performance royalties from BMI. He assigned them to Hirsch, who duly notified BMI. The IRS later asserted deficiencies against Miller, and sought to claim the royalties. The IRS first asserted that under *Peregrine* the right to royalties had to be perfected by filing in the Copyright Office. Since the IRS was deemed to have recorded, while Hirsch had not, the IRS claimed it prevailed under Section 205(d). In a questionable ruling, the Ninth Circuit asserted that royalties “are not assignments of copyrights or interests in copyrights,” that need to be recorded, despite the express statutory language in section 501(b) granting authors a beneficial interest in the copyright to collect their royalties.⁴³⁹ In fact, the IRS lien was a statutory “transfer” of Miller’s copyright interest that would take priority over an unrecorded security transfer – unless an exemption existed in the Copyright Act. Such an exemption does exist in Section 205(e).⁴⁴⁰ That section provides that a prior written nonexclusive license prevails over a later transfer of ownership, whether or not the nonexclusive license is recorded.

By law, the BMI public performance license was non-exclusive.⁴⁴¹ Hence, under Section 205(e), the BMI license, and the royalties due under it, did not need to be recorded to gain priority over the later transfer of ownership to the IRS. In evaluating the assignment, the Court asked whether, under New York law, it was a “sale” or an “unperfected security interest.”⁴⁴² The issue was irrelevant, since Article 9, if applicable, would apply to both. But Article 9 did not apply because the royalties were not an account that required a filing to perfect.⁴⁴³ Since Hirsch had given notice of the assignment to BMI, Hirsch’s was perfected against the subsequent transfer to the IRS without the necessity of filing either in the Copyright Office or pursuant to Article 9.

438. 104 F.3d 1163 (9th Cir. 1997).

439. *Id.*

440. *Id.* at 1166.

441. See *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 24 (1979).

442. *Hirsch*, 104 F.3d at 1167.

443. See *supra* n. 120 and accompanying text.

2. *The Patsent Act*

The recording provisions in the Patent Act have remained a kissing cousin of those in the Copyright Act from their inception. It starts with the Act of 1870:

The Act of 1870:

Sec. 36. *And be it further enacted*, That every patent or any interest therein shall be assignable in law, by an instrument in writing; and the patentee or his assigns or legal representatives may, in like manner, grant and convey an exclusive right under this patent to the whole or any specified part of the United States; and said assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the patent office within three months of the date thereof.⁴⁴⁴

In the Act of 1922, this provision was amended to read:

The Act of 1922:

Sec. 4898. Every patent or any interest therein shall be assignable in law, by an instrument in writing; and the patentee or his assigns or legal representatives may, in like manner, grant and convey an exclusive right under this patent to the whole or any specified part of the United States. An assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the Patent Office within three months of the date thereof *or prior to such subsequent purchase or mortgage*.⁴⁴⁵

The current provision in Section 261 of the Patent Act provides in relevant part:

The Patent Act of 1955 Section 261:

Subject to the provisions of this title, patents shall have the attributes of personal property.

Applications for patent, patents, or any interest therein, shall be assignable in law by an instrument in writing. The applicant, patentee, or his assigns or legal representatives may in like manner grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States

An assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office within three months from its date or prior to such subsequent purchase or mortgage.

The current language remains functionally identical to that in the Act of 1870. As the courts have long held, it operates like a real

444. Act of July 8, 1870, 16 Stat. 198 § 36 (emphasis added).

445. Act of February 18, 1922, 42 Stat. 389, 391 ch. 58 § 6.

property recording act.⁴⁴⁶

Despite its common origin with the Copyright Act, the courts have interpreted the Patent Act differently. The problem started with *In re Transportation Design & Technology Inc.*⁴⁴⁷ The question was whether a security interest in a patent was perfected against a bankruptcy trustee by filing in the state UCC register or in the PTO. The court held, unremarkably enough, that “if the secured creditor wishes to protect itself against the debtor transferring title to the patent to a *bona fide* purchaser or mortgagee who properly records, then the secured creditor must bring its security interest (which is not ordinarily a transfer of title) within the provisions of the Patent Act governing transfer of title to patents.”⁴⁴⁸ This is certainly correct. But the court went on to say that since the Patent Act does not specifically mention “lien creditors,” a filing in the state UCC register was the appropriate way to perfect against a bankruptcy trustee.⁴⁴⁹ In *Transport Design*, however, the trustee, erroneously as it turned out, proceeded solely as a “lien creditor” under Section 544(a)(1) of the Bankruptcy Code. No one bothered to ask whether, under applicable California law at the time, the trustee could have even obtained a judicial lien on the patent. In fact, he could not.⁴⁵⁰ And no one considered the result had the trustee proceeded as an unsatisfied execution creditor under Section 544(a)(2). On the narrowest of grounds, *Transport Design* is correct that one does not record in the PTO to prime a patent “lien creditor,” not because of any lacunae in the Patent Act, but because, for patents, there is no such animal.

The same issue reappeared in *City Bank & Trust Co. v. Otto Fabric, Inc.*⁴⁵¹ Reversing a bankruptcy court’s decision that a filing in the PTO was necessary to trump the trustee, *Otto Fabric* held that the Patent Act did not apply to the bankruptcy trustee acting under section 544(a)(3) of the Bankruptcy Code. Of course, section 544(a)(3) refers to real property, not intellectual property, so again this decision is, on the narrowest of grounds, facially correct; the trustee goofed again. But the reasoning the court used to reach its result leaves much to be desired. In a remark that would have sent shudders down the spine of the drafters of the Patent Act, the court

446. See *supra* n. 151 and accompanying text.

447. 48 B.R. 635 (Bankr. S.D. Cal. 1985).

448. *Id.* at 640.

449. *Id.*

450. See the chart, *supra* n. 323 for a discussion of California; see also Brennan, *supra* n. 9, at § II.C.3.b.

451. 83 B.R. 780, 782 (Bankr. D. Kan. 1988).

said, “[w]hile recording as assignment with the Patent Office *would* protect the assignee against the claim of a subsequent lien creditor, the statute does not state that the assignment *must* be recorded to provide such protection.”⁴⁵² This is pure nonsense. If a statute does not require an instrument to be recorded, its recording anyway is ineffective.⁴⁵³ If the Patent Act does not require a recording to prime a subsequent creditor, then permissive recording does not do it either. Following this with a remark that must have sent the drafters of the “strong arm” provision spinning in their graves, it then said that since the Patent Act did not mention liens, a patent security interest need not be filed at all to trump the bankruptcy trustee.⁴⁵⁴ In other words, *Otto Fabric* maintained that the Patent Act actually endorses secret liens on patents to the detriment of later creditors. That Congress intended the recording provisions in the Patent Act to reverse the historic hostility to secret liens is simply not credible.⁴⁵⁵

Recently, *In re Cybernetics Services*,⁴⁵⁶ reached the same conclusion. As of this writing, the case is on appeal. Perhaps the Ninth Circuit will provide some needed clarification.⁴⁵⁷

3. *The Lanham Act*

The federal trademark statutes have a similar history. The first modern federal trademark statute was passed in the 1905.⁴⁵⁸ Section 10 provided:

The Act of 1905:

Sec. 10. Every registered trade-mark and every mark for the registration of which has been made, together with the application

452. *Id.* (emphasis in original).

453. *Am. Solid Leather Button Co.*, 47 F. at 743 (recording equitable patent mortgage ineffective since statute did not require their recording); *see also* 51 Am. Jur. 2d *Liens* § 8 (2000).

454. *Otto Fabric*, 83 B.R. at 782. *See also* Clark, *supra* n. 45, at 1-91, so interpreting *Otto Fabric*.

455. Two other cases also cited for the proposition that a patent security interest is perfected by a UCC filing do not in fact so hold. The first one, *Chesapeake Fiber Packaging Corp. v. Sebro Packaging Corp.*, 143 B.R. 360 (Bankr. D. Md. 1992) held that paying past due attorneys' fees did not make someone a *bona fide* purchaser within Section 261 of Patent Act. *Id.* at 369. Obviously, whether the security instrument was recordable in the PTO was irrelevant because the secured creditor won in any case. In *Charles Holt v. U.S.*, 13 U.C.C. Rep. Serv. 336 (D.D.C. 1973), the question was whether a patent “pledge” was even valid, not recordable. Although the decision references a filing, it does not tell us whether it was in the state system or the PTO.

456. 239 B.R. 917 (Bankr. 9th Cir. 1999).

457. Disclosure: I represent the trustee on appeal.

458. Act of Feb. 20, 1905, 33 Stat. 724, *codified* 15 U.S.C. §§ 81-133 (2000). For a history of the federal trademark statutes, *see* McCarthy, *supra* n. 16, at § 5.03.

for registration of the same, shall be assignable in connection with the good will of the business in which the mark is used, by a instrument in writing, duly acknowledged or otherwise proved, according to the laws of the country or State in which it is executed or made; any such assignment shall be void against any subsequent purchaser for valuable consideration without notice, unless it is recorded is recorded in the Patent Office within 3 months from the date thereof or prior to such subsequent purchase.⁴⁵⁹

There were numerous piecemeal revisions of the federal trademark laws until they were given a comprehensive overhaul in the Lanham Act of 1946.⁴⁶⁰ Significant revisions were made in the Trademark Law Revision Act of 1988.⁴⁶¹ The recording provisions, however, remained consistent, at least as far as security transfers go. The current provision now reads:

Section 1060. Assignment

(a) A registered mark or a mark for which an application to register has been filed shall be assignable with the good will of the business in which the mark is used, or with that part of the good will of the business connected with the use of and symbolized by the mark Assignments shall be by instruments in writing duly executed 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.

The Lanham Act refers to an “assignment” like the 1909 Copyright Act and the Patent Act. It does not mention “mortgage.” Does this mean the Lanham Act does not cover security transfers? As discussed above, intangibles have always been properly financed under the law of assignment, and collateral assignments are treated as mortgages.⁴⁶² The Lanham Act says an unrecorded assignment is void against a subsequent “purchaser,” a term that has always included a mortgagee.⁴⁶³ At least facially, it would seem reasonable to treat the Lanham Act like the Copyright Act and the Patent Act: a recording act, like the real property recording acts, which accommodates recording of ownership transfers (“true” assignments) and security transfers (“collateral” assignments) against later “purchasers” (ownership and security transferees). The cases that have interpreted the Lanham Act, however, have concluded that a security interest in a federal trademark must be perfected only under

459. Act of Feb. 20, 1905, 33 Stat. 724 § 10.

460. Act of July 5, 1946, ch. 540, 60 Stat. 444. See McCarthy, *supra* n. 16, at § 5.05[4].

461. Pub. L. 100-667, 102 Stat. 3935. See McCarthy, *supra* n. 16, at § 5.05[4].

462. See *supra* n. 85 and accompanying text.

463. See *supra* n. 77 and accompanying text.

Article 9. The reasoning is far from persuasive.

The seminal case is a bankruptcy court decision in *In re Roman Cleanser Co.*⁴⁶⁴ The court framed the issue as whether the term "assignment" in the Lanham Act included a "security interest." The court began with the following language from *Acme Valve & Fitting Company v. Wayne*.⁴⁶⁵ "In order for a transfer of rights in a trademark to constitute a sale or assignment, thereby vesting title to the trademark in a party, the transfer must be absolute and must relate to the entire rights in the trademark."⁴⁶⁶ It then said: "A grant of a security interest is merely a device to secure indebtedness, an agreement for the future assignment in the event of default and not an absolute assignment of the trademark or the good will attached to it."⁴⁶⁷ For this it relied on *Li'l Red Barn, Inc. v. Red Barn System, Inc.*⁴⁶⁸ The court concluded by noting that since many commercial finance commentators were confused about how to perfect a trademark security interest, filing in the UCC was the preferable approach to relieve them of their confusion.⁴⁶⁹

Confusion in the commercial finance bar, however, is not a reason to abrogate what Congress has established. *Acme Valve* dealt with the difference between an assignment and a license, not an absolute assignment and a collateral assignment.⁴⁷⁰ *Li'l Barn* involved an agreement to reassign the trademark in the future in case of default, not a security interest.⁴⁷¹ Neither of these cases support *Roman Cleanser's* reasoning. Moreover, that reasoning ignores the prior authority on financing intangibles under the law of assignment.⁴⁷² In *Waterman*, the Supreme Court said that an "absolute" assignment of a patent "being a conveyance made to secure the payment of a debt . . . was a mortgage in apt terms, and in legal effect."⁴⁷³ In *Ormsby*, an assignment "transferred the patent as collateral security, or as in the way of a mortgage; it makes no difference which."⁴⁷⁴ Indeed, the chattel mortgage at issue *In Re*

464. 43 B.R. 940 (Bankr. E.D. Mich. 1984), *aff'd* 802 F.2d 207 (6th Cir. 1986).

465. 386 F. Supp. 1162, 1165 (S.D. Tex. 1974).

466. *Roman Cleanser Co.*, 43 B.R. at 944.

467. *Id.* at 945.

468. 322 F. Supp. 98 (N.D. Ind. 1970).

469. *Roman Cleanser Co.*, 43 B.R. at 945-946.

470. *Acme Valve*, 386 F. Supp. at 1165.

471. *Li'l Red Barn*, 322 F. Supp. at 106.

472. See Gilmore, *supra* n. 7, 13.3.

473. *Waterman*, 138 U.S. at 258.

474. *Ormsby*, 133 F. at 549.

*Leslie-Judge Co.*⁴⁷⁵ also covered a federal trademark, which the court invalidated for the lack of a federal filing. Prior authority all pointed to the fact that a security “assignment” of a federal trademark did include a “mortgage,” and that a federal filing was the only way to perfect against a “purchaser.”

To claim that a security interest is an agreement for the future assignment in the event of default and not an absolute assignment of the trademark defies common sense. One may see why by looking at what happens when the secured creditor forecloses. Does the ownership interest transferred at the foreclosure sale take effect on the foreclosure sale date, or relate back to the recording date? Consider the following scenario:

- On Jan. 15 the Trademark Owner (TO) duly registers a trademark in the PTO.
- On Feb. 15, TO grants a security interest to Secured Creditor (SC) who only files in the state UCC register.
- On Mar. 15, TO assigns the trademark to *Bona Fide Purchaser* (BFP) who has no notice of the security transfer. (The TO may have moved to another state.) BFP records the assignment in the PTO.
- On Aug. 15 TO defaults and SC conducts a foreclosure sale, transferring all interest in the trademark to Foreclosure Sale Purchaser (FSP).

Now, who owns the trademark, BFP or FSP? If *Roman Cleanser* is correct that a security interest is only an agreement for the future assignment in the event of default, then the assignment to FSP occurred on Aug. 15 when the foreclosure sale occurred. But, on that date, TO no longer owned the trademark; it had been assigned to BFP. The whole purpose of a security interest is to give the creditor the right to take the debtor’s interest in the collateral in the event of default. Allowing the debtor to dispose of the collateral free of the security interest makes any security pointless.

To avoid that result, we would need to conclude that FSP’s title to the trademark related back to the filing date, before the transfer to BFP. There is a problem. The Lanham Act says: “An assignment shall be void against any subsequent purchaser . . . *unless* . . . recorded in the Patent and Trademark Office within 3 months after the date of the subsequent purchase or prior to the assignment.”⁴⁷⁶

475. 272 F. 886 (2d Cir. 1921) *cert. denied sub nom. Green v. Felder*, 256 U.S. 704 (1921).

476. 15 U.S.C. § 1060(a) (2000).

FSP's "purchase" was not recorded in the PTO prior to the assignment to BFP. FSP's title relates back under *state* law, not federal law. Allowing such a relation back lets state law gut the Lanham Act.

Two different systems cannot determine one priority line up in the same asset. One must prevail over the other. If *Roman Cleanser* is right that a security interest is only a future assignment, then it has made trademark security interests useless. If it means they relate back under state law, then it has eliminated the PTO as a source of reliable information about trademark ownership. *Roman Cleanser's* premise – that security interests in federal trademarks can be perfected under state law – leads to absurd results.

The Sixth Circuit affirmed the bankruptcy court's decision in *Roman Cleanser*⁴⁷⁷ but on narrower grounds. The trustee, inexplicably, did not appeal the ruling about filing in the PTO, so a bewildered Sixth Circuit said they could not consider it.⁴⁷⁸ Instead, it affirmed on the ground that the security interest was not an invalid assignment in gross because it also covered customer lists necessary to exploit the trademarked goods. This is hardly a ringing endorsement.

The other cases can be quickly disposed of. *In re TR-3 Industries*⁴⁷⁹ merely contained a stipulated statement of facts and conclusions of law prepared by the secured creditor, not a reasoned opinion. *In re C.C. & Co.*⁴⁸⁰ only repeated without analysis the language from *Roman Cleanser* that a security interest is not an assignment. *In re Chattanooga Choo-Choo*⁴⁸¹ cited *Roman Cleanser*, *CC& Co.* and *TR-3* without analysis, but found for the trustee because the financing statement did not mention the service mark. *In re 199Z, Inc.*⁴⁸² again only said that trademark "assignments" are not "security interests" and cited *Roman Cleanser*. Finally, *In re Together Development Corp.*⁴⁸³ made the remarkable claim that even filing in the PTO was insufficient to perfect. It concluded that the failure to mention "mortgage" in the Lanham act meant they were not covered because "[when the Lanham Act was adopted] a 'chattel mortgage'

477. *Roman Cleanser Co.*, 43 B.R. 940 (Bankr. E.D. Mich. 1984), *aff'd* 802 F.2d 207 (6th Cir. 1986).

478. *Roman Cleanser Co.*, 802 F.2d at 209.

479. 41 B.R. 128 (Bankr. C.D. Cal. 1984).

480. 86 B.R. 485 (Bankr. E.D. Va. 1988).

481. 98 B.R. 792 (Bankr. E.D. Tenn. 1989).

482. 137 B.R. 778 (Bankr. C.D. Cal. 1992).

483. 227 B.R. 439 (Bankr. D. Mass. 1998).

or ‘conditional sale’ was the vehicle through which most consensual personal property liens were granted. Outside of the sales context, to describe the grant of a security interest it was then common to refer to the grant of a ‘mortgage’ rather than an ‘assignment,’ as the term is used on the Lanham Act.”⁴⁸⁴ Unfortunately, this is exactly the opposite of *Waterman’s* holding that an assignment given for security is a mortgage. It also ignores the fact that a “purchaser” – the term used in the Lanham Act – has always included a mortgagee, and a secured creditor today.

4. *Irreconcilable Statutory Schemes*

The decisions interpreting the federal information acts are now in hopeless disarray. All three statutes, the Copyright Act, the Patent Act and the Lanham Act:

- use essentially the same statutory language;
- are modeled on real property recording acts;
- apply to intangible assets located nationwide;
- establish national centers for information about both ownership and security transfers;
- deal with property that has a chain of title;
- have a federal statutory signature requirement for ownership and security transfers;
- cannot be reached by levy or attachment under state laws;
- cover assignments, the traditional law for ownership and security transfers of intangibles;
- cover purchasers, a term that always included mortgagees and secured creditors.

Yet case law requires a secured creditor to follow different perfection regimens for these assets.

Copyrights: The creditor must record in the Copyright Office to perfect against both subsequent purchasers (owners and creditors) and the bankruptcy trustee;

Patents: The creditor must record in the PTO to perfect against subsequent purchasers (owners and creditors) but file in the state to perfect against general creditors and the bankruptcy trustee; and

Trademarks: The creditor must file in the state to perfect against subsequent purchasers (owners and creditors), general creditors and the bankruptcy trustee.

This type of judicial obscurantism was soundly criticized by the

484. *Id.* at 441.

legal realists who drafted the UCC.

Federal information cannot be effectively financed under the personal property financing rules in Article 9. Following is a summary of the irreconcilable differences between the systems:

Statutory Purposes: The fundamental purpose of intellectual property law is to encourage new creations.⁴⁸⁵ Unrestricted transferability is anathema to this purpose because it deprives the creator of the ability to realize income from exploitation by giving free reign to free riders. State law has the opposite goal: free transferability of goods.⁴⁸⁶

Statutory Model: The federal information systems are modeled on real property recording acts. Article 9 uses a simplified notice filing system like that in the earlier registry acts. Indeed, the notice filing scheme used in Article 9, while doubtless appropriate for its statutory purposes, is wholly inappropriate for the ownership system used in the federal information acts. Notice filing for title ownership was the system used under the Medieval Statute of Enrollments, a system rejected by all the American Colonies and States in favor of recording acts.⁴⁸⁷

Statutory Type: The federal information systems use a "race-grace" scheme in which the first to record in good faith and without notice prevails, subject to a statutory grace period. Article 9 uses a first to file or perfect rule; notice of a prior interest is irrelevant.

Indexing: The federal information systems index against the property, *i.e.* the registered work, patent or trademark application. State personal property registers index against the debtor.

Covered Transfers: The federal information systems cover both ownership and security transfers. Article 9 only covers security transfers.

Chain of Title: Intellectual property ownership has an elaborate chain of title, all of which must be searched. For personal property only one search against the debtor is typically required.

Scope of Recording: A filing under Article 9 of necessity only applies within the state borders. Since federal information is an intangible located simultaneously everywhere nationwide, the federal statutes provide national recording systems with nation-wide scope.

Protected Parties: The federal information systems, like the real property recording acts, protect against subsequent *bona fide*

485. See Brennan, *supra* n. 9, § II.A.

486. See Brennan, *supra* n. 9, § II.A.

487. See *supra* n. 43 and accompanying text.

purchasers, not lien creditors. Article 9 protects against lien creditors, not against buyers in the ordinary course.

Ownership: An unfiled security interest is junior to a later creditor who has merely taken possession of tangible property by levy due to the *apparent* ownership rule. Intellectual property does not recognize apparent ownership by possession of a copy. A judicial creditor must use equitable proceedings and proceed to judicial sale under the *actual* ownership rule.

Floating Liens: Article 9 allows floating liens over all property of the debtor identified by type. Since federal filings must be indexed against the property, the federal systems do not recognize floating liens. This is just like real estate. Imagine allowing a floating lien against “all real property now or later owned by Wal-Mart.” How would a lender financing a specific store in Kansas City even know where to begin to search to find prior liens?

After-acquired Property: To facilitate financing changeable inventory, Article 9 allows filings to cover “after-acquired” property so long as it falls within the identified type. The federal systems do not recognize “after-acquired” property filings. Not only is there nothing to index against until the property is identified, but there has always been an historical reluctance to recognize conveyances of tomorrow’s inspiration for fear of overreaching against creators.⁴⁸⁸

Purchase Money Interests: Article 9 allows a “purchase money security interest” to trump a pre-existing floating lien by compliance with statutory rules. The federal information acts do not need to recognize a purchase money creditor because they do not recognize floating liens. All filings in the federal systems must be indexed against a registered work, patent or mark.

Ordinary Course Buyers: Article 9 also allows a buyer in the ordinary course to take free a pre-existing perfected security interest to allow efficient inventory financing. This is anathema to the intellectual property acts, which do not recognize “licensees in the ordinary course.”

International Aspects: Information is subject to an extensive web of international treaties and obligations.⁴⁸⁹ Tangible personal property financing is not.

The following chart summarizes these differences:

488. See e.g. *Rosenthal v. Goldstein*, 112 N.Y. Misc. 606, 611 (1920) (pre-patent disclosure cannot be compelled in supplemental proceedings due to “inviolability of the common-law right of the inventor to preserve his secret”).

489. See Brennan, *supra* n. 9, § III.E.

Issue	Federal IP Systems	Article 9 System
Statutory Purpose	Encourage new creations	Free alienability of goods
Statutory Model	Recording act	Registry act
Statutory Type	Race-grace	Pure notice
Filing Principle	Transaction filing	Notice Filing
Indexing method	Against property	Against debtor
Covered transfers	Ownership and security	Security only
Searches required	All transfers in chain of title	Only against debtor
Scope	Nationwide	Statewide
Filing protects against	<i>Bona fide</i> purchasers	Lien creditors and BFPs
Ownership as to creditors	Actual	Apparent
Floating liens	Not allowed	Allowed
After-acquired property	Filing does not cover	Filing covers
Purchase-money interest	No super-priority	Super-priority
Buyer in ordinary course	No super-priority	Super-priority
International scope	Extensive treaty coverage	Limited treaty coverage

Statutory Comparison Chart

III

Federal Law Reforms

Information financing has become too important to the national interest to tolerate this continued confusion. Copyrights, patents and federal trademarks are national intangibles, supported under federal law, and subject to an extensive web of international obligations that bind the United States as a nation. The federal information statutes, at least as Congress wrote them, could have been easily interpreted in a consistent and coherent manner had there been any inclination to do so. Indeed, utilizing the federal statutes for establishing priority and consequent perfection for security interests in federal information would have the most commercially efficient approach. Instead, the plain language of the federal information statutes has been folded, spindled and mutilated beyond all recognition in an attempt to force fit information financing into an Article 9 structure that was never meant for it. It appears that only Congressional guidance can set the matter right. The following are suggested changes to the federal statutes to do so.

A. Copyright Act

The Copyright Act represents the most comprehensive and coherently interpreted of the federal information acts. Although the act as written is sufficient, due to confusion among some commentators and the courts, it would be helpful to provide definitive statutory guidance. The following are suggested changes:

Scope of Act: To avoid further confusion, the Copyright Act should specifically reference that it covers “security interests” in both rights and royalties. This should be done by amending the definition of “mortgage” in Section 101 to include a “security interest.” The definition should also provide that a transfer of ownership with the reservation of a royalty is not *per se* a “mortgage” or “security interest” to reverse the position taken in Revised Article 9.⁴⁹⁰ The act should also cover a security interest in rights or royalties under a non-exclusive license.⁴⁹¹ It that priority of such an security interest is established in the same manner as priority is established in the underlying nonexclusive license itself, disapproving the contrary language in *Hirsch*.

Priority Scheme: Section 205 of the Copyright Act should be clarified to establish the following priority scheme:

- Retain the rule in Section 205(d) as to the relative priority between two recorded transfers with regard to *bona fide* transferees. Indicate that the priority applies both to rights and royalties derived from the exercise of the rights.
- Retain the exception in Section 205(e) for non-exclusive licenses, and indicate that it also applies to royalties derived from non-exclusive licenses.
- Add a back-up rule that, as between two transfers, neither one of which qualifies for record priority under the previous rules, the one first executed prevails. This is the common law “first in time” rule. Note that “transfers” includes both transfers of ownership and non-exclusive licenses. This means rights or royalties under copyright licenses could still be financed under the law of assignment, but risk losing priority to a bona-fide transferee who duly records in the Copyright Office.

490. See Brennan, *supra* n. 9, § III.G. The definition should provide that a mortgage only arises where the debtor has a right of redemption in accordance with long established law.

491. Technically, these would not be a “transfer of ownership” under Section 101 and hence not included in the definition of “mortgage,” just as a nonexclusive license is not a transfer of ownership.

Assignment Rules: Codify the existing federal law on assignments that Revised 9 has tried to alter as follows⁴⁹²:

- An express contractual restriction on the assignment or sublicensing of rights or royalties should be enforceable, except that a transferor may assign its right to receive royalties where all obligations of the transferor are fully performed.
- Where a transfer of ownership is silent, the transferee should be presumed authorized to make further transfers, assignments and sublicenses, both of its rights and any royalty income it earns, without consent of the transferor. In such a transfer the transferor should be presumed entitled to transfer its right to receive any royalties, although the transferor cannot make a further transfer of the rights granted to the transferee within the scope of the transfer.
- Where a non-exclusive license is silent, the licensee may not make further transfers, assignments or sublicenses, either of its rights or royalty income, without consent of the licensor. However, in accordance with Section 301(d) of the Copyright Act, a licensor's consent should be presumed in the case of a nonexclusive license to include a work in another joint or collective work, but only for a transfer in conjunction with a transfer of the joint or collective works.

Insolvency Representatives: Provide that a security interest in a copyright or its royalties is ineffective against a bankruptcy trustee unless duly recorded in the Copyright Office, excepting only non-exclusive licenses entitled to priority under Section 205(e) without recording. This can be done by amending Section 544(a)(2) of the Bankruptcy Code to provide that the trustee, as an unsatisfied execution creditor for intellectual property, is deemed to have taken all steps to perfect against prior liens by proceeding to judicial sale and both registering the work and recording the judicial sale deed in any applicable register. This should overrule the decision in *World Auxiliary Power* for unregistered copyrights. Alternatively, one could amend the Copyright Act to provide that a transfer of ownership includes a transfer to an insolvency representative, but this seems the less desirable course. For clarity, federal law should also provide that state law may not allow involuntary execution of any copyright

492. See Brennan, *supra* n. 9, § III.E.

interest except after noticed hearing in which the owner of the copyright interest is given a change to be heard on valuation and possible alternate remedies.

International Licenses: Restore the former law for financing royalties remitted to the United States under international licenses that Revised 9 has eliminated.⁴⁹³ Provide that, for purposes of United States law, an assignee of royalties under copyright licenses in other countries that are remitted to the United States obtains priority in such royalties as against other creditors of the assignor by providing notice of its interest to the parties remitting the royalties. If necessary, establish that this priority requires recording a notice in the Copyright Office.

Limited Relation Back: To answer the complaint about constant registration for new versions of software, codify the limited relation-back rule adopted in *Avalon*. That is, provide that the effective date of a transfer duly recorded against a registered work is to be deemed the effective date of recording of the transfer against a derivative work, provided that (i) the derivative work is duly registered within six months of the original registration, and (ii) that the recorded transfer expressly provides that it covers derivative works.

Express Preemption: So that there is no doubt, provide that the registration, recordation and priority rules in the Copyright Act preempt all state laws, including for security transfers.

B. Patent Act

As discussed in the companion article, nearly every country requires a filing in the national patent registration system to perfect a patent security interest.⁴⁹⁴ This requirement has been formalized in the recent Patent Law Treaty, Article 14(b)(iii) of which requires all signatory countries to allow filing "licenses and security interests" in their national patent registers.⁴⁹⁵ Rule 17 of the Regulations annexed to the Treaty contain detailed rules on the form of such filings. It requires recognition of filings for both exclusive and non-exclusive licenses, and for involuntary transfers under court order. The United States has signed the treaty and it will be submitted for Senate approval in 2001. In light of this change, it seems that significant changes must be made in the U.S. patent registration system. The

493. See Brennan, *supra* n. 9, § III.D.

494. See Brennan, *supra* n. 9, § III.E.

495. The Treaty was approved at the WIPO Diplomatic Conference in Geneva in June, 2000. For the text of the Treaty, see the WIPO Web site, <<http://www.wipo.int/treaties/ip/plt/treaty.html>> (accessed Dec 22, 2000).

following are suggested changes:

Scope of Act: The Patent Act should be amended to allow recording of assignments, exclusive licenses, non-exclusive licenses, “mortgages” including “security interests,” and judicial sales in both rights and royalties. For convenience, it may be helpful to adopt terminology such as “ownership transfer” (for assignments, grants, exclusive licenses of all three patent rights, and any mortgage of rights or royalties under them) and “use transfer” for other transfers and their resulting royalties.

Priority Scheme: Section 261 of the Patent Act should be clarified to establish the following priority scheme:

- Extend the filing rule in Section 261 to cover licenses. That is, provide that any ownership transfer (assignment), or transfer of royalties arising from it, is void as against any subsequent ownership transfer, unless such is recorded in the PTO within three months of its date of execution or before the later ownership transfer.
- Provide that any ownership transfer is subject to any use transfer (license) that is in writing and taken before the ownership transfer is executed or in good faith and without knowledge before the ownership transfer is recorded. Otherwise, the use transfer is void as against a recorded ownership transfer.
- Provide that any use transfer is void as against any subsequent use transfer, unless such is recorded in the PTO within three months of its date of execution or before the later use transfer.
- Indicate the priority applies both to rights and royalties derived from their exercise.
- Provide that any transfer occurring upon foreclosure of any mortgage (security interest) relates back to the date on which the mortgage was duly recorded in PTO and takes its priority as of that date.
- Add a back-up rule that, as between two transfers, neither one of which qualifies for record priority under the previous rules, the one first executed prevails. This is the common law “first in time” rule.

Assignment Rules: Codify the existing federal law on assignments that Revised 9 has tried to alter as follows:⁴⁹⁶

- Adopt the same rules as suggested above for copyrights.

496. See Brennan, *supra* n. 9, § III.E.

- An express contractual restriction on the assignment or sublicensing of rights or royalties should be enforceable, except that a transferor may assign its right to receive royalties where all obligations of the transferor are fully performed.
- Where a transfer of ownership is silent, the transferee should be presumed authorized to make further transfers, assignments and sublicenses, both of its rights and any royalty income it earns, without consent of the transferor. In such a transfer the transferor should be presumed entitled to transfer its right to receive any royalties, although the transferor cannot make a further transfer of the rights granted to the transferee within the scope of the transfer.
- Where a non-exclusive license is silent, the licensee may not make further transfers, assignments and sublicenses, either of its rights or royalty income, without consent of the licensor.

Insolvency Representatives: Provide that a security interest in a patent or its royalties is ineffective against a bankruptcy trustee unless duly recorded in the PTO, excepting only for use transfers entitled to priority as discussed above. This can be done by amending Section 544(a)(2) of the Bankruptcy Code as suggested for copyrights. This should overrule the decisions in *Transport Design* and *Otto Fabric*. Alternatively, one could provide that a patent ownership transfer includes a transfer to an insolvency representative, but this seems the less desirable course. It may also be desirable to provide that state law may not allow involuntary execution on or judicial sale of any patent interest except after a notice hearing in which the owner of the patent is given a chance to be heard on valuation and possible alternate remedies.

International Licenses: Restore the former law for financing royalties remitted to the United States under international licenses that Revised 9 has eliminated.⁴⁹⁷ Provide that, for purposes of United States law, an assignee of royalties derived under patent licenses in other countries that are remitted to the United States obtains priority in such royalties as against other creditors of the assignor by providing notice of its interest to the parties remitting the royalties. If necessary, establish that this priority required recording a notice in the Copyright Office.

497. See Brennan, *supra* n. 9, § III.D.

Limited relation back: Allow a limited relation-back for improvement patents by the same inventor similar to that for derivative copyrights.

Express preemption: So that there is no doubt, provide that the registration, recordation and priority rules in the Patent Act preempt all state laws, including for security transfers.

C. Lanham Act

The Lanham Act is desperately in need of reform, especially after the changes made by Revised 9. Many countries require a filing for trademark security transfers due to the Trademark Law Treaty, to which the U.S. has adhered.⁴⁹⁸ It would seem appropriate to amend the Lanham Act to conform to the changes required in the Copyright Act and the Patent Act. This would involve Congressional adoption of an earlier act that sought to include security transfers of trademarks within the Lanham Act.⁴⁹⁹ Suggested changes are:

Scope of Act: Amend the Lanham Act to allow recording of assignments, exclusive licenses, non-exclusive licenses, “mortgages” including “security interests,” and judicial sales in both rights and royalties. For convenience, it may be helpful to adopt terminology such as “ownership transfer” (for assignments, and exclusive licenses) and “use transfer” for other transfers and their resulting royalties. The rules should apply to both rights and royalties.

Assignment in Gross: Provide that granting a mortgage (security interest) in a trademark interest is not an “assignment in gross” so long as the mortgage covers additional items necessary to enforce the quality of goods or services designated by the mark. This is in effect codifying *Haymaker*. It may be appropriate to provide that such security interest is effective to ensure continued quality control if it obligates the debtor to maintain the goods and services subject to the mortgage with such quality as existed when the mortgage was made.

Priority Scheme: Section 1060 of the Lanham Act should be clarified to establish the following priority scheme:

498. See McCarthy, *supra* n. 16, at ch. 32. For the text of the Treaty, see the WIPO Web site <<http://www.wipo.int/treaties/ip/trademark-law/articles.html#11>> (accessed Dec 22, 2000). One may well ask whether Revised 9, allowing security transfers – and on foreclosure ownership transfers – of trademarks to be effective without filing in the PTO, now puts the U.S. out of compliance with the Trademark Law Treaty. See Article 11(1)(a) (required procedures for recordal of the change of ownership in national trademark office), and Article 11(4) (prohibiting filing requirements other than those in the treaty). Are these consistent with the rules for transferring ownership of a trademark by filing a security interest and conducting a foreclosure sale under state law?

499. See McCarthy, *supra* n. 16, at ch. 21.

- Extend the filing rules to the new interests. That is, provide that any transfer is void as against any subsequent transfer, unless it is recorded in the PTO within three months of its date of execution or before the later transfer. Indicate that the priority applies both to rights and royalties derived from the exercise of the rights.
- Provide that any ownership transfer is subject to any non-exclusive license that is in writing and taken before the ownership transfer is executed or in good faith and without knowledge before the ownership transfer is recorded.
- Provide that any transfer occurring upon foreclosure of any mortgage (security interest) relates back to the date on which the mortgage was duly recorded in PTO and takes its priority as of that date.
- Add a back-up rule that, as between two transfers, neither one of which qualifies for record priority under the previous rules, the one first executed prevails. This is the common law “first in time” rule.

Assignment Rules: Codify the existing federal law on assignments that Revised 9 has tried to alter⁵⁰⁰ by adopting similar rules to those suggested above for copyrights:

- An express contractual restriction on the assignment or sublicensing of rights or royalties should be enforceable, except that a transferor may assign its right to receive royalties where all obligations of the transferor are fully performed.
- For a complete assignment of a trademark, the assignee should be presumed authorized to make further transfers, assignments and sublicenses, both of its rights and any royalty income it earns, without consent of the assignor.
- Where any trademark transfer license is silent, the transferee may not make further transfers, assignments and sublicenses, either of its rights or royalty income, without consent of the licensor.

Insolvency Representatives: Provide that a security interest in a federal trademark or its royalties is ineffective against the bankruptcy trustee unless duly recorded in the PTO, excepting only for use transfers entitled to priority as discussed above. This can be done by amending Section 544(a)(2) of the Bankruptcy Code as suggested for

500. See Brennan, *supra* n. 9, § III.E.

copyrights. This should overrule the decisions in *Roman Candle* and its progeny. Alternatively, one could provide that a trademark ownership transfer includes a transfer to an insolvency representative, but this seems the less desirable course. It may also be desirable to provide that state law may not allow involuntary execution on or judicial sale of any federal trademark interest except after a notice hearing in which the owner of the trademark is given a chance to be heard on valuation and possible alternate remedies.

International Licenses: Restore the former law for financing royalties remitted to the United States under international licenses that Revised 9 has eliminated.⁵⁰¹ Provide that, for purposes of United States law, an assignee of royalties derived under trademark licenses in other countries that are remitted to the United States obtains priority in such royalties as against other creditors of the assignor by providing notice of its interest to the parties remitting the royalties. If necessary, establish that this priority required recording a notice in the PTO.

Express preemption: So that there is no doubt, provide that the registration, recordation and priority rules in the Lanham Act preempt all state laws, including for security transfers.

D. Federal Co-ordination

Ideally, all three statutes should use comparable language and priority rules. The Copyright Office and PTO should also be given statutory authority and direction to establish suggested forms for registering transfers and mortgages. Ideally, the forms should be coordinated so that a lender can file a single form listing multiple items of information collateral. A system for electronic filing should also be explored.

IV Conclusion

The creation and exploitation of intangible information is fundamentally different from the manufacture and sale of industrial commodities. Information has a chain of title. There is no apparent ownership rule. There are four factors that must be accommodated in any information financing. The filing and priority rules in state commercial law are simply incapable of dealing effectively with these differences. Indeed, they were never meant to. Unfortunately, too many in the commercial law bar, despite constant warnings from the

501. See Brennan, *supra* n. 9, § III.D.

drafters of original Article 9 not to do so, have nonetheless tried to force fit information into structures established for entirely different assets, to results legally unsettling and commercially inefficient.

Grant Gilmore, the Reporter for original Article 9, and unsurpassed by any lawyer in the last two centuries in his knowledge of personal property finance law, put it simply:

[I]t seems to be generally assumed that the federal filing systems are exclusive, and it is surely desirable that they should be; no useful purpose would be served and much confusion would result if it were held to be within the power⁵⁰² of a state to require a state filing in addition to the federal filing.

Information financing has become too important to the national interest to tolerate the continued confused commentary and confusing decisions. It is doubtful solutions can or will not be found at the state level due to Revised Article 9, a matter discussed in detail in the next article. A different approach is needed.

It seems only Congress can set the matter right. For national assets like information, that will determine America's national role in a global information economy, this is only fitting. Congress must act now to establish preemptive federal laws for financing information. It has become a national imperative.

502. See Gilmore, *supra* n. 7, § 19.9, at 544-545.

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