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Financing Intellectual Property under Revised Article 9: National and International Conflicts

Lorin Brennan

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Financing Intellectual Property under Revised Article 9: National and International Conflicts

by
LORIN BRENNAN*

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Introduction

Our country is undergoing a sea change as it transits from an industrial to an information economy. The information industries have moved to economic center stage, displacing the manufacturing sector not only in sheer size, but also as the new engine of economic growth and opportunity.¹ The policies underpinning the creation and exploitation of intangible intellectual property, however, differ sharply from those for the manufacture and sale of tangible goods. Trying to force fit intellectual property into the confines of industrial goods law is reminiscent of the ugly sisters of Cinderella butchering their feet to fit slippers never meant for them.

A sad example of this myopia is the revision of Article 9 of the Uniform Commercial Code, commonly called "Revised Article 9" or simply "Revised 9."² In the emerging information economy, secured financing has become a matter of some importance. The companion article, *Financing Intellectual Property Under Federal Law: A National Imperative*,³ discusses how effective financing of copyrights, patents and trademarks under federal law should operate in harmony with state personal property financing laws. In the original Article 9 the need for harmony was understood. It reflected an appropriate partnership between state and federal law.⁴

Revised Article 9 does not reflect such a partnership. The fundamental purpose of intellectual property law is to encourage new works by allowing creators to collect royalties as a reward for creativity. The goal of Revised 9, however, is to allow financiers of

1. Stephen E. Siwek & Gale Mosteller, *Copyright Industry in the U.S. Economy: The 1999 Report* (1998). This Report was prepared by Economists Incorporated for the International Intellectual Property Alliance. A copy is available on-line at http://www.iipa.com/html/reports_by_issue.html (visited May 15, 2000). See The American Law Institute, Proposed Final Draft, *Uniform Commercial Code Revised Article 9*, National Conference of Commissioners on Uniform State Laws Seventy-Fifth Meeting, April 15, 1998.

2. 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, twenty states have adopted Revised 9. For a useful compendium, see *The New Article 9*, prepared by the ABA Business Law Section.

3. See Lorin Brennan, *Financing Intellectual Property under Federal Law: A National Imperative*, 23 Hastings Comm/Ent L.J. 2 (2001) ["Federal Financing"].

4. See Grant Gilmore, *Security Interests in Personal Property*, vol. 1, § 19.9, 544-545 (Little, Brown & Co. 1965) ["Gilmore"] ("[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.").

remote licensees to seize creators' royalties without restraint. The result is a statute out of synch with the new information economy.

Unlike industrial commodities, intangible information is a "public good." For viable markets to exist, the law must protect creators against "free riders" who copy and use information without paying royalties. Free riders are justly categorized as economic parasites, since, by siphoning off the income necessary to encourage creation, they deprive creators, and ultimately the public, of sources of new information. For this reason, the law allows creators various exclusive rights to exploit their information through controlled licensing. There are often tiers of licensees, sublicensees and sub-sublicensees down to the end user. Royalties are remitted from each sublicensee to its sublicensor until eventually returned to the creator. The result is that intellectual property is exploited like real property, with a complex "chain of title" allowing creators to exercise control over remote users, just like the owner of an office building has control over tenants and through them subtenants.⁵

Industrial goods are the opposite. For them, competition is created by driving down manufacturing and distribution costs. The law encourages free alienability of industrial goods, which allows suppliers to compete in bringing the goods to those who will pay the best price. To allow easy transfer it suppresses any concept of a "chain of title."⁶ Once goods are sold, the seller loses the ability to control further resale or use of the goods by the buyer, retaining at best only a right to payment. This approach would be anathema to intellectual property, which must control distribution to direct income back to the creative sector. If buying a DVD movie allowed worldwide broadcasting, or buying a patented drug allowed unrestricted manufacturing and sale, the movie producer or the drug inventor would not be able to recover their costs of production or invention.

Unfortunately, Revised Article 9 insists that the free transferability policy for industrial goods must now apply to intellectual property. It does this by severely restricting a licensor's ability to prevent a forced dedication of its royalties to a licensee's secured lender. When licensing information, the licensor in effect becomes a creditor of the licensee for the royalties. A licensor can, of course, be merely a general creditor, so that its claim to royalties is junior to a licensee's secured creditor. But current law also allows the

5. See Federal Financing, *supra* n. 3, § II.D.2.

6. See Federal Financing, *supra* n. 3, § II.D.3.

licensor mechanisms to perfect its royalty payments ahead of other creditors of the licensee. Revised Article 9 would now systematically eliminate a licensor's ability to do so. The result is that licensees, through the unrestrained use of security devices, can obtain use of royalty income that was otherwise payable to their licensors. When all goes well, there is no problem; but when all goes well, there never is. When something does go wrong, however, a licensor may now find itself unable to collect royalties ahead of the licensee's "floating" lender. The effect is to require licensors to dedicate their creations to licensees with no assurances they will be able to collect royalties for so doing.

Such a major policy shift has deep economic and legal implications. The Drafters of Revised 9 argue that allowing free alienability for security encourages economic efficiency in the distribution of goods, since by encumbering their assets to the hilt debtors can obtain the cash needed to pay their debts. Whatever the correctness of this approach for industrial goods, it does not apply to intellectual property. Allowing a licensee to use *its* assets for collateral is one thing. Saying the licensee must have unrestricted use of the *licensor's* royalties as well is something else entirely. Such a policy encourages licensees to become free riders, putting Revised Article 9 on a collision course with federal information law.

Correcting the problems caused by Revised 9 requires immediate and comprehensive federal intervention. True, federal law preempts many problem areas. But the scope of preemption, especially for income earned outside the United States, is far from complete. To focus the issues involved, Part II contains an executive summary of the conflicting policies that underpin intellectual property law and that are adopted in Revised Article 9. Part III then provides a detailed review of the provisions of Revised 9 that are incompatible with intellectual property law. Part IV concludes an illustration of the effect of Revised 9 on information financing.

I Executive Overview

An examination of information financing must begin with the basic differences between intangible information and industrial goods.

A. Intellectual Property Law

The essential purpose of intellectual property law is to benefit the public by encouraging new creations.⁷ It does this by allowing

7. For copyright, see *Harpers & Row, Publishers, Inc. v. Nation Enter.*, 471 U.S. 539, 558 (1985) (“[I]t should not be forgotten that the Framers intended copyright itself to be the engine of free expression. By establishing a marketable right to the use of one’s expression, copyright supplies the economic incentive to create and disseminate ideas.”); *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975) (“The immediate effect of our copyright law is to secure a fair return for an ‘author’s’ creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good.”).

For patents, see *Bonito Boats Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 150-151 (1989) (“The federal patent system thus embodies a carefully crafted bargain for encouraging the creation and disclosure of new, useful and nonobvious advances in technology and design in return for the exclusive right to practice the invention for a period of years.”); *Dawson Chem. Co. v. Rohm & Hass Co.*, 448 U.S. 176 (1980) (“The policy of free competition runs deep in our law. . . . But the policy of stimulating invention that underlies the entire patent system runs no less deep.”); *Kewanee Oil Co. v. Bicon Corp.*, 416 U.S. 470, 480 (1973) (“The patent laws promote this progress [of Science and the useful Arts] by offering a right of exclusion for a limited period as an incentive to inventors to risk the often enormous costs in terms of time, research and development. The productive effect thereby fostered will have a positive effect on society through the introduction of new products and processes of manufacture in the economy, and the emanations by way of increased employment and better lives for our citizens.”).

For trademarks, see *W.T. Rogers Co., Inc. v. Keene*, 778 F.2d 334, 338 (7th Cir. 1985) (“The purpose [of trademark law] is to reduce the cost of information to consumers by making it easy for them to identify the products or producers with which they have had either good experiences, so that they want to keep buying the product (or buying from the producer), or bad experiences, so that they want to avoid the product or the producer in the future.”).

In general, see *Mazer v. Stein*, 347 U.S. 201, 219 (1954) (“The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance the public welfare through the talents of authors and inventors in ‘Science and useful Arts.’”); *Kewanee Oil Co.*, 416 U.S. at 485 (“Trade secret law will encourage invention in areas where patent law does not reach, and will prompt the independent innovator to proceed with the discovery and exploitation of his invention. Competition is fostered and the public is not deprived of the use of valuable, if not quite patentable, invention.”); *Rockwell Graphic Sys., Inc. v. Dev Indus., Inc.*, 925 F.2d 174, 180 (7th Cir. 1991) (“The future of the nation depends in no small part on the efficiency of industry, and the efficiency of industry depends in no small part on the protection of intellectual property.”) See also Lorin Brennan, *The Public Policy of Information Licensing*, 36 Hous.

creators to realize value by controlling the exploitation of their works, inventions, and marks. Unlike a tangible product, intangible information is not consumed by use. Without legal protection against “free riders,” creators could not survive. As Profs. Landes and Posner explain:⁸

A distinguishing characteristic of intellectual property is its “public good” aspect. . . . In its absence [copyright protection], anyone can buy a copy of the book when it first appears and make and sell copies. The market price of the book will eventually be bid down to the marginal cost of copying, with the unfortunate result that the book will not be produced in the first place, because the author and publisher will not be able to recover their costs of creating the work. The problem is magnified by the fact that the author’s cost of creating the work, and many publishing costs (for example, editing costs) are incurred before it is known what the demand for the work will be. Uncertainty about demand is a particularly serious problem with respect to artistic works. . . . Thus, the difference between price and marginal cost of the successful work must not only cover the cost of expression but also compensate for the risk of failure.

Creators must be able control unauthorized uses for a viable market to exist for their creations.

[C]reators and their potential customers would face a market failure in the absence of a legal rule that requires copyists to seek permission and pay license fees. . . . In a world where lack of legal restraint on copying leads to market failure, authors cannot easily get paid. Yet, if in a world that *has* copying restrictions copyists can form markets, they are not stymied. Rather, markets evolve.

This relationship between creator and copyist represents a classic case of a “prisoner’s dilemma.”¹⁰ Without intellectual property law,

L.R. 61, 74-77 (1999).

8. William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. Legal Stud. 325, 326-327 (1989). [“Landes & Posner”]. See also A. Samuel Oddi, *Un-Unified Economic Theories of Patents – The Not-Quite-Holy Grail*, 71 Notre Dame L.R. 267 (1996); and William M. Landes & Richard A. Posner, *The Economics of Trademark Law* 78 Trademark Reporter 267 (1988); Mark F. Grady, *A Positive Economic Theory of the Right of Publicity*, 1 UCLA Ent. L.R. 97 (1994).

9. Wendy J. Gordon, *Asymmetric Market Failure and Prisoner’s Dilemma in Intellectual Property*, 17 U. Dayton L. R. 853, 854-855 (1991). In this usage, “copying” is shorthand for infringing any of the copyright owner’s exclusive rights. *SOS v. Payday, Inc.*, 886 F.2d 1081, 1085 n. 3 (9th Cir. 1989).

10. The “prisoner’s dilemma” models the situation where two parties are better off cooperating, but would not do so absent a rule mandating it. Without legal protection for intellectual property, “choosing not to be a creator becomes the dominant strategy. The reason is clear. There is a huge potential loss associated with creating, and a huge potential gain associated with copying. Both may opt to be copyists [and get nothing]. After all, zero payoff is better than losing one’s shirt. Yet had both been creators, they would be better off – as would society, their potential customers. To cure this situation, the law creates anti-copying rules, in the forms of doctrines such as copyright, patent, and

neither creator nor copyist has a rational incentive to create, and both suffer. With it, however, creations can flourish and both parties prosper.

[A]uthors typically desire wide dissemination of their work, but want the public to *pay* for the access they receive. To give authors bargaining leverage with which to extract fees, the law gives them the right to exclude that functions in much the same way as do fences, or real property's rights against trespass: These rights gives owners an ability to bar certain uses of their creative work and thus gives them the ability to extract a price from those who wish to use the work.¹¹

Restraining unauthorized use is essential to collect the royalties creators need to cover the costs and risks of new creation.¹²

Few creators have the resources both to make new creations and to bring them to market. Thus, creators often exploit their creations by licensing. There can be tiers of licensees, sublicensees, and sub-sublicensees. They arrange for making necessary physical configurations, advertising and promotion, and generally make the information available to the end user. The end user pays royalties to its sublicensor, who in turns pays a royalty to its licensor, and so on, until income is returned to the creator. The result is a cycle: rights flow from creators through licensees to end users, and royalties flow back from end users through licensors to creators.

An essential part of this cycle is the ability of the "upstream" licensor to negotiate the terms of the use by its "downstream" licensees and the corresponding payment of royalties.¹³ Controlling

misappropriation." Gordon, *supra* n. 9, at 855. For further discussion of the prisoner's dilemma, see Douglas G. Baird, Robert H. Gertner & Randal C. Picker, *Game Theory and the Law*, ch. 6 (Harvard University Press 1994).

11. Gordon, *supra* n. 9, at 855 (emphasis in original).

12. See J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition* § 2.4, at 2-6 (West 2000 ed.) ["McCarthy"] ("In economic parlance, the infringer who 'reaps where he has not sown,' would be known as a 'free rider.' . . . Such a 'free rider' is an economic parasite who must be enjoined by law. If such an infringer is not enjoined, the quality encouragement function [of trademark law] is destroyed.").

13. See e.g. *Brulotte v. Thys Co.*, 379 U.S. 29, 33 (1964), *reh. den.* 379 U.S. 985 (1965) ("A patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly."); *Automatic Radio Co. v. Hazeltine*, 339 U.S. 827, 833 (1949) ("The right to a patent includes the right to market the use of the patent at a reasonable return."); *Waterman v. Mackenzie*, 138 U.S. 252, 260 (1891) ("The right conferred by letters-patent for an invention is limited to a term of years; and a large part of its value consists in the profits derived from royalties and license fees. In analogy to the rules governing mortgages of lands and chattels, and with even stronger reason, the assignee of a patent by a mortgage duly recorded, whose security is constantly wasting by lapse of time, must be held (unless otherwise provided in the mortgage) entitled to grant licenses, to receive license fees and royalties, and to have an account of profits or an award of damages against infringers.").

who exploits a creation, on what terms, for how much money, and with what assurances of payment, is an essential part of what intellectual property law accords to creators.¹⁴ This is often reflected in contractual terms restricting transfer of either party's rights or royalties. There are a variety of reasons why this is done.

Controlling parties: For creators and licensors, it is important to find licensees who will give the best exposure for the highest royalties.¹⁵ For licensees, it is important to recoup the investment in exploitation expenses and to establish brand loyalty by ensuring a continuous supply of desirable creations.¹⁶ Works of the mind are fragile constructs. It is often difficult, if not impossible, to know in advance how the public will respond. Given this uncertainty, the decision about who is the best licensee or what creations are the most desirable is often highly subjective. Intellectual property law leaves these decisions to the individual parties to sort out by enforcing contract terms that prohibit transfer.¹⁷

Controlling arbitrage: Another reason for restricting transfer is to control arbitrage. Given the ease of copying, in many cases the differentiating factor is the scope of the license, not the characteristics of the copy. For example, in *Pro CD v. Zeidenberg*,¹⁸ a vendor provided a database of telephone directories in the consumer market at one price, and in the business market at a much higher price. To control arbitrage, the court upheld that the license limited the consumer version to personal use.¹⁹ Similarly in *Adobe Systems Inc. v.*

14. See Marie T. Reilly, *The Federal Interest in the Transfer of Patent Licenses in Bankruptcy*, 1 J. Bankr. L. & Prac. 6 (Jan./Feb. 2001); Claude E. Barfield and Mark A. Groombridge, *The Economic Case for Copyright Owner Control over Parallel Imports*, 1 J. World Int. Prop. 903 (1998).

15. See e.g. *Delacroix v. Lublin Graphics, Inc.* 993 F. Supp. 74 (D. Conn. 1997) (artist terminated relationship with publisher over concern about amount of royalties and quality of representation).

16. See Meiners & Staff, *Patents, Copyrights and Trademarks: Property or Monopoly?* 13 Harv. J. L. & Pub. Policy 911, 931 (1990) ("A price premium over and above the costs of production (including a normal profit) can create incentives for firms to produce high quality products. These price premiums represent the return to investments in brand-names or trademarks.").

17. E.g. *Third Story Music, Inc. v. Waits*, 41 Cal. App. 4th 798 (1995) (music distributor did not breach of covenant of good faith by refusing to grant license after song writer objected). For a discussion see *infra* n. 254 and accompanying text.

18. *Pro CD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

19. "Competition among vendors, not judicial revision of a package's contents, is how consumers are protected in a market economy. Pro CD has rivals, which may elect to compete by offering superior software, monthly updates, improved terms of use, lower price, or a better compromise among these elements. . . . [A]djusting terms in buyers' favor might help Matthew Zeidenberg today (he already has the software) but would lead

One Stop Micro,²⁰ Adobe provided software for educational use at low prices but restricted re-licensing in the commercial market. One Stop adulterated the educational versions by cutting open the box and removing the "educational use only" labeling, and then disposed of the software in the general market, taking for itself the difference between the lower educational price and higher commercial price. Since without the restrictions Adobe would have no incentive to provide discounted software in the educational markets, the court upheld the license restrictions and found One Stop's conduct infringing.

Unique aspects: Works of the mind are not fungible goods. *Star Wars* is not *Star Man*. *Viagra* is not *Vita-Grow*. "All painters do not paint portraits like Sir Joshua Reynolds, . . . nor do all writers write dramas like Shakespeare or fiction like Dickens. Rare genius and extraordinary skill are not transferable, and contracts for their employment are therefore personal and cannot be assigned."²¹ For a licensee commissioning a new creation, the personal skill of the creator can be a critical factor. A licensee may therefore desire to restrict the creator's ability to squander its royalties through over-encumbrance that reduces the incentive to render future performance. For a licensor, the personal characteristics of a licensee may be equally important for presenting a creation in a fitting light.²² And, of course, a licensor would resist over-encumbrance by the licensee that threatens to deprive the licensor of its royalties.

B. State Commercial Law

State commercial law has a different goal: the free transferability of tangible goods. Free transferability allows owners of goods to negotiate the best price from those who want them most, leading to the most efficient utilization of assets. The Reporters of Revised Article 9 affirm that this principle is a primary motivation for the

to a response, such as a higher price, that might make consumers as a whole worse off." *Pro CD*, 86 F.3d at 1453. For a similar argument, see Frank H. Easterbrook, *The Court and the Economic System*, 98 Harv. L. Rev. 4, 12 (1984).

20. *Adobe Sys. v. One Stop Micro*, 84 F. Supp. 2d 1086 (N.D. Cal. 2000).

21. *Taylor v. Palmer*, 31 Cal. 241, 266 (1866).

22. See e.g. *Kewanee Oil Co.*, 416 U.S. at 486-87 ("A most fundamental human right, that of privacy, is threatened when industrial espionage is condoned or is made profitable."); *Unarco Indus., Inc. v. Kelly Co.*, 465 F.2d 1303 (7th Cir. 1972) *cert. denied*, 410 U.S. 929 (1973) (patent license originally granted because company was "not a serious competitor"); *Gilliam v. Am. Broad. Co.*, 538 F.2d 14 (2d Cir. 1976) (authors of *Monty Python* programs objected to sublicense from BBC to ABC because of intended editing of their work.); *Third Story Music, Inc. v. Waits*, 41 Cal. App. 4th 798 (1995) (songwriter objected to exploitation of his works by formed record company).

revision:

Our normative theory of security interests is grounded on the normative theories that justify the institution of private property. The right to own private property is the bedrock of capitalism and an essential component of a market economy. . . . A central feature of the economic account of property is transferability – free alienability – of property rights, without which resources could not find their way to users who value them more.²³

From this principle derives the notion that a debtor should be allowed to transfer, for security reasons, as many assets as possible. As the Reporters say, “For the most part, the current version of [Revised] Article 9 reflects our position: The law should not impair the ability of debtors to secure as much or as little of their debts with as much or as little of their existing and future property as they deem appropriate.”²⁴ The primary mechanism for allowing the debtor to do so is the floating lien. “A central theme of the Article 9 revision project is to reassert the floating lien by sweeping away some of the limitations the original drafters placed on floating liens.”²⁵ A specific application in Revised Article 9 is to make royalties otherwise payable to intellectual property licensors junior to pre-existing floating liens against licensees.

Of course, too easy an extension of secured credit can disadvantage unsecured creditors. “The ability to victimize involuntary creditors may in significant part explain why secured credit is such a widespread phenomenon. Simply by entering into a security agreement, the debtor and a favored creditor can expropriate for themselves value that, absent the agreement, would go to the involuntary creditors.”²⁶ The result is that debtors, especially those sinking into financial distress, have an incentive to encumber their assets up to and beyond their liquidation value, leaving nothing for the unsecured creditors.²⁷

23. Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtor's Choices Seriously*, 80 Va. L. Rev. 2021, 2047-2049 (1994).

24. Harris & Mooney, *supra* n. 23, at 2021. This argument begs the question whether a licensor's right to royalties under an intellectual property license is or should be an “asset” of the licensee subject to encumbrance, regardless of objection by the licensor.

25. Julian B. McDonald, *Article 9 and the Security Controversy*, in Peter F. Coogan, William E. Hogan, Detlev F. Vagts & Julian B. McDonnell, *Secured Transactions under the Uniform Commercial Code*, § 7.02 (1999 ed.) [“Coogan”] (“Emboldened by their success, the sponsors of the U.C.C. have now proposed a Revised Article 9. A central theme of the Article 9 revision project is to reassert the floating lien by sweeping away some of the limitations the original drafters placed on floating liens.”).

26. Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 Va. L. R. 1887, 1897-1898 (1994).

27. See LoPucki, *supra* n. 26, at 1930-1931: “The express intention of the drafters of

The Reporters for Revised Article 9 concede the problem when a debtor is sinking into bankruptcy.²⁸ Nonetheless, they assert that the widespread availability of secured credit may allow a debtor to obtain the cash necessary to pay off its debts, helping stave off insolvency.²⁹ As Official Comment 8 to Revised 9-408 says, "Compared to the relatively few debtors that enter bankruptcy, there are many more that do not. By making available previously unavailable property as collateral, this section should enable debtors to obtain additional credit."

C. Irreconcilable Differences

Whether or not it is good policy to allow debtors to encumber their tangible assets to the hilt, the policy is inappropriate where intellectual property is concerned. The Reporters for Revised 9 acknowledge as much. Immediately following the statement quoted above, they say:

Nonetheless, some restrictions on alienability actually may promote efficiency. In her study of alienability, Susan Rose-Ackerman explained that "the familiar problems of externality control[,] . . . imperfect information, 'prisoner's dilemmas,' free rider problems, and the cost of administering alternative policies" may each justify appropriate restraints on alienation.³⁰

Intellectual property represents the classic case of "free rider problems" and "prisoner's dilemmas" for which the law has long recognized the need for restrictions on alienability in order to create a market for new creations.³¹ For industrial goods, paying the purchase

Article 9 of the Uniform Commercial Code has been to expand the amount of credit available to debtors by making it easier and less expensive to take security. The drafters also have sought to legitimize the use of virtually every kind of asset as collateral. Once the law authorized the encumbrance of nearly all assets, many kinds of debtors encumbered them. Except among the largest firms, it is a rare debtor that, at the time of liquidation, has assets not encumbered beyond their liquidation value. As every bankruptcy practitioner knows, security tends to expand to the liquidation value of the collateral as a debtor sinks into financial distress."

28. See Coogan, *supra* n. 25, § 7.02[5][b]: "If these impressions of the floating lien in bankruptcy can be confirmed, the shielding effect that prompted the historic resistance to personal property security devices remains alive and well. Indeed, the academic defenders of the floating lien (who also happen to be the reporters for the Article 9 revision) appear to concede how bleak the picture is once the debtor ends up in bankruptcy but rest on the positive effects secured credit can have when firms do not fail."

29. See Harris & Mooney, *supra* n. 23, at 2055.

30. See Harris & Mooney, *supra* n. 23, at 2049.

31. See e.g. *Dawson Chem. Co. v. Rohm & Hass Co.*, 448 U.S. 176 (1980) (stating that without patent law "... noninventors would be almost assured of an opportunity to share in the spoils, even though they had contributed nothing to the discovery"); *Kenner Parket Toys, Inc. v. Rose Art Indus., Inc.*, 963 F.2d 350 (Fed. Cir. 1992) ("Both the mark's fame

price recoups the seller's value in that item. But for intellectual property, the cost of a single copy does not recoup the value of the intangible information. The real value comes in the research and development costs inherent in creativity; free riding by end users does not encourage competition in creativity but, by feeding on the revenues it needs to thrive, destroys it. As Baudelaire put it, "God has driven us to create, but Nature has contrived that to do so we must eat, three times a day."

Unfortunately, the Drafters of Revised 9 decided to subject intellectual property to the same unrestrained transferability rules as tangible goods after all. They elected to "make the value of otherwise nonassignable rights under a license available to licensees so they can obtain more credit (and be more likely to pay their debts, including license fees)."³² Such a rule, they said, "reflects the strong public policy in favor of the assignability of the right to receive money because this enhances the value of the account as collateral (to the benefit of the debtor and the account debtor)."³³ Indeed, they assert that receiving royalties is no longer something a creator is entitled to expect. "Once the licensee's rights have been transformed into money, the licensor no longer has an intellectual property interest to protect. If the licensee does transfer its rights . . . the secured party is entitled to enforce its security interest in the *proceeds* generated by the transfer of the licensee's rights."³⁴ "Grabbing the proceeds," as the

and the consumer's trust in that symbol . . . are subject to exploitation by free riders."); *Scandia Down Corp. v. Euroquilt, Inc.*, 772 F.2d 1423, 1430 (7th Cir. 1985) ("The more valuable the trademark, the more other firms will be tempted to take a free ride. . . . As marks become less use for identification, search, and hostage purposes, firms invest less in them, and consumers suffer.").

32. Steven O. Weise, *The Financing of Intellectual Property under Revised Article 9*, 74 Chi.-Kent L.R. 1077, 1089, 1093-1094 (1999). Such "nonassignable rights" are of course assignable with consent of the licensor, but usually in consideration of royalties.

33. Weise, *supra* n. 32, at 1089. This alleged "strong public policy," if it even exists, arises for the sale of industrial goods, not the exploitation of intellectual property. See Shubha Ghosh, *The Morphing of Property Rules and Liability Rules: An Intellectual Property Optimist Examines Article 9 and Bankruptcy*, 8 Fordham Int. Prop. Media & Ent. L.J. 99, 172 (1997) ("Advocates of article 9 or bankruptcy law reform generally ignore the effects their reform will have on intellectual property because they address the issue solely from the perspective of the secured creditor and the debtor. This approach is flawed because the success of any reform proposal will depend on a full understanding of the intricate conflicts between intellectual property law, bankruptcy law, and secured credit law.").

34. Weise, *supra* n. 32, at 1096 (emphasis in original). But see *Chem. 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.*

Drafters now christen it,³⁵ is deemed a “strong public policy” to which a licensor can not object. Indeed, the Official Comments assert that information creators have “no rational basis” for objecting to a licensee security interest that necessarily stands ahead of, and can thus deprive them of, any royalties due from the exploitation of their creations.³⁶

Undoubtedly, there are cases where readily available secured credit can provide needed working capital. But cash hides many sins, and in a declining enterprise too easy cash merely delays the inevitable. There is a difference between funding growth and fueling a Ponzi scheme.³⁷ The real question is who decides. Under current law, the parties do. The ability to earn royalties is an essential part of the bargain intellectual property accords to creators. Thus, a creator may grant a license in exchange for an unsecured claim for royalties.³⁸ Alternatively, the creator may insist on security from a financially shaky licensee. These decisions are made at each stage as rights are transferred from licensor to licensee. In each case, the parties negotiate who will bear the credit risk. This best promotes the societal goal of encouraging new creations by allowing the parties to decide themselves how to cover the risks of creativity.

Revised 9 would now strip the royalty proceeds from the

46 F. Supp. 402, 405 (D. Del. 1942) (same); *Estate of White*, 84 Cal. App. 2d 409, 413 (1948) (bequest of common law copyright carried with it right to royalties by implication).

35. Weise, *supra* n. 32, at 1096.

36. Official Comment No. 6 to Revised 9-408.

37. A Ponzi scheme “refers to an investment scheme in which returns to investors are not financed through the success of the underlying business venture, but are taken from the principal sums of newly acquired investments. Typically, investors are promised large returns for their investments. Initial investors are actually paid the promised returns, which attract additional investors.” *In re Hedged-Investments Assoc., Inc.*, 48 F.3d 470, n. 2 (10th Cir. 1995). The term comes from the “remarkable, criminal financial career” of one Charles Ponzi, who in the 1920s duped investors of more than \$14,000,000 in a fraudulent pyramid marketing scheme, colorfully described in *Cunningham v. Brown*, 265 U.S. 1 (1923). A Ponzi is the epitome of a financial swindle with no economic substance. See David Gray Carlson, *Secured Lending as a Zero-Sum Game*, 19 Cardozo L. R. 1635 (1998) (arguing that classical zero-sum analysis of secured credit is actually modeling a Ponzi scheme.).

38. For example, a motion picture producer may acquire rights in a novel, intending to spend considerable sums producing and exploiting a movie derived from it. The producer may therefore insist on an irrevocable assignment and the author’s agreement that any royalty payments will merely be general claims against the producer. The author may find this acceptable, especially if the producer is a major company and is making significant up-front payments. See e.g. *Fosson v. Palace (Waterland), Ltd.*, 78 F.3d 1448, 1454-55 (9th Cir. 1996) (recording contract). Similarly, an exclusive licensee may desire a security interest in its rights to protect against termination in case of the licensor’s bankruptcy. See *Recorded Picture Co. v. Nelson Ent., Inc.* 53 Cal. App. 4th 350, fn 2 (1997).

informational rights and make them available to a licensee's lender regardless of the deal with the licensor. A landlord could not accept a regime that says lease the room but do not collect the rent. Yet under Revised 9:

- Revised 9-102(a) now treats intellectual property royalties as accounts that must be perfected under the filing rules in Revised 9. This means a prior "floating lien" against a licensee will take priority over a licensor's right to royalties under Revised 9's "first to file or perfect" priority rules. Without purchase money status, the licensor cannot obtain priority unless it begs the licensee's lender to subordinate.³⁹
- Although a seller of goods can protect its right to receive payment ahead of a prior "floating lien" against its buyer with a purchase money security interest, Revised 9-103 prohibits information licensors from claiming purchase money status.
- Under current law, a creditor of a licensee takes any intellectual property license subject to the licensor's royalty obligation. Under Revised 9-102(a)(6) & 9-307(c) for the licensor to take priority over the creditors of licensees now requires filing against each licensee where ever it is "located," including filing against many international licensees remitting royalties to the United States in their home countries.
- Revised 9-316 further provides that any attempt by a licensor to secure its claim to royalties against a licensee's creditors only endures for one year unless the licensor files against every licensee wherever it is "located" worldwide. Failure to do so invalidates the licensor's security position not only prospectively but also retroactively.
- Under Article 2-210, a seller of goods can enforce restrictions on a buyer's security assignment of its executory contractual rights, allowing sellers to obtain assurances of payment before performance. Revised 9-408 denies this protection to licensors, allowing licensees to assign rights under executory contracts despite contract

39. "The Drafting Committee considered whether to extend superpriority to PMSIs in software generally. The Drafting Committee decided not to do that. If a secured party that has a security interest in software desires superpriority, it can seek to obtain a subordination agreement with the prior secured party." Weise, *supra* n. 32, at 1103.

language to the contrary or a material impairment of the licensor's rights.

- Under current law, a licensor can cancel an exclusive license for material failure to pay royalties when due. Revised 9 now purports to reclassify assignments and exclusive licenses of information as “really” security interests that can only be “foreclosed” under the rules in Revised 9, a result that could impair a licensor's ability to cancel an intellectual property license even for material breach.
- Under current law, licensors of software can rely on filing in the Copyright Office to establish priority in their rights and royalties. Revised 9 now purports to allow secured lenders to perfect a security interest in a *copyright* merely by taking possession of a copy of the software (“embedded software”) or the record evidencing the license (“chattel paper”), and prevail even over a prior federal recording.

Since there is little a licensor can do to prevent it, a licensee is both authorized and encouraged to utilize the licensor's royalties to the hilt to fund its own business, even if that means encumbering a failing business beyond its liquidation value. Absent federal preemption, a licensor can only change this result through extraordinary, and oft times futile, efforts. The end result is to direct the income necessary for new creations away from creators and into the hands of secured creditors of remote licensees.

II

What Revised 9 Does to Intellectual Property Financing

Revised Article 9 is a subtle and difficult statute. Many of its changes must be examined individually before a coherent pattern emerges. This Part tries to provide such a look. It begins with a brief review of matters covered more fully in the companion article to set the conceptual framework. The next five sections then discuss problems in the perfection rules for information. The following two sections discuss Revised 9's alteration of the law of assignment for intellectual property. Following that, four sections discuss provisions of Revised 9 that conflict with federal intellectual property law. This Part concludes with some traps in the transition and choice of law rules.

A. An Information Primer

This section briefly reviews matters discussed in greater detail in the companion article, discussing the financing intellectual property under federal law.⁴⁰

"Intellectual property" encompasses a wide variety of interests, which for convenience we will sometimes call "information." For analytic convenience, we can divide information into:

- *Federal Information*, meaning interests under the Copyright Act,⁴¹ the Patent Act⁴² and the Lanham Act;⁴³ and
- *State Information*, meaning purely state interests, such as state trademarks and related franchise rights,⁴⁴ trade secrets,⁴⁵ rights of publicity,⁴⁶ pre-1972 sound recordings,⁴⁷ rights to ideas,⁴⁸ *droit de suite*,⁴⁹ and the like.

Information interests are transferred either by assignment or license. Broadly speaking, an "assignment" is an ownership transfer, and a "license" is a use privilege.⁵⁰ Licenses are further divided into "exclusive," meaning the licensor can not make another transfer within the same scope, and "nonexclusive," meaning the licensor can.⁵¹ For patents, an exclusive license of all three patent rights is treated as a partial assignment; otherwise it is a license.⁵² The

40. See Federal Financing, *supra* n. 3, § II.A & B.

41. 17 U.S.C. §§ 101 *et seq* (1994). To avoid needless detail, this article will not discuss mask works, rights in digital sound recordings, or vessel hull designs.

42. 35 U.S.C. §§ 1 *et seq* (1994). Similarly, a discussion of design patents is omitted.

43. 15 U.S.C. §§ 1005 *et seq* (1994).

44. See McCarthy, *supra* n. 12, *esp.* ch. 18.

45. See generally Roger J. Milgrim, *Milgrim on Trade Secrets*, *esp.* ch. 2 (2000 ed.) ["Milgrim"].

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

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

48. See Nimmer & Nimmer, *supra* n. 47, § 16.01; also Orenstein & Guinn, *supra* n. 46, ch. 1A.

49. See Nimmer & Nimmer, *supra* n. 47, § 8C.04; Liliane de Perredon-Fawcett, *The Droit de Suite in Literary and Artistic Property* (Eng. trans. by Louise-Martin-Valiquette 1991).

50. See J. Thomas McCarthy, *McCarthy's Desk Encyclopedia of Intellectual Property* (1991) (definition of "assignment" and "license").

51. See *I.A.E., Inc. v. Shaver*, 74 F.3d 768, 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.").

52. *Ortho Pharm. Corp. v. Genetics Inst., Inc.* 52 F.3d 1026, 1030 (Fed. Cir. 1995); *Vaupel Textilmaschinen v. Meccanica Euro Italia*, 944 F.2d 870 (Fed. Cir. 1991).

Copyright Act has eliminated this “indivisibility doctrine” for copyrights. An exclusive license is an ownership transfer akin to a patent partial assignment that confers standing on the licensee.⁵³

Unlike tangible goods, information has a *chain of title*. U.C.C. Article 2-401 provides that in a sale of goods “title” passes mandatorily to the buyer upon delivery of the goods. This does not apply to information; termination of a prior transfer terminates all subsequent transfers, making further use infringing.⁵⁴ This means that 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.

An information asset can be financed anywhere in the chain of title. Of course, if the borrower is the initial creator of the information there will be no prior transferors, and if the borrower is the end user there will be no later transferees. However, when taking an information interest as collateral the lender must typically be prepared to “look up” the chain of title to see who has come before, and to “look down” to assure itself of priority in its royalty receivables over creditors of later transferees. Therefore, in information financing transactions, the creditor potentially has four different sources of collateral to consider:

- The transferor’s (debtor’s) interest in the information;
- The transferor’s (debtor’s) royalty income received from transferees (“receipts”);
- The transferee’s interest in the information; and
- The share of transferee’s exploitation income from which royalties are due (“receivables”).

A secured lender needs to perfect its interest in all four. The secured creditor needs to ensure that the debtor owns the information. This requires “looking up” the chain of title by conducting a title search – just like a real estate lender does. The lender must then perfect its security interests against the information rights that the debtor owns (Item 1) and ensure that it has priority in royalties received by the debtor (Item 2) over other creditors of the debtor, including any bankruptcy trustee. The lender also wants to ensure that it has priority over the information interest granted to subsequent transferees (Item 3) and priority over other creditors of the transferee in collecting the share of any exploitation income

53. 17 U.S.C. § 201(d)(2); see Nimmer & Nimmer, *supra* n. 47, § 10.02[A].

54. See Federal Financing, *supra* n. 3, § III.D(3).

earmarked as royalties (Item 4).

In this scheme, it is transferees that have the due diligence burden of searching the chain of title to determine ownership. They get the benefit when they in turn become transferors. This is necessary to fulfill the basic purpose of intellectual property law of protecting against free riders. As we will see, Revised 9 tries to turn this process on its head.

B. R 9-317(d): Priority Rules and Secret Liens

1. Original Article 9

The most ancient tenet of commercial finance law has been the need to avoid secret liens.⁵⁵ For nonpossessory interests, this happens through the public filing systems. These systems establish a priority line-up so the public user can know: "Who's on first?" For security interests in informational rights, original Article 9 uses a simple set of rules to do so.

Current 9-201

Except as otherwise provided by this Act a security interest is effective according to its terms between the parties, against purchasers of the collateral and against creditors.

Current 9-301

(1) Except as otherwise provided in subsection (2) [for purchase money interests], an unperfected security interest is subordinate to the rights of

- (a) persons entitled to priority under section 9-312 [for conflicting security interests];
- (b) a person who becomes a lien creditor before the security interest is perfected; . . .
- (d) in the case of accounts, general intangibles and investment property, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

Under original Article 9-302, filing a financing statement is necessary to perfect all security interests unless an exception applies. Putting aside for the moment where the filing must be done, under Article 9-301 a security interest in informational rights must be perfected by a public filing to gain priority over other security interests, lien creditors and *bona fide* transferees. Original Article 9 did not classify royalties as "accounts," so a "sale" (executed assignment) of royalties is outside of original Article 9.⁵⁶

55. See Federal Financing, *supra* n. 3, § III.A(1).

56. See Federal Financing, *supra* n. 3, § III.B(3).

2. *Revised Article 9*

Revised 9, while starting off in the same place, veers off in a different direction. Its priority provisions read:

Revised 9-201

(a) Except as otherwise provided in this code, a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.

Revised 9-317

(a) A security interest or agricultural lien is subordinate to the rights of:

- (1) A person entitled to priority under Section 9-322 [for conflicting security interests]; and
- (2) A person that becomes a lien creditor before the earlier of the time the security interest or agricultural lien is perfected or a financing statement covering the collateral is filed.
- (d) A licensee of a general intangible or a buyer, other than a secured party, of accounts, electronic chattel paper, general intangibles, or investment property other than a certificated security takes free of a security interest if the licensee or buyer gives value without knowledge of the security interest and before it is perfected.

Although Revised 9-201(a) continues original Article 9-201 unchanged, Revised 9-317(d) makes a significant change from original Article 9-301(1)(d). For many transfers of informational rights, it apparently reverts to the "secret lien" regime under the pre-Code validation statutes.⁵⁷

3. *Detailed Analysis*

Revised 9-317(d) could have continued the language in original Article 9-301(1)(d) and referred to a "transferee" of a general intangible. Instead it refers only to a "licensee" and a "buyer." Does either one include an "assignee?" There is good reason to believe they do not, at least for executory assignments. If not, then such an "assignee" would not take free of an unperfected security interest, but instead be subject to it under Revised 9-201(a).⁵⁸

a. Assignees Are Not "Licensees"

Since Revised Article 9 omits any definition of "license," under Revised Article 9-102(c) one must look to general principles of law

57. See Federal Financing, *supra* n. 3, § III.A(1).

58. Revised 9-201(a) refers to "purchasers" of collateral, while Revised 9-317 refers to "buyers." A "buyer" is not a "purchaser," since a "purchaser" includes secured creditors. See UCC Article 1-201 (32) & (33). Does the term "purchaser" include an assignee under an executory contract? Revised 9 gives no answer.

under UCC Article 1-103. Under long settled law, a “license” is not an “assignment.”⁵⁹ An assignment is an ownership transfer; a license is a use privilege. In some situations an exclusive license can be treated as an ownership transfer akin to a partial assignment, such as an exclusive license of all three patent rights or of a divisible copyright interest. Whether these are “licenses” under Revised 9 we do not know. But an ownership transfer (assignment) is not a use privilege (license).

b. Assignees Are Not “Buyers”

A more complicated question is whether a “buyer” includes an “assignee.” In a strict sense, intellectual property is not “sold”⁶⁰ although parties sometimes speak of “selling” information interests.⁶¹ As far as Revised 9 goes, it appears that the term “buyer” is only intended to apply, at most, to assignees under executed assignments, not under executory ones. The reason comes from the way Revised 9 deals with *Octagon Gas Systems, Inc. v. Rimmer*.⁶²

In the 1980s, a type of financing called “securitization” arose.⁶³ Basically, an “originator” company transfers accounts to a “special purpose vehicle” (“SPV”). The SPV then issues securities on the capital markets to pay for them. The trick is to categorize the transfer to the SPV as a “sale,” i.e., an executed assignment, on the theory that a fully executed transaction is immune from challenge in the originator’s bankruptcy.⁶⁴ Proponents argue securitization allows an

59. See *supra* n. 50 and accompanying text. The proposed Uniform Computer Information Transactions Act does define “license” as a generic term that includes “assignments.” UCITA § 102(a)(37). However, this was an express statutory definition to simplify the drafting, and the statute takes care not to confuse assignments with licenses, using terms like “transaction” or “transfer” where necessary to do so.

60. See e.g. *Burkert v. Petrol Plus of Naugatuck, Inc.*, 216 Conn. 65 (1990) (trademark licensor not a “seller” within meaning of state Product Liability Act); also Lorin Brennan, *Why Article 2 Cannot Apply to Software Transactions*, 38 Duq. L.R. 459 (2000).

61. *Adobe Sys. Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086, 1091 (N.D. Cal. 2000) (acknowledging that trade usage commonly uses sales terminology in software licensing agreements because the terms are convenient and familiar, but that all parties understand that the software is licensed, not sold).

62. *Octagon Gas Sys., Inc. v. Rimmer*, 995 F.2d 948 (10th Cir. 1993).

63. See Steven L. Schwarcz, *The Impact on Securitization of Revised UCC Article 9*, 74 Chi.-Kent L.R. 947, 947–948 (1999).

64. See 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.R. 397, 457 (1994) (“To obtain the necessary rating [for the SPV to issue securities], there must be a true sale of the receivables from the originator to the bankruptcy-remote entity or trustee. The structure must ensure that the receivables would not be considered part of the bankruptcy estate of the originator if they were to file for

originator to obtain financing otherwise unavailable or at lower rates.⁶⁵ Detractors argue it is an end-run around bankruptcy policy.⁶⁶ In any case, securitization blossomed.

Then came *Octagon Gas*. A gas company made an absolute, perpetual assignment of a percentage royalty in mineral rights to Rimmer, who never filed a financing statement. The gas company went bankrupt and sold its assets to a third party in reorganization. The issue was whether the third party could avoid the royalty. Rimmer argued that he “bought” the royalty, so the gas company no longer held an interest that passed to its bankruptcy estate. The Tenth Circuit disagreed. It held that mineral rights following extraction constitute a “good,” so that the royalty was an “account” under Article 9. Thus, “Article 9’s treatment of accounts sold as collateral would place Rimmer’s account within the property of [the] bankruptcy estate.”⁶⁷ This would potentially allow the trustee to reject the assignment to Rimmer as an executory contract.

The response from the financing community was little short of apoplectic.⁶⁸ Therefore, the Drafters of Revised 9 therefore set out to ensure that *Octagon Gas* would not impair securitization. To this end, Revised 9-318(a) says “a debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain any legal or equitable interest in the accounts sold.”⁶⁹ This was intended to “drive the final nail into the *Octagon* coffin” by eliminating the “‘rarified’ argument that *Octagon* was correctly decided because certain limited property interests may remain with the originator after the sale of financial assets.”⁷⁰ As a result, for purposes of Revised 9 a “buyer” is a party who takes under a fully executed assignment.

Where information is concerned, however, in many assignments the assignor does retain significant interests in the assigned information, a matter discussed further below.⁷¹ The result is that

bankruptcy.”).

65. See Schwarcz, *supra* n. 63, at 948.

66. See David Gray Carlson, *The Rotten Foundations of Securitization*, 39 Wm. & Mary L.R. 1055, 1106 (1998).

67. *Octagon Gas*, 955 F.2d at 954. Under original Article 9-106, an “account” is “any right to payment for goods sold,” so classifying the mineral rights as a “good” was critical to the court’s reasoning.

68. See Plank, *supra* n. 64; but see Carlson, *supra* n. 66 (arguing *Octagon Gas* wrongly decided).

69. See Schwarcz, *supra* n. 63, at 947-948.

70. See Schwarcz, *supra* n. 63, at 952. The “rarified” argument comes from Carlson, *supra* n. 66, at 1088-1016.

71. See *infra* § III.G below and text accompanying n. 231, *infra*.

many assignments are executory and subject to rejection under Section 365(a) of the Bankruptcy Code.⁷² Whether a contract is executory for this purpose is a matter of federal law.⁷³ Courts relying on the "Countryman Test" find a contract is executory if breach of the remaining obligations by *both* parties would constitute a material breach.⁷⁴ An outright assignment of all rights worldwide in perpetuity is treated as full performance by the transferor and hence not executory, even if the transferee owes on-going royalty obligations.⁷⁵ On the other hand, if the transfer grants exclusive rights for a limited media, territory or term, the transferor's on-going obligation to refrain from granting to others and to defend the transferee from infringement, and the transferee's on-going obligation to account and pay royalties, makes the contract executory.⁷⁶ The case law has not differentiated between an executory exclusive license and an executory partial assignment, but one can expect that they will be treated under the same rules. After all, section 365(a) refers to an executory "contract," which certainly covers assignments as well as licenses.⁷⁷ And the courts have held that whether a contract is executory turns on the rights and duties of the contracting parties, not the characterization of the instrument.⁷⁸ An influential decision, *In re*

72. For an extended analysis see Moore, *supra* n. 401, at 580-588.

73. See *In re Quintex Ent., Inc.*, 950 F.2d 1491, 1495 (9th Cir. 1991); *In re Wegner*, 839 F.2d 533, 536 (9th Cir. 1988).

74. *Quintex*, 950 F.2d at 1495 ("Thus, we will only consider a contract executory if material unperformed obligations remain for both parties.") See Moore, *supra* n. 401, at 581 (discussing "Countryman Test").

75. See e.g. *Quintex*, 950 F.2d at 1497 (fully performed actor's contract granting worldwide perpetual rights not executory despite royalty obligations); *Chesapeake Fiber Packaging Corp. v. Sebro Packaging Corp.*, 143 B.R. 360, 365 (D. Md. 1992) (patent assignment not executory despite on-going royalty obligations); *In re Learning Publications, Inc.*, 94 B.R. 763 (Bankr. M.D. Fla. 1988) (assignment of worldwide perpetual rights in book not executory); *In re New York Shoes, Inc.*, 84 B.R. 947, 960 (Bankr. E.D.Pa. 1988) (trademark license); *In re Stein & Day, Inc.*, 81 B.R. 263 (Bankr. S.D.N.Y. 1988) (copyright assignment).

76. See *Quintex*, 950 F.2d at 1496 (motion picture license for limited term, with duty by licensor not to license to others and to supervise colorization of films, and by licensee to pay royalties, executory); *In re Select-A-Seat Corp.*, 625 F.2d 290 (9th Cir. 1980) (exclusive software license executory); *In Re Biopolymers, Inc.*, 136 B.R. 28 (Bankr. D. Conn. 1992) (patent license); *In re Three Star Telecast, Inc.* 93 B.R. 310 (D. Puerto Rico 1988) (exclusive television broadcast license); *In re New York City Shoes, Inc.* 84 B.R. at 960 (Bankr. E.D. Penn. 1988) (exclusive trademark license); *In re Best Film & Video Corp.* 46 B.R. 861 (Bankr. E.D. N.Y. 1985) (exclusive movie distribution contact).

77. See e.g. *In re Braley*, 39 B.R. 133 (Bankr. D. Vt. 1984) (assignment of proceeds executory).

78. See *Quintex Ent.*, 950 F.2d at 1496.

*Drexel Burnham Lambert Group, Inc.*⁷⁹ rejected the Countryman Test, holding that whether a contract is executory turns solely on the unperformed obligations of the debtor. If this decision is followed generally, then even a worldwide, perpetual assignment of all rights can be executory as to an assignee that owes on-going royalty obligations.

If a contract is executory, then the trustee can accept or reject the contract for the benefit of the estate. *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*⁸⁰ allowed the trustee for a bankrupt licensor to reject an executory technology license saying: “[the licensee] would be entitled to treat rejection as a breach and seek a monetary damages remedy; however, it could not seek to retain its contract rights in the technology by specific performance even if that remedy would ordinarily be available in this type of contract.”⁸¹ In response, Congress added Section 365(n) to the Bankruptcy Code, allowing a licensee to retain its rights under certain conditions.⁸² Section 365(n), however, only refers to a license, not an assignment, and there could be a difference.⁸³ In any case, Section 365(n) does not apply where the transferee is the bankrupt.

This means that in an executory assignment, the assignor does retain an interest in the information that may be affected by the assignor’s bankruptcy, just as *Octagon Gas* said a seller of accounts

79. *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 687 (Bankr. S.D.N.Y. 1992).

80. *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985).

81. *Id.* at 1048. The license in *Lubizol* was nonexclusive. However, *Lubizol* relied on *In re Select-A-Seat Corp.*, 625 F.2d 290 (9th Cir. 1980) (holding that under the prior Bankruptcy Act, that an executory *exclusive* software license could be terminated by the trustee for a bankrupt licensor).

82. 11 U.S.C. § 365(n) (1994). Section 365(n) does not extend to trademarks, trade names or service marks due to Congress’ belief that such licensing relationships needed more study. Collier on Bankruptcy ¶ 365.14[e] (15th ed. rev. 1999). Section 365(n) is largely untested. One problem is that the definition of “intellectual property” in 11 U.S.C. § 101(E) only refers to a “work of authorship protected under title 17.” It is unclear if this applies outside the U.S. (e.g. to a transfer of a copyright interest in France) or whether a “world-wide” assignment can be severed, allowing the trustee to terminate at least as to the non-U.S. rights.

83. Sen. Rpt. 100-505, at 4 (Sept 14, 1998): “When intellectual property is assigned rather than licensed, the original creator loses his personal stake. The licensee or assignee frequently is interested in the intellectual property for a specific application or geographic market. In order to assure the continued availability of the intellectual property against the contingency of the creators’ bankruptcy, however, the party seeking the intellectual property for limited use must demand assignment of the property, notwithstanding that a license of the property would otherwise serve his purpose. The creator then is either totally alienated from his creation or, at best, given a license by the assignee.” It is clear from the context that the Senate Conferees are speaking of patents.

may retain an interest in the accounts affected by the seller's bankruptcy. Since the definition of "buyer" in Revised 9-318(a) is intended to reverse *Octagon Gas*, and since it omits general intangibles, what does this mean for a "buyer" in Revised 9-317(d)? Is a "buyer" of accounts the same as a "buyer" of general intangibles? As one commentator observed:

There is, however, a potential ambiguity in the language of Revised section 9-318(a). By stating that a 'debtor that has sold an account . . . does not retain a legal or equitable interest in the collateral sold,' it invites a court to find that where the debtor is in fact shown to have retained a legal or equitable interest, there is no sale under state law.⁸⁴

It would thus appear that, if the assignment is executory, there is no "sale," and hence no "buyer."

On the other hand, maybe "buyer" means one thing for accounts and another thing for general intangibles. But using "buyer" to mean two different things in the same statutory provision violates a fundamental drafting rule of using words in their ordinary meaning.⁸⁵ Moreover, the meanings are direct opposites. For accounts, a buyer would mean someone who leaves no legal or equitable interest with the assignor, whereas for general intangibles it would include someone who does. If the Drafters intended "buyer" to have this Janus-like quality, they gave not a hint in the statutory text or Official Comments. To the contrary, they repeatedly emphasized the need for clarity in drafting and the use of plain English.⁸⁶

84. See Schwarcz, *supra* n. 63, n. 31. Prof. Schwarcz also argues that Revised 9-401(a), which says whether collateral may be voluntarily or involuntarily transferred is governed by law outside Revised 9, makes clear the categorization of the transaction is not effected by the definition in Article 9 that a security interest includes a sale of accounts. See Schwarcz, *supra* n. 63, at 952. However, Revised 9-401(a) refers to *transferability* of the intellectual property interest, not whether the assignor retains an interest in the first place.

85. See Plank, *supra* n. 64, at 399-400: "Legal writing, like all writing, is best when the writer follows well-recognized principles. This is especially true and perhaps more important for drafting statutes that regulate the lives and livelihood of millions of people and businesses. One of these fundamental principles is the principle of normal usage: the drafter of legislation should use words in the sense that the audience would normally attribute to them. . . . In other words, one should not define the term 'cow' to include a horse."

86. Louis F. Del Duca, Vincent C. DeLiberato, Jr., David L. Hostetter, Kenneth C. Kettering & Steven O. Weise, Symposium, *Simplification in Drafting - The Uniform Commercial Code Article 9 Experience*, 74 Chi.-Kent L.R. 1309 (1999); Steven L. Schwarz, *A Fundamental Inquiry into the Statutory Rulemaking Process of Private Legislatures*, 29 Ga. L. Rev. 909, 928 (1995) ("A statute . . . governing commercial law . . . should be clear. Clarity is important to minimize mistakes, ambiguities, and resulting disputes and litigation. Clarity also helps to preserve expectations, which is essential to market transactions.").

In a sale of accounts, as in *Octagon Gas*, there are two different contacts: the contract creating the account, and the contract assigning that account. It is quite possible for the assignment to be a “sale,” *i.e.*, executed, while the underlying account is not. For an executory information assignment, however, there is only one contract - the assignment itself. Revised 9-317(d) has collapsed these two different contracts, and apparently consciously so. During the drafting process, the Drafters claimed that assignments and exclusive licenses of intellectual property were “really” security interests. In this view, all transfers of intellectual property fall into only three categories: a non-exclusive or “true” license, an executed assignment or “sale” and a “security interest.” Revised 9-317(d) then covers the “true” license and sale cases, and Revised 9-322 allocates priorities among security interests. Revised 9-317(d) does not address executory information assignments, because, for Revised 9, they do not exist. Other language is consistent with this approach. “Account” in Revised 9-102(a)(2) refers to property “sold, leased, licensed, assigned or otherwise disposed of.” Revised 9-617 refers to a “transferee” on foreclosure, thus including both an “assignee” and a “licensee.” Revised 9-505 lists words the statute considers equivalent to “buyer;” “assignee” is not among them. This demonstrates that Revised 9 can, and does, distinguish a “buyer” from an “assignee” when it means to do so.

c. The Resurrection of Secret Liens

The canard that information assignments and exclusive licenses are “really” security transfers is discussed below.⁸⁷ If it is wrong, then executory information assignments are not within Revised 9-317(d). This means that under Revised 9-201 a security interest is perfected in the informational rights under an executory assignment and against further executory assignments of those rights without the necessity of filing. This is not unprecedented. After *Klauder*⁸⁸ numerous states enacted validation statutes providing that an assignment of accounts was perfected when made without need of a filing.⁸⁹ Indeed, for more than a decade, California, no slouch where intellectual property is concerned, said that an assignment of a right to payment for common law literary and artistic property was perfected without filing.⁹⁰ One

87. See *infra* n. 231, and accompanying text.

88. *Corn Exch. Natl. Bank and Trust Co. v. Klauder*, 318 U.S. 434 (1943).

89. See Gilmore, *supra* n. 4, § 8.7, discussing *Klauder* and the subsequent validation statutes.

90. See Federal Financing, *supra* n. 3, § III.B.(2).

could argue that Revised 9 has merely, albeit inexplicably, reverted to this regime for information. But it does raise problems.

The first is with state information. State trademark registers typically provide that an assignment is invalid against a *bona fide* transferee unless registered with the Secretary of State.⁹¹ Assume the owner of a state trademark makes a secret security assignment of the mark, and then later makes an executory assignment to an ignorant third party who records in the state trademark register. The secured creditor forecloses. Who owns the trademark, the transferee at the foreclosure sale of the "secret" lien, or the recording executory assignee? Under Revised 9, apparently the foreclosure sale transferee does. As a result, state trademark registers may no longer be reliable sources of information about who owns the mark.

The second problem is with federal information. The validation statutes never applied to federal interests. A state statute that now asserts that a security interest in federal information is effective without a filing runs directly counter to federal policies against secret liens.⁹² Indeed, unlike simple accounts, intellectual property often has an elaborate chain of title, such that foreclosure of any prior interest would wipe out a junior transfer.⁹³ Under Revised 9, foreclosure of a prior secret security interest would trump a later executory assignment. Under current law, this result would be preempted for copyrights, and, arguably, for patents. Federal trademarks are another matter. The courts holding that security interests in federal trademarks are only perfected under state law have potentially allowed Revised Article 9 to gut the Lanham Act.

Finally, there is bankruptcy law. Section 548 of the Bankruptcy Code allows the trustee to avoid fraudulent transfers comparable to the Uniform Fraudulent Transfers Act.⁹⁴ Since *Twyne's Case*, secret liens have been one of the "signs and marks" of fraud.⁹⁵ If Revised 9-317(d) now allows a secret information security interest against an executory assignment without a filing, the security interest may be subject to attack under Section 548. Of course, it might be argued that

91. See McCarthy Trademark, *supra* n. 12, ch. 22, discussing Model State Trademark Act.

92. See e.g. *Yamamoto & Co. (Am.) Inc. v. Victor United, Inc.*, 219 U.S.P.Q. 968, 980 (C.D. Cal. 1982) (undisclosed private letter agreement for recapture of trademark in case of default by assignee a fraud on creditors.).

93. See Federal Financing, *supra* n. 3, § III.D.(3); also *infra* n. 302, and accompanying text.

94. See generally 5 *Collier on Bankruptcy* ¶ 548.1 *et seq.* (15th rev. ed. 1997 Lexis Publishing).

95. See Federal Financing, *supra* n. 3, § III.A.

the old validation statutes did not require a filing for an assignment of accounts, so eliminating a filing is not fraudulent *per se*.⁹⁶ The bankruptcy courts will need to decide that. Note that the secured creditor cannot insulate itself from such an attack by filing the security interest anyway. If a statute does not require a document to be filed, then its filing does not impart constructive notice.⁹⁷ If Revised Article 9-317(d) does not require a filing, then filing will not insulate the secured creditor from a federal fraudulent conveyance attack.

The distinctions between licensee, buyer and executory assignee may appear to be nitpicking. If so, it is the courts who have insisted on it. *Security National Bank & Trust Company v. Dentsply Professional Plan*⁹⁸ illustrates the judicial attitude:

Although strict adherence to [UCC] requirements may at times lead to harsh results, efforts by courts to fashion equitable solutions for mitigation of hardships experienced by creditors in the literal application of statutory filing requirements may have the undesirable effect of reducing the degree of reliance the market place should be able to place on Code provisions. The inevitable harm doubtless would be more serious to commerce than the occasional harshness from strict obedience.

The courts have routinely held that Article 9 must be strictly interpreted to avoid uncertainty and to prevent prejudice to third persons.⁹⁹ The commercial bar has long agreed.¹⁰⁰

96. As discussed in Federal Financing, *supra* n. 3, § III.G(2), the decision in *City Bank & Trust Co. v. Otto Fabric, Inc.*, 83 B.R. 780, 782 (D. Kan. 1988), indicates that a security interest in a patent is perfected against a bankruptcy trustee without the need of either state or federal filing. See also Barkley Clark, *The Law of Secured Transactions under the Uniform Commercial Code*, ¶ 1.08[a][1][g], at 1-91 (rev. ed. Warren Gorham Lambert 1993). As discussed in the text following notes 169, *infra*, the Drafters' intended to incorporate the *Otto Fabric* result in Revised 9-311(a)(1). Revised 9-317(d) would continue this policy. If the assignment is treated as non-executory, then the lender's collateral – the assignee's interest – is not affected. If the assignment is treated as executory and the trustee tries to reject, the lender can argue that it has priority over whatever rights revert to the trustee, or other general creditors, regardless of a filing due to Revised 9-317(d). This effectively reads Section 365 out of the Bankruptcy Code.

97. See e.g. *Hall v. Kansas City Terra Cotta Co.*, 97 Kan. 103 (1916); *Am. Solid Leather Button Co.*, 47 F. at 743; 6 Am.Jur.2d *Attachment and Garnishment* § 498 ("Transfers not within a recording statute are not effected by it."); 51 Am.Jur2d *Liens* § 8 ("[T]he mere filing of a lien on the public records does not give constructive notice to anyone, unless such effect is provided for by statute."); 11 Corpus Juris *Chattel Mortgages* § 226 (1917).

98. 617 P.2d 1340, 1343 (Okla. 1980).

99. See Ronald A. Anderson & Lary Lawrence, *Anderson on the Uniform Commercial Code* §§ 9-102:89 (1999 Rev. ed.); *accord Thrift, Inc. v. A.D.E., Inc.*, 454 N.E.2d 878, 882 (Ind. App. 1983) ("A fundamental policy of Article 9 of the U.C.C. is to discourage secret liens.").

The merits and demerits of the validation statutes were extensively vetted before the adoption of original Article 9.¹⁰¹ They need not be repeated here. While such a system may benefit the first assignee, it creates a minefield for the public user trying to discover “Who’s on first?” The federal information statutes show the preferable approach: a centralized national location for federal intangibles where subsequent transferees can find public information about prior transfers and avoid secret liens.

C. R 9-307(c): Filing Confusion – Location of the Debtor

1. Original Article 9

After “Who’s on First?” the next question every secured creditor asks is “Where do I file?” In a good system, the answer should be easy. Under original Article 9, for intellectual property, it is. Under original Article 9-106, intellectual property is classified as a “general intangible.”¹⁰² Article 9-103(3)(b) says for general intangibles:

Current 9-103(3)(b)

The law (including the conflicts of law rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or nonperfection of the security interests in collateral.

Typically, this rule would require filing in the state where the debtor is located. Of course, for federal information or for information interests located in another country, the applicable law may direct filing in the federal information registers or the registers in other countries. We will consider these cases in later sections after reviewing the general rule here.

100. See e.g. Steven L. Schwarcz, *The Impact on Securitization Revised UCC Article 9*, 74 Chi-Kent L.R. 947, 953 (1999) (“Two of the essential goals of a commercial law statute are clarity and simplicity of implementation.”).

101. For a thorough discussion of the debate, see Plank, *supra* n. 64.

102. Under original Article 9-106, general intangibles “means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property, rights to proceeds of written letter of credit, and money.” Prof. Gilmore describes the thinking: “The only real function of all three terms [account, contract right, general intangible] as the Article finally came to be drafted, is to describe intangible rights which cannot be pledged. . . . The third term, ‘general intangibles,’ was introduced relatively late in the drafting process when an astute but friendly critic pointed out that neither ‘account’ nor ‘contract right,’ as defined, described a great many types of intangibles which did in fact serve as commercial collateral: copyrights, patents, . . . rights in literary and artistic property and so on without end.” Gilmore, *supra* n. 4, § 12.5, at 380.

2. *Revised Article 9*

Under Revised 9, a secured creditor must now wade through a bewildering thicket of sections to determine where to file (at least for licenses and executed assignments). On its surface, Revised 9-301(1) continues the “location of the debtor” rule:

Revised 9-301(1)

Except as otherwise provided in this section [the other provisions are inapplicable to intangibles], while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of security interests in collateral.

In application, however, this rule is not as simple as it seems. Revised 9-307 contains a complex set of rules to determine the location of a debtor. The relevant sections are:

Revised 9-307

(b) Except as otherwise provided in this section, the following rules determine a debtor’s location:

(1) A debtor who is an individual is located in the individual’s principal residence;

(2) A debtor that is an organization and has only one place of business is located at its place of business;

(3) A debtor that is an organization and has more than one place of business is located at its chief executive office;

(c) Subdivision (b) applies only if a debtor’s residence, place of business, or chief executive office, as applicable, is located in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest’s obtaining priority over the rights of a lien creditor with respect to the collateral. If subdivision (b) does not apply, the debtor is located in the District of Columbia.

(e) A registered organization that is organized under the law of a State is located in that State.

Putting aside any questions of federal preemption for the moment, under this rule, it appears that security interests in intellectual property collateral held by a variety of debtors must now be perfected under the law of the District of Columbia.

3. *Detailed Analysis*

a. Omission of the *Bona Fide Purchaser*

Original Article 9-103(3)(b) looks to the law where the debtor is located to determine perfection *of the security interest*. By referring

broadly to the security interest, it applies both to a bona fide purchaser and a lien creditor. Revised 9-307(c), however, has omitted the bona fide purchaser from the priority calculus. Instead, the sole test is whether state law “*generally* requires” a filing for “*the* security interest” to obtain priority over “the rights of a *lien creditor* with respect to *the* collateral.” The reference to *the* security interest and *the* collateral makes it clear that “generally requires” applies to the security interest and collateral in question, not to any security interest on any collateral.¹⁰³ This is the crucial point. If Revised 9-307(c) is merely a generalized reference to the fact that the state maintains a filing system for perfecting a nonpossessory security interest in any type of collateral, then Revised 9-307(c) is filled with unnecessary verbiage. But Article 9 must be strictly interpreted. To give effect to the phrase “with respect to the collateral” requires applying the “against a lien creditor” test to *the* collateral covered by the security interest in question, not just any collateral.

Before examining how Revised 9-307(c) works, the first step is to analyze to which debtors it applies. Putting aside the special cases, Revised 9-307 provides for up to three potentially overlapping classes. The first class, under Revised 9-307(e), is a “registered organization,” which Revised 9-102(a)(70) defines as an organization organized in a State in the United States that maintains a public record of the organization. This will typically be a corporation or limited partnership. The second class, under Revised 9-307(b), is any individual or other organization, such as a general partnership, organized in the United States. The third class includes all entities outside the United States. Since the definition of registered organization only applies to entities organized in the United States, this class will also include corporations organized in other countries.

Debtors falling under Revised 9-307(b) are certainly subject to

103. But see Neil B. Cohen & Edwin E. Smith, *International Secured Transactions and Revised Article 9*, 74 Chi.-Kent. L.R. 1191, 1204 (1999), arguing thus: “Revised Article 9 requires a judgment call in order to apply section 9-307(c) – the secured party must decide whether that law *generally* requires public filings or the like as a condition of priority over lien creditors. The qualification inherent in the word ‘generally’ is an important one. After all, even under Original Article 9, not all nonpossessory security interests must be filed; there are several temporary perfection and automatic perfection rules for such interests.” (emphasis in original). Apparently, the “generally” test is not applied to *all* security devices for *all* collateral, but to *all* security devices for *the* collateral. Thus, if in most cases a filing is required for *the* specific type of collateral, the test is met. On the other hand, if in most cases a filing is not required for *the* collateral, then despite a few cases where a filing is required, then test is not met. Indeed, if Revised 9-307(c) did not intend to apply the lien creditor test to *the* collateral, the phrases “of the security interest’s” and “with respect to the collateral” would be extraneous.

the test in Revised 9-307(c). Thus, all individuals – and many creators of information are individuals – as well as sole proprietorships, general partnerships and corporations organized outside the United States are covered. It is unclear whether registered organizations are subject to Revised 9-307(c). One interpretation is that Revised 9-307(e) states an absolute rule independent of Revised 9-307(b), an interpretation supported by the introductory phrase “except as otherwise provided in this section.” Another interpretation is that Revised 9-307(e) merely says that the State of organization is conclusively deemed the “place of business” for registered organization purposes of Revised 9-307(b)(1)&(2), at which point the filing rules in that State are then tested against Revised 9-307(c). While this interpretation is less obvious, it does make the entire section internally consistent. The last sentence of Revised 9-307(c) states categorically, “If subsection (b) does not apply, the debtor is located in the District of Columbia.” If Revised 9-307(e) is independent of Revised 9-307(b), then of course Revised 9-307(b) “does not apply” and a registered organization would not be located in the District of Columbia under Revised 9-307(c), but in its state of organization under Revised 9-307(e). The courts will need to sort out the proper result under the “strict interpretation” policy. Let us call debtors subject to Revised 9-307(c) “covered debtors.”

The Drafters of Revised 9 assert that “[a]ll United States jurisdictions, having adopted Article 9, generally require information concerning the existence of nonpossessory security interests to be made generally available in a filing system as a condition of the secured party’s obtaining priority over a lien creditor.”¹⁰⁴ In support they merely cite to Article 9-301(1)(b). But this overlooks Article 9-301(1)(d). That section says that in the case of general intangibles, an unperfected security interest is subordinate to a *transferee* for value and without knowledge. The priority rules in original Article 9-301 cover both lien creditors and bona fide purchasers. The drafters of original Article 9 adopted the lien creditor concept to accommodate the floating lien, but they realized there were limits to its reach.¹⁰⁵ They adopted a mixed system establishing priority over a lien creditor, a necessary construct for a floating lien, but they continued the historic role of providing priority over the bona fide purchaser where the floating lien was inappropriate. Revised Article 9, in its desire to extend the floating lien, has lost the bona fide purchaser.

104. Cohen & Smith, *supra* n. 103, at 1203.

105. See Gilmore, *supra* n. 4, § 11.7, at 361-364.

Revised Article 9 does not determine how or when a creditor becomes a lien creditor. State enforcement of judgment law does that. How that law operates where information is concerned is discussed at length in the companion article.¹⁰⁶ Since Revised 9 now makes it the litmus test for determining where to file an information security interest against a covered debtor, we need to review it briefly here. Revised 9-102(a)(52) continues the definition of "lien creditor" unchanged from current Article 9-301(3). It basically covers two classes of creditors: (i) judicial creditors who have obtained a lien by attachment, levy or the like; and (ii) insolvency representatives, *i.e.*, the bankruptcy trustee, assignee for the benefit of creditors, and a receiver in equity.

Judicial Creditors: As discussed in the companion article,¹⁰⁷ in many states a judgment creditor cannot lien intangible information by attachment or levy because under local enforcement of judgment law a levy requires the sheriff to take physical possession of personal property, an action that is not possible for an intangible. Federal law also does not allow an involuntary judicial lien because an assignment of federal information requires a writing signed by the information owner or an authorized agent, and a sheriff under a levy does not so qualify. Together these requirements mean that for federal information, and typically state information as well, a judgment creditor must reach information through equitable execution, *i.e.*, by a supplemental proceeding or, in the few states where still available, a creditor's bill. This requires the judgment creditor to bring the debtor into court, have the court order the debtor to transfer the information, and, if the debtor refuses, to appoint a receiver to execute an assignment as an "authorized agent" for the debtor. A creditor utilizing such procedure, however, is not a lien creditor. In most states, use of the supplemental proceeding does not create a lien at all. In a few states the procedure creates the equivalent of an equitable lien, but it is ineffective against prior or subsequent bona fide information security interests without notice, even if unfiled. Such a judgment creditor only perfects its interest by proceeding to judicial sale, at which point the creditor qualifies as a bona fide transferee, not a lien creditor, and can invoke original Article 9-301(1)(d). This means that a filing is typically not necessary to perfect a security interest in information against a *lien creditor*, but is required against a *bona fide purchaser*.

106. See Federal Financing, *supra* n. 3, III.E.

107. See Federal Financing, *supra* n. 3, III.E(3).

Two recent decisions illustrate this result. In *South Bay Enterprises v. Miranda Bay Petroleum*,¹⁰⁸ the inventor of a cleaning solvent had a lien against a licensee to secure the payment of royalties.¹⁰⁹ A judgment creditor with a writ of execution against the licensee returned unsatisfied and claimed nonetheless that it was a lien creditor with priority over the security interest. Not so, said the *South Bay* court. Since the writ of execution was returned unsatisfied, this eliminated the judgment creditor's status as a lien creditor, and the inventor's security interest, though unfiled, had priority.¹¹⁰ *Network Solutions, Inc. v. Umbro International, Inc.*¹¹¹ addressed whether a writ of garnishment could reach a judgment debtor's contract right to a domain name. The court reasoned that since a *fiery facias* cannot reach an intangible patent or copyright, a writ of garnishment can not reach the intangible contract right to a domain name. Thus, a lender loaning to a Web company need not worry that the rights in the domain name will be lost to a later lien creditor (assuming it attaches). The worry is a judgment sale purchaser.¹¹²

Insolvency Representatives: A lien creditor also includes insolvency representatives. As discussed in the companion article,¹¹³ under Section 541(a)(2) of the Bankruptcy Code, for intellectual property the bankruptcy trustee should be treated as an unsatisfied execution creditor who has utilized equitable execution and proceeded to judicial sale. For a state receiver, under state and federal law, intellectual property does not become subject to the

108. 957 S.W.2d 287 (Ky.App. 1997).

109. Unfortunately, the court says only that the inventor had "an unperfected security interest due to the royalty agreement." *Id.* at 288. It does not tell us whether it was treating the royalty obligation itself as a security interest, or whether, as is common in such transactions, the inventor obtained a separate security agreement in the rights granted to the licensee, or other assets, to secure royalties.

110. *Accord In re Baird*, 55 B.R. 316, 318 (Bankr. 1985) (writ of execution returned after automatic stay did not perfect lien against bankruptcy trustee); *In re Wilson*, 38 B.R. 940 (Bankr. 1984) (bankruptcy trustee prevailed over creditor with writ of execution on real property returned unsatisfied).

111. 259 Va. 759, 761 (2000).

112. Code of Virginia § 8.01-501 allows the creation of a lien on intangible property by delivery of a writ of *fiery facias* to the judgment debtor, but the lien is ineffective against an assignee for valuable consideration and without notice. This follows the traditional pattern of an equitable lien that establishes priority over later executing creditors, but not innocent third parties. *In re Dulane*, 29 B.R. 79, 80 (Bankr. 1982) involved judgment creditors who had obtained issuance of writ of *fiery facias* against the accounts (intangibles) of a partnership. The IRS then asserted a tax lien. The court held that although the creditors had obtained a lien as of the date of delivery of the writ to the sheriff, it "remained inchoate and unperfected as against third parties" acquiring subsequent liens without notice. Thus, the IRS prevailed. *Id.* at 82.

113. See Federal Financing, *supra* n. 3, § III.F.

receivership until the receiver obtains a court ordered transfer to the receiver or other person entitled.¹¹⁴ The receiver has a lien as of the date of appointment, but it is inchoate and ineffective against third parties without notice until perfected by receiver's sale.¹¹⁵

The assignee for the benefit of creditors is more complicated. As discussed in the companion article,¹¹⁶ for federal information, an assignee's interest is arguably not perfected without a federal filing of the assignment. If federal law, not state law, requires the filing, then Revised 307(c) should not apply because *state* law does not require a filing. However, although the assignee has the lien avoidance power of a lien creditor, the assignee's interest arises by assignment, so it appears that the federal writing requirement would be satisfied. Under Revised Article 9-317(d), a security interest is perfected against an *executory* assignment without the necessity of filing. Will there be cases in which an *assignment* for the benefit of creditors is executory? If so, does Revised 9-317(d) mean that a secured creditor need not file to perfect against a later executory assignment for the benefit of creditors?

Finally, there is the "generally" test. Revised 9-307(c) asks whether a state "*generally* requires information concerning the existence of a nonpossessory security interest to be made *generally* available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a *lien creditor*." If both federal information law and state enforcement of judgment law do not require a filing against a levying creditor or a receiver, is the "generally" test met even though in some rare circumstances a secured creditor must file against the assignee for the benefit of creditors? The Drafters argue that the "generally" test is met where filing *is* required except in rare cases.¹¹⁷ It should then also be met where filing *is not* required except in rare cases. If the goal of the filing rules is to create certainty, then it would give greater certainty if the "generally" test is met when one need not file against most lien creditors. The result would be that a creditor needs to perfect information security interests against covered debtors under

114. See Federal Financing, *supra* n. 3, § III.E.5.

115. This is just like the situation in "order of delivery" states. They provide that delivery of a writ of execution to the sheriff creates a lien, but the lien is inchoate until the sheriff actually levies and takes possession of the property. In these states, the judgment creditor does not become a "lien creditor" unless and until the sheriff levies, but on levy the lien relates back to the delivery date. See Federal Financing, *supra* n. 3, § III.E.2.

116. See Federal Financing, *supra* n. 3, § III.E.2.

117. See *supra* n. 103, and accompanying text.

the law of the District of Columbia.

b. A Case Study - California

An example illustrating this approach is California. It adopted Revised 9 in 1999.¹¹⁸ The implementing legislation also made a number of changes to the state's judgment and pre-judgment enforcement laws, often to conform to the new terminology of Revised 9. Since California has a comprehensive (and convoluted) law in this regard, it might be useful to examine in detail how it would implement Revised 9-307(c).

Judicial Lien Creditor: The starting point is the "lien creditor by attachment or levy." This requires looking at whether a creditor on a simple contract can obtain a lien superior to an unrecorded security interest in intellectual property without proceeding to judicial sale. In California, it appears not.

Pre-Judgment Attachment: The California Attachment Law is codified in the Code of Civil Procedure §§ 481.010 *et. seq.*¹¹⁹ CCP § 487.010 lists the property subject to attachment, and it "... make[s] clear that property for which a method of levy is not provided is not subject to attachment, *e.g.* copyrights and patents."¹²⁰ Presumably this would also include trademarks. CCP § 488.370 does allow an attachment on "an account receivable" by service of a writ of attachment on an "account debtor." The implementing legislation amended the definitions in CCP § 481.020 ("account debtor") and CCP § 481.030 ("account receivable") to correspond to those in Revised 9-102(a)(3) ("account debtor") and Revised 9-102(a)(2) ("account"). Since royalties under information licenses are now "accounts" under Revised 9, at first blush this would allow an attachment on *royalties* but not on the *rights*. But not so fast. An account debtor is *not* a debtor. An account debtor is a person obligated on a general intangible, *e.g.* the licensee. Thus, a creditor cannot get an attachment on intellectual property owned by a debtor, nor on royalties once paid to the debtor. It could try to "attach"¹²¹ royalties payable from third party licensees by the classic "notice financing" method of giving notice to account debtors. However,

118. Cal. Stats., c. 991 (West 1999).

119. 6 B.E. Witkin, *California Procedure, Provisional Remedies*, vol. 6 §§ 34 *et seq.* (3rd. ed. 1985).

120. *Legislative Committee Comments* to C.C.P. § 487.010, reprinted in *West's Annotated California Codes* (West 2000); *see also* Witkin, *supra* n. 119, *Provisional Remedies* § 72.

121. Technically, this is really a garnishment.

although an attachment creates a lien under CCP § 488.500, the implementing legislation also amended CCP § 488.500(b) to make the lien subject to CCP § 697.740. As we will see, this makes any attachment lien ineffective against prior bona fide encumbrancers without notice. Thus, no attachment is possible on right or royalties of the debtor, and an attachment lien against royalties payable by a licensee to the debtor would be junior to a prior unfiled security interest in good faith and for value that had previously attached to them.

Post-Judgment Enforcement: The California Enforcement of Judgments Law, Code of Civil Procedure §§ 680.010 *et seq.*, creates an array of judgment enforcement procedures. While several of these procedures create a lien, where information is concerned, they are all junior to prior unfiled bona fide security interests without notice:

(1) CCP § 697.510 authorizes a judgment lien on personal property by filing with the Secretary of State. Under CCP § 697.530, however, this is not available for intellectual property rights. CCP § 657.530(a) does allow such a lien on “accounts receivable,” which now means an “account” consistent with Revised 9-102(a)(2). However, California has a non-uniform definition of “lien creditor” in Cal. Com. Code § 9-102(a)(52)(B), which says that a creditor utilizing this procedure is not a “lien creditor.” Thus it cannot create a lien on rights or royalties.

(2) CCP § 699.710 allows a writ of execution on “all property subject to enforcement of a money judgment.” However, CCP § 695.030 says property that is not assignable or transferable is not subject to enforcement of a money judgment. As discussed below,¹²² under federal law, interests under federal trademark licenses, and interests under non-exclusive patent and copyright licenses, are not assignable without consent of the information owner. Prior California case law held that patent ownership interests were not subject to levy, *i.e.*, forced assignment at law.¹²³ Instead, a creditor had to appoint a receiver after a *fiери facias* was returned *nulla bona*.¹²⁴ The Legislative Comments indicate this remains the appropriate procedure “where a writ of execution would not reach certain property.”¹²⁵ It would also be mandatory under signature requirements of federal law.¹²⁶ If

122. See text accompanying notes, *infra*.

123. *Peterson v. Sheriff*, 115 Cal. 211 (1896).

124. *Pac. Bank v. Robinson*, 57 Cal. 520, 522 (1881).

125. Legislative Comment C.C.P. § 708.610, reprinted in *West's California Codes Annotated* (West 2000).

126. See Federal Financing, *supra* n. 3, § III.E(6).

nonetheless California does allow a writ of execution on federal information, then CCP § 697.710 provides that service of the writ of execution on the judgment debtor creates an execution lien.¹²⁷ But this lien is subject to CCP § 697.740.

(3) California also provides for an examination proceeding in CCP § 708.110. Under CCP § 708.110(d), service of the order to appear creates a lien on the personal property of the judgment debtor, and under CCP 708.120 a lien is created on the debtor's personal property in the hands of a third party when the third party is served with a notice to appear. , California also recognizes a creditor's bill in CCP § 708.210. Service of a summons in the creditor's bill creates a lien on the property of the judgment debtor that is subject to the bill under CCP § 708.250. However, CCP § 697.920 also makes these liens subject to CCP § 697.740.

(4) CCP § 607.740(a) says that, if personal property "not in the custody of the levying officer" is "transferred or encumbered," then any lien is ineffective against "a person who acquires an interest in the property under the law of this state for reasonably equivalent value without knowledge of the lien." In other words, for property not in physical possession of the sheriff, *i.e.*, intellectual property, the "lien" in effect orders priorities among competing creditors, like the traditional equitable lien created by the creditor's bill.¹²⁸ It would not

127. CCP § 700.010 says that levy may be made on a general intangible by service of writ of execution on an *account debtor*. Prof. Paul Heald, *Resolving Priority Disputes In Intellectual Property Collateral*, 1 Ga. J. Int. Prop. L., 135, 144-145 (1993), argues that this means California has authorized levy on a general intangible by service of a writ of execution on the *judgment debtor*. I suggest this is incorrect. An account debtor is a person obligated on a general intangible, *e.g.* a licensee. C.C.P. § 700.010 is merely saying that service of the writ on a third party who owes money to the judgment debtor creates a lien for that payment. This is the traditional method of perfecting in an account (payment obligation) – by giving notice to the account debtor. See Federal Financing, *supra* n. 33, § III.B(2).

128. See Federal Financing, *supra* n. 3, § III.E(3). *In re Hilde*, 120 F.3d 950 (9th Cir. 1997) involved a case where a bank had commenced an examination proceeding by serving a debtor, but the debtor declared bankruptcy before the bank obtained a turnover order. The trustee argued that the lien was not perfected against the trustee as a subsequent *lien creditor* for items of tangible personal property. The Court disagreed, noting that the statute does not require the examination lien to be "perfected" after its creation. Upon creation it had the same effect "as service of an execution lien where property is not in custody of the levying officer" on all property of the debtor. *Id.* In effect, this treated the examination lien as operating like the *lis pendens* effect of the older creditor's bill. See Federal Financing, *supra* n. 3, § II.E(3). Thus, the examination lien had priority over the *subsequent* lien accorded a bankruptcy trustee. However, the court noted that the execution lien would be ineffective against parties listed in CCP § 697.940, *e.g.* prior bona fide encumbrancers without notice, but held that the trustee did not fall in this class for the subject property. *Id.* at 954.

prime a bona fide security interest without notice. The Legislative Comments say the section is intended to cover “intangible personal property such as accounts receivable and general intangibles” by establishing a rule consistent with prior state law “governing the effect of equitable liens.”¹²⁹ In California, an equitable lien is ineffective against innocent purchasers or encumbrancers for value and without notice.¹³⁰ The procedure to prevent transfer of property by the debtor to third parties without notice is to seek a court order prohibiting transfer under CCP § 708.180 (supplemental proceeding), CCP § 708.240 (creditor’s bill) or CCP § 708.520 (general procedure). The implementing legislation amended other parts of CCP § 607.740 to conform to Revised 9. However, CCP § 607.740(a) was left unchanged.

(5) CCP § 701.040 says that “except as otherwise ordered by the court upon a determination that the judgment creditor’s lien has priority over the security interest, if property levied upon is subject to a security interest that attached prior to levy, the property or obligation is subject to enforcement of the security interest without regard to the levy unless the property is in the custody of the levying officer.” This section confirms that in California a security interest has priority against a levying creditor when it attaches, unless the court finds some reason to give priority, such as the sheriff taking possession. In California, priority would evidently require proceeding

129. Legislative Comments to CCP § 697.740, reprinted in West’s Annotated California Codes. The California Law Revision Commission explains the reason for the exception thus: “If a lien is created on personal property pursuant to a levy of execution, but the property subject to a lien is not in possession of the levying officer, the interests of bona fide purchasers or encumbrancers are not effected by the lien *because the process that creates the lien is not sufficient to provide constructive notice*. Accordingly, the lien does not follow the property when it is transferred to a transferee or encumbrancer who gives fair consideration without knowledge of the lien.” 16 Cal. Law Revision Com. Rep. (Dec. 1982) at 1052 (emphasis added).

130. *Moore v. Schneider*, 196 Cal. 380 (1925) (equitable lien ineffective against prior bona fide purchaser of real property without notice); *Schut v. Doyle*, 168 Cal. App. 2d 698, 703 (1959); *Jud Whitehead Heater Co. v. Obler*, 111 Cal. App. 2d 861, 873 (1952) (personal property; rule stated but held inapplicable since defendant had not given value); *Wagner v. Sariotti*, 56 Cal. App. 2d 693, 698 (1943) (rule stated but held inapplicable because defendant had knowledge); 42 Cal. Jur. 3d, *Liens* § 40. As the California Law Revision Commission explains: “[T]he courts have held that liens created by service of an order in supplemental proceedings or by commencement of a creditor’s suit are not effective against a subsequent transferee of the property subject to the lien who gives fair consideration for the property without notice of the lien. The proposed [Enforcement of Judgment] law includes provisions specifying the effect of the lien created in examination proceedings, a creditor’s suit or charging order proceedings. The lien is given the same effect as an execution lien where the property levied on is not in custody of the levying officer.” 16 Cal. Law Revision Com. Rep. (Dec. 1982) at 1052.

to judicial sale where information is concerned. Under CCP § 701.630, the judicial sale extinguishes lien under which the property was sold and “any lien subordinate thereto.” Currently, the judicial sale purchaser without notice could take advantage of any recording act, including original Article 9-301(1)(d). If Revised 9-371(d) has eliminated the ability of an executory assignee to prime an unrecorded security interest, and if a judicial sale is treated as an executory assignment, then in California a judicial sale purchaser may no longer prevail over an unfiled information security interest. For federal information, however, the purchaser could rely on the recording provisions in federal law.

(6) California has another enforcement procedure where intellectual property is concerned: the assignment order. Before any execution on intellectual property, CCP § 701.520 accords the judgment debtor a right to noticed hearing to determine if an assignment order is more appropriate than forced sale. If the debtor does not timely file objection, then under CCP § 701.520 the levying officer can execute a certificate of sale, CCP § 701.650(2). Otherwise, if the debtor does object and the court finds under CCP § 701.520(d) that a forced sale is unlikely to realize full value, it can order that royalties be assigned to the judgment creditor pursuant to CCP § 708.510. However, under CCP § 708.530 the assignee is deemed a bona fide assignee for value under Civil Code § 955.1, not a lien creditor.

Insolvency representatives:

Receiver: California Code of Civil Procedure § 708.610 allows the appointment of a receiver to enforce a judgment. CCP § 708.620 has eliminated the prerequisite of a writ of execution returned unsatisfied, and instead allows appointment where a receiver is “a reasonable method to obtain fair and orderly satisfaction of the judgment.” The Legislative Comments indicate this is the preferred method where “a writ of execution would not reach certain property.”¹³¹ California follows the general rule that a receiver merely takes the title of the debtor.¹³² However, it also follows the usual exception allowing a receiver to attack prior unrecorded chattel mortgages.¹³³ This power is likened to that of a sheriff under a writ of execution.¹³⁴ However, the mere act of appointment does not vest a

131. Legislative Comments to CCP § 708.620, reprinted in *West's Annotated California Codes* (West 2000).

132. 55 Cal. Jur. 3d, *Receivers* § 40.

133. *Camerer v. Cal. Savings & Comm. Bank*, 4 Cal. 2d 159 (1935).

134. 55 Cal. Jur. 3d, *Receivers* § 39.

receiver with ownership or possession sufficient to invoke this power.¹³⁵ The receiver has no lien until taking possession, directly or under court order,¹³⁶ although under Article 9 the receiver's interest, when perfected, relates back to the date of appointment. To reach intellectual property requires a court ordered assignment to the receiver.¹³⁷

Assignee for the Benefit of Creditors: At one time, California had two methods for making an assignment for the benefit of creditors: at common law or by statute.¹³⁸ The statutory alternative procedure was rarely used and was repealed in 1980, so that California only recognizes common law assignments, subject to limited statutory guidance.¹³⁹ The common law right derives from California Civil Code § 22.2, which says: "The common law of England, so far as it is not repugnant to or inconsistent with the Constitution of the United States, or the Constitution or law of this State, is the rule of decision in all courts of this State."¹⁴⁰ Initially, California followed the common law rule that choses in action were not assignable.¹⁴¹ Under older authority, this meant that intangibles did not pass to an assignee for the benefit of creditors.¹⁴² But in 1872, California, by statute, made all species of property transferable, including intellectual property.¹⁴³ Thus, despite the common law infirmities, intellectual property should be assignable for the benefit of creditors under California common law. Under CCP § 493.010, the assignment must cover all non-exempt assets and treat all creditors without preference.

California follows the common law rule that the assignee merely

135. *Finnegan v. Finnegan*, 64 Cal. App. 2d 109, 112 (1944) ("The mere appointment of a receiver does not itself vest in him title to the patents."); accord *Zanetti v. Zanetti*, 77 Cal. App. 2d 553 (1947); 55 Cal. Jur. 3d, *Receivers* § 42.

136. *Bank of Woodland v. Heron*, 120 Cal. 614, 620 (1898) (crop mortgage); *Miller v. Super. Ct.*, 63 Cal. App. 1 (1923) (receiver appointed after sheriff took possession could not claim property).

137. *Pac. Bank v. Robinson*, 57 Cal. 520, 522 (1881) (patent).

138. Cal. Civ. Code §§ 3449-3473 (*repealed* 1980, chpt. 35, § 3).

139. *Credit Managers Assoc. v. Natl. Indep. Bus. Alliance*, 162 Cal. App. 3d 1166, 1170 (1984).

140. *Id.* at 1169-70.

141. See *Staff v. Maders Canal & Irrigation Co.*, 34 Cal. App. 41, 46 (1917) (citing rule, but noting change by statute).

142. See 4 Am. Jur., *Assignment for the Benefit of Creditors* § 26 (1936) (cases cited). This is the 1936 edition.

143. Cal. Civ. Code § 1044; *Loew's v. Super. Ct.*, 18 Cal. 2d 419 (1941) (common law copyright); *Johnston v. Twentieth-Century Fox Film Corp.* 82 Cal. App. 2d 796 (1948) (same).

takes the title of the debtor.¹⁴⁴ Absent statutory authority, the assignee does not take title to property previously conveyed or encumbered by the assignor, even if in fraud of creditors.¹⁴⁵ California's version of the Uniform Fraudulent Transfers Act allows the assignee to avoid fraudulent transfers that render the debtor insolvent the same as any other creditor.¹⁴⁶ Code of Civil Procedure § 1800 also allows the assignee authority to avoid preferential transfers among creditors, analogous to Section 547 of the Bankruptcy Code.¹⁴⁷ As to prior security interests on intellectual property, CCP § 1800(b) allows the assignee to recover any security transfer of property unless an exception applies. CCP § 1800(c) excepts security interests that allow the assignor to acquire property so long as they are "perfected" within 20 days of attachment. CCP § 1800(e)(1)(B) says a security interest in intellectual property is perfected "when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee." A "judicial lien," per CCP § 1800(a)(4), means "a lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." As discussed above, in California, a creditor on a simple contract cannot obtain a judicial lien on intellectual property by levy, and the equitable lien is ineffective against third parties without notice. Thus, the mere appointment of an assignee does not set aside a prior, unrecorded information security interest if it is *bona fide*. The assignee must obtain a court ordered transfer and, for federal information, record federally.

Although this analysis is detailed, it is now what Revised 9 apparently requires for information collateral held by a covered debtor in each state. It is certainly required for information. Looking at the California statutes, most of which were specifically addressed by the Legislature in the legislation enacting Revised 9, it appears quite certain that security interests in information held by a California covered debtor must be perfected under the laws of the District of Columbia.

144. *Moore v. Schneider*, 196 Cal. 380, 385-386 (1925) (absent statutory authority, assignee can not recover title conveyed in fraud of creditors); 16 Cal. Jur. 3d, *Assignment for the Benefit of Creditors* § 37 (1983).

145. *Moore*, 196 Cal. at 385-386 (real property); *Francisco v. Aguirre*, 94 Cal. 3d 180, 182 (1982) (assignee took subject to unrecorded chattel mortgage even though in fraud of creditors).

146. Cal. Civ. Code § 3439.01(c) (including assignee for the benefit of creditors in definition of "creditor").

147. See *Blonder v. Cumberland Engr.*, 71 Cal. App. 4th 1057, 1061 (1999).

c. Circular *Renvoi* and Other Conflicts Confusion

Under Revised 9-307(c), for information collateral, a covered debtor will typically be located in the District of Columbia. Under Revised 9-301(1), District law will then govern the effect of perfection and the priority of security interests. As of this writing, the District has only enacted original Article 9, not Revised 9.¹⁴⁸ Unless and until it does, the conflict rule in the District's version of original Article 9-103(b) will determine the applicable law. It requires looking to the law – including the conflict of law rules – of the jurisdiction where the debtor is “located” per original Article 9-103(d). This will often, but not always, be the jurisdiction that referred the matter to the District.¹⁴⁹ If it is the referring state, then its conflict rule – Revised 9-307(c) – sends us back to the District, which refers us back to the referring state, which refers us back to D.C. – and so on. Revised 9 has implanted a circular *renvoi* in the heart of the critical question for every secured creditor: “Where do I file?”

One may think a practical solution is simply to file in all possible locations, but that is no answer. At a minimum, multiple filing means multiple searching. And what happens if the searches reveal a conflict? Assume that a creditor files in the referring state on Day 1 and in the District on Day 3. An intervening transfer or lien occurs on Day 2. Is the secured creditor perfected against it or not, and under whose law? The searching question is actually more pronounced than this. Intellectual property, as an intangible, has no fixed *situs*. It is simultaneously everywhere, and thus is subject to judgment execution remedies¹⁵⁰ in any state that obtains *in personam* jurisdiction over the debtor.¹⁵¹ This means that an intervening transfer could arise anywhere in the country. So where does one search or file?

This resurrects one of the thorniest of the pre-Code conflicts problems, the priority of a security interest filed in one state against a judgment creditor in another.¹⁵² A state is not required to recognize the effectiveness of a security interest filed in another state, but can

148. See D.C. Code § 28-9:101 *et seq.* (1981).

149. Since there are differences between original Article 9-103 and Revised 9-307(b), District law may refer to the law of yet a third state. See Cohen & Smith, *supra* n. 103, at 1194-1199.

150. As discussed in Federal Financing, *supra* n. 3, § III.E, the remedies would be equitable execution by judicial sale on noticed hearing, not attachment or levy.

151. See e.g. *Keeton v. Hustler Mag., Inc.* 465 U.S. 770 (1984).

152. See Friedrich K. Juenger, *Nonpossessory Security Interests In Am. Conflicts Law*, 84 Commercial L.J. 63 (1979); David H. Vernon, *Recorded Chattel Security Interests In The Conflict of Laws*, 47 Iowa L.R. 346 (1962); 11 Am. Jur. *Conflict of Laws* § 74 *et seq.* (conflicts problems under prior chattel mortgage acts).

do so as a matter of comity.¹⁵³ During the Depression many, but not all states recognized out of state filings where the collateral was removed from the first state without the secured creditor's consent.¹⁵⁴ Since federal information is simultaneously everywhere nationwide, it would not fit within this exception. This is the problem the Supreme Court identified in *Stevens v. Gladding*.¹⁵⁵ It was one of the reasons Congress enacted national information filing systems.¹⁵⁶

There may be one escape hatch. If the District has not adopted Revised 9, then the better approach is not to use original Article 9-103(3)(b), but rather the deferral to federal law in original Article 9-104(a) or at least the deferral to the priority rules in original Article 9-302(3). In that case, District law would direct that security interests in federal information be filed in the appropriate *federal* filing offices in the Capitol, a far more rational result all around.

d. Analytical Checklist

A secured creditor looking where to file to perfect a security interest in information collateral under Revised Article 9 might consider the following checklist:

Step 1: Determine the type of information involved. Does it involve state information or federal information, and if so, what type? If federal law does not preempt the Revised 9 filing rules, proceed to Step 2.

Step 2: Decide the state where the debtor is located under either Revised 9-307(b) or, if the debtor is a registered organization, under Revised 9-307(e).

Step 3: Look to the state determined under Step 2 to determine whether it has enacted Revised 9. If the state has not enacted Revised 9, skip to Step 6. If the state has enacted Revised 9-307 then look if it has enacted any non-uniform provisions. Determine whether the debtor is a "covered debtor" subject to Revised 9-307(c) as enacted in the state. If the debtor is a registered organization, determine how the state resolves the apparent conflict between Revised 9-307(c) and 9-307(e).

Step 4: If the debtor is a covered debtor under the law of the state found under Step 3, then examine this law further to determine how it would apply the "against a lien creditor" and the "generally

153. See e.g. *Atha v. Brockius*, 39 Cal. 2d 635 (1952); 3 C.J.S. *Executions* § 140.

154. See Vernon, *supra* n. 152 (discussing case law).

155. 58 U.S. 447, 452 (1855).

156. See Federal Financing, *supra* n. 3, III.E(5).

requires” tests to the information collateral. This should include examining whether the state has a filing system for the information that supplants Revised 9, and testing how the state enforcement of judgment and debtor/creditor laws deal with the creating an involuntary lien, if at all, on the information collateral.

Step 5: If the covered deemed is deemed located in in the District of Columbia, examine its law to determine whether it has enacted Revised Article 9.

Step 6: If the state determined under Step 3 or the District has not enacted Revised 9, then determine where its law would require the security interest to be filed under original Article 9-103. This could be some third state.¹⁵⁷ If the third state has adopted Revised 9, repeat Steps 4 through 6. If circular loops (*renvoi*) appear then search all possible locations. If the searches reveal a conflict, spend some time reading the disparate case law and scholarly debate about the appropriate choice of law rules when security transfers in different states conflict.

Step 7: If the District has adopted Revised 9, determine whether is it has enacted any non-uniform provisions. If not, decide how a court in the District will deal with the provisions in Revised 9 discussed elsewhere in this article.

Lenders who believe they have perfected an information security interest under Revised 9 simply by filing in a debtor’s state of incorporation or principal “place of business” could be in for a surprise.

D. R 9-311(a): Filing Rules - Federal Information

1. Original Article 9

Original Article 9 contains two rules for deferring to federal intellectual property recording systems:

Current 9-104

This Article does not apply

- (a) To a security interest subject to any statute of the United States, to the extent that such statute governs the rights of the parties to and third persons affected by transactions in particular types of property;

Current 9-302

157. See e.g. *Walter E. Heller, Canada, Ltd. v. Buchbinder*, 26 U.C.C. Rep. Serv. 192 (D.C.App. 1979) (when an account debtor is located in the District, a sale of accounts in Canada is still a security interest which must be perfected under District version of Article 9; since debtor located in Canada, filing properly made in Canada).

(3) The filing of a financing statement otherwise permitted by this Article is not necessary or effective to perfect in property subject to:

(a) a statute or treaty of the United States which provides for a national or international registration . . . or which specifies a place of filing different from that specified in this Article for filing of the security interest;

(4) Compliance with a statute or treaty described in subsection (3) is equivalent to the filing of a financing statement under this Article, and a security interest in property subject to the statute or treaty can be perfected only by compliance therewith except as provided in Section 9-103 on multiple state transactions. Duration and renewal of perfection of a security interest perfected in compliance with the statute or treaty are governed by the provisions of the statute or treaty; in other respects the security interest is subject to this Article.

Pre-Code case law held that, for federal information, state law determined the method of creating and foreclosing a security transfer, while federal law set the priority and consequent perfection rules.¹⁵⁸ Thus, as far as Article 9 was concerned, the “full step-back” in Article 9-104(a) did not apply to federal information, although the “limited step-back” in Article 9-302(3)(a) did. Prof. Gilmore was emphatic that this was the correct reading.¹⁵⁹

There can be no doubt that both the copyright and patent statutes were meant to be within the description of § 9-302(3)(a). . . . There is nothing in the language or background of either statute to suggest that some types of security transactions were to be subject to the recording provisions while other types were not. Insofar as there is any room for doubt that the copyright and patent recording systems are, as a matter of federal law, exclusive of state filing systems, both of these systems should be held to fall within subsection (3)(a), with the result that compliance with the federal statute becomes the exclusive method of perfection under subsection (4).

2. Revised Article 9

Revised Article 9 adopts a more restrictive approach in deferring to federal intellectual property law:

Revised 9-109(c)

(c) This division does not apply to the extent that . . .

(1) A statute, regulation, or treaty of the United States preempts this division.

Revised 9-311

158. See *Republic Pictures Corp. v. Security-First Natl. Bank*, 197 F.2d 767 (9th Cir. 1952) (holding that federal courts lack jurisdiction to foreclose a copyright chattel mortgage); Gilmore, *supra* n. 4, § 19.9, at 545.

159. Gilmore, *supra* n. 4, § 19.9, at 545.

(a) . . . the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to any of the following:

- (1) A statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt subdivision (a) of Section 9-310.

Revised 9-311(a)(1) has little application to federal information. The federal statutes apply to bona fide purchasers, not lien creditors. Thus, the relationship between Revised 9 and federal law must be measured by the "to the extent preempted" standard in Revised 9-109(c).

3. Detailed Analysis

a. Omission of the Bona Fide Purchaser - Again

Under Revised 9-310(a), a financing statement must be filed to perfect a security interest unless an exception applies. Revised 9-311(a)(1) says an exception exists for a security interest "in property subject to a statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a *lien creditor* with respect to the property" preempts Revised 9's filing requirements. Once again, Revised 9 omits the bona fide purchaser.

Unfortunately, the courts have made a hash of where to perfect a security interest in federal information.¹⁶⁰ The federal statutes are all functionally identical, acting like real property recording acts.¹⁶¹ Nonetheless, the copyright cases, typified by *Peregrine*,¹⁶² hold a security interest must be perfected against all parties by filing in the Copyright Office. For patents, *Transport Design* says a security interest can be perfected against a lien creditor by a state filing,¹⁶³ while *Otto Fabric* says that no filing at all is required.¹⁶⁴ Both agree filing in the PTO is needed against a bona fide purchaser. The trademark cases, led by *Roman Cleanser*¹⁶⁵ and *Together Corp.*,¹⁶⁶ claim security interests in federal trademarks can be perfected against

160. See Federal Financing, *supra* n. 3, § III.G.

161. See Federal Financing, *supra* n. 3, § III.C(1).

162. *In re Peregrine Enter., Ltd.* 116 B.R. 194, n. 19 (Bankr. C.D. Cal. 1990).

163. *In re Transportation Design & Tech. Inc.*, 48 B.R. 635 (Bankr. S.D. Cal. 1985).

164. *City Bank & Trust Co. v. Otto Fabric, Inc.*, 83 B.R. 780, 782 (D. Kan. 1988).

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

166. *In re Together Dev. Corp.*, 227 B.R. 439 (Bankr. D.Mass. 1998).

all parties only by a state UCC filing. As suggested in the companion article, only the copyright cases make coherent sense.

Revised 9 looks to engraft the results in *Otto Fabric* and *Roman Cleanser* into its deferral rule. Revised 9-311(a)(1) says that a secured creditor should not have to file in any federal office to perfect against a bankruptcy trustee since neither the Copyright Act, the Patent Act nor the Lanham Act expressly require it. If the trustee objects, the lender can claim that under Section 544(a) of the Bankruptcy Code, lien creditor status and consequent perfection is determined by state law. Since Revised 9-311(a)(1) eliminates a federal filing to perfect against a lien creditor as a matter of state law, under this reading a floating lien should be good against a bankruptcy trustee for federal information.

This approach, however, misreads both federal intellectual property law and bankruptcy law. Under federal law, a judgment creditor cannot obtain an involuntary lien on intellectual property as this would violate the federal writing requirement.¹⁶⁷ Such a creditor must perfect by commencing equitable proceedings and acquiring a court ordered transfer, qualifying under the federal statutes as a bona fide purchaser. Under Section 544(a)(2) of the Bankruptcy Code, for intangible information, the trustee should be treated as an unsatisfied execution creditor who has obtained a judicial deed and recorded it in the relevant federal filing office.¹⁶⁸ This means a creditor must file in the appropriate federal filing office to perfect against the bankruptcy trustee, even under Revised 9's more stringent "to the extent preempted" test.

b. Effect of Federal Preemption

Whatever Revised 9 might say, it is federal law, not state law, which sets the preemption test. The federal courts recognize three types of preemption.¹⁶⁹ "Express" preemption occurs where an explicit statutory command replaces state law. "Field" or "implied" preemption arises when federal law so thoroughly occupies a legislative field as to leave the reasonable inference that Congress left no room for the states to supplement it. "Conflict" preemption exists when state law conflicts with federal law in a way that makes it impossible to comply with both, or stands as an obstacle to

167. See Federal Financing, *supra* n. 3, § III.E(5).

168. See Federal Financing, *supra* n. 3, § III.F.

169. See *Orson v. Miramax Film Corp.*, 189 F.3d 377, 381 (3rd Cir. 1999) (explaining different types of preemption); accord *Allis-Chalmers Corp. v. Luek*, 471 U.S. 202, 209 (1985) (describing tests); *Lear v. Atkins*, 395 U.S. 653 (1969) (patent law).

accomplishing the full purposes and objectives of Congress.¹⁷⁰

c. Chart: Conflicts with Federal Law

An evaluation of every possible preemption challenge is beyond the scope of this article. The following chart, however, lists specific areas in Revised Article 9 that appear facially inconsistent with federal intellectual property laws:

Revised Article 9	Conflicting Federal Law
R 9-102(a)(44): "embedded software" is a "good"	Copyright Act § 202: "embedded software" cannot be a "good"
R 9-102(a)(11): software licenses as "chattel paper"	Copyright Act §§ 204, 205; licenses are at best prima facie <i>evidence</i> of transfer; recording establishes priority
R 9-103: denies "purchase money" status to copyrights or patents so that licenses become immediately subject to prior floating liens	Copyright Act § 205(c); Patent Act § 261; Lanham Act 1040(a); prior state filed floating lien would conflict with later federal filing identifying work, invention or mark
R 9-108: collateral can be described in general terms	Copyright Act § 205(c); Patent Act § 261; Lanham Act 1040(a); requires identifying work, invention or mark
R 9-204: security interest effective in after-acquired collateral	Copyright Act § 205(c); Patent Act § 261; Lanham Act 1040(a); requires identifying work, invention or mark
R 9-207(d): Validates "secret liens" against later executory information assignments	Copyright Act § 205(c); Patent Act § 261; secret liens invalid against later filing BFPs; Lanham Act § 1040(a)?
R 9-301: Law where debtor "located" governs questions of priority and perfection	Copyright Act § 205; Patent Act § 261; Lanham Act § 1040(a); federal law determines priority regardless of location of debtor
R 9-307(c): Debtor located in District of Columbia for copyright, patent and trademark priority questions in U.S.	Copyright Act § 205; Patent Act § 261; Lanham Act § 1040(a) federal law determines priority question regardless of location of debtor
R 9-307(c): Filing in District of Columbia perfects for copyright patent and trademark interests outside U.S.	Berne Convention art. 5(2) (law of protecting country decides for copyrights); Patent Law Treaty art. 14 (patent security interests must be filed in national patent office); Trademark Law Treaty art. 11 (trademark interests must be filed in national trademark office)
R 9-310(a): Security interest perfected by filing in state UCC registers	Copyright Act § 205 (Copyright Office for all interests); Patent Act § 261 (Patent Office for security interests); Lanham Act § 1060: state filing only?

170. *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

R 9-311(a)(1): Federal law only preempts Revised 9 if it requires filing for priority over a lien creditor	Federal law sets preemption standards; express, field and conflict preemption
R 9-316(a): Security interest in information only endures for one year unless refiled against transferee	Copyright Act § 205 & Patent Act § 261: Once filed, mortgage continues for its entire term; Lanham Act § 1060: state filing rules apply?
R 9-317: Exclusive licensee takes free of security interest if license gives value without knowledge before security interest is perfected.	Copyright Act § 205 & Patent Act § 261: Allows a grace period after federal recording before priority applies.
R 9-321: "Licensee in ordinary course" can continue using information even if it knows licensor's interest foreclosed out	Copyright Act § 506: knowing continued use a felony. Patent Act 285: patent counterfeiting. 28 U.S.C. § 2003 - knowing continued use felony trademark counterfeiting.
R 9-408(a): Contractual prohibitions on assignments of rights or royalties under information licenses unenforceable	Nonexclusive copyright and patent licenses not transferable without consent of licensor under federal law; trademark licenses not assignable without consent
R: 9-509: Secured creditor can file financing statement without debtor's signature	Copyright Act § 204; Patent Act § 261; Lanham Act § 1040(a); federal law requires signature of the debtor-owner of the work, invention or mark
R 9-102(a)(2) & 9-610: Assignments and exclusive licenses are now security interests that must be "foreclosed" to terminate a licensee's interest on default	On cancellation, copyright, patent and trademark licenses end, making further use an infringement

Original Article 9 allowed federal law to set the priority scheme, using state law to fill the gap with attachment and foreclosure rules. Revised Article 9, however, both in basic philosophy and statutory mechanics, conflicts with the federal scheme. The resulting litigation will be extensive, intense and, but for Revised 9, wholly unnecessary.

E. R 9-307(c): Filing Rules - International Information

1. Original Article 9

Intellectual property has become America's leading national export.¹⁷¹ American creators increasingly rely on export earnings to fund new creations, and financing export licenses has become a substantial business. To obtain financing, a creator needs to assure a lender that at a minimum it can perfect its interest in royalties once they are repatriated to the United States. Original Article 9 allows a convenient system to do so: traditional notification financing.¹⁷² This happens because of the limited scope of the definition of "account":

Current 9-106

"Account" means any right to payment for goods sold or leased or

171. See Stephen E. Siwek & Gale Mosteller, *supra* n. 1.

172. See Federal Financing, *supra* n. 3, § III.B.

for services rendered which is not evidenced by an instrument of chattel paper, whether or not its has been earned by performance.

Due to this provision, royalties due under intellectual property licenses, at least when they are remitted to the United States, are not “accounts” and therefore can be financed under the law of assignment, using notice to the licensees overseas to perfect the lender’s security interest, at least against creditors of the licensor in the United States.

2. *Revised Article 9*

Revised Article 9 again changes the rules for intellectual property export financing with the following sections:

Revised 9-102(a)(2)

“Account”, except as used in “account for”, means a right to payment, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of . . .

Revised 9-102(a)(28)

“Debtor” means any of the following:

- (A) A person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor.

Under these provisions, to perfect a security interest in a licensor’s royalties remitted from licensee’s overseas it appears that the lender must now file in myriad national intellectual property registers around the world at enormous expense.

3. *Detailed Analysis*

a. *Export Financing Overview*

Information transfers involve both the intellectual property interest (the “rights”) and the contractual right to receive payments (the “royalties”). A creditor loaning against the security of such a transfer must therefore consider how to perfect in both rights and royalties against both its immediate owner-debtor and transferees from its debtor. With regard to rights, the territorial principal applies. This means that the laws of each protecting country determine the scope of protection.¹⁷³ There is no such thing as a “foreign” copyright,

173. For discussion, see Paul Edward Geller & Melville B. Nimmer, *International Copyright Law and Practice*, Introduction (2000 ed) [“Geller”](copyrights); Nimmer & Nimmer, *supra* n. 47, at § 17.02 (copyright); McCarthy Trademark, *supra* n. 44, § 32:1 (trademarks); Donald S. Chisum, *Chisum on Patents* § 14.01 (2000 ed.) [“Chisum”] (patents); also Gretchen Ann Bender, *Clash of the Titans: The Territoriality of Patent Law*

patent or trademark; rather there is a separate, national copyright, patent or trademark in each protecting country. On the other hand, when dealing with the contract interest, conflicts law uses a unifying approach that tries to apply the same *lex contractus* wherever the contract is enforced.¹⁷⁴

How can a lender perfect a security interest in transfers by an American information creator to other countries? For example, assume a Producer makes an exclusive license of various rights in a motion picture to a French company.¹⁷⁵ The French company will remit to the U.S. Lender royalty payments derived from exploiting the rights in France. A U.S. Lender making a loan secured by such a license needs to obtain priority over: (i) French creditors, *i.e.*, creditors of the French licensee that may take priority over the copyright interest granted to the licensee in France or the royalty payments to be remitted by them; and (ii) U.S. creditors, *i.e.*, creditors of the Producer that may take priority over the license payments once remitted to the U.S. (We can assume the lender has assured itself of priority in the *rights* in the U.S.) For the French creditors, the Lender will need to perfect against them, if at all, under French law, since it will govern the copyright interest in France. Neither Original nor Revised Article 9 can change that. With regard to U.S. creditors, however, U.S. law, including, as applicable Article 9, will govern. This follows not only because the collateral – the royalty payment – will be remitted to the U.S., but because the contract interest – the right to payment – will presumably be governed by the contract law of a U.S. jurisdiction. For the Lender, securing the right to collect this royalty payment for the international licensees, especially against a bankruptcy trustee of the Producer, will be of paramount concern.

b. How Current Law Works

Under Original Article 9, perfecting in the licensor's international royalties is straightforward. A Lender sends each licensee a Notice and Acknowledgement. The Notice notifies the licensee that all payments due under the license have been assigned

vs. *The European Union*, 40 Idea 49 (2000). U.S. courts have affirmed the territorial principle as the U.S. copyright conflicts rule. See *e.g.* *Twin Books v. The Walt Disney Co.*, 83 F.3d 1162 (9th Cir. 1996); *Subafilms Ltd. v. MGM-Pathe Comm. Co.*, 24 F.3d 1088, 1095 (9th Cir. 1994) (U.S. copyright law has no extra-territorial effect); *Totalplan Corp. of Am. v. Colborne*, 14 F.3d 824 (2nd Cir. 1994) (U.S. trademark law does not apply in Japan); *Person's Co. v. Christman*, 900 F.2d 1565 (Fed. Cir. 1990) (“[T]rademarks exist within each country solely according to that country’s statutory scheme.”).

174. See Geller, *supra* n. 173, *Introduction* at § 6.

175. This hypothetical is further elaborated in § III.A, *infra* notes 378-381.

to the Lender. The Acknowledgement requires the licensee to acknowledge the assignment and typically to verify the amount owed and to waive set-off rights. It may also create a legal right for the lender to pursue the licensee in case of failure to pay, although its economic value can be problematic.¹⁷⁶

In any case, this notification procedure perfects the Lender's interest against the Producer's creditors in the United States, especially in the royalty income once repatriated. Under original Article 9-106, an "account" only means a right to payment for "goods sold or leased or services rendered." It does not include royalties arising from a license of intellectual property, which are general intangibles.¹⁷⁷ Thus, as far as U.S. law goes, the assignment to the lender of the Producer's right to receive royalties under the international licenses is perfected by the applicable law of assignment, not by the filing rules in Original Article 9. American states utilize one of three different perfection rules in this case: the American rule of strict first in time; the English rule of first to notify the account debtor; or the Restatement's "four horsemen" rule.¹⁷⁸ Under all of these rules, notice to the account debtor – the Notice and Acknowledgement sent to the international licensees – has always been sufficient to perfect. This means if a U.S. Producer files for bankruptcy in the U.S., the Lender has a perfected interest against the U.S. bankruptcy trustee in the royalty payments under the international licenses.¹⁷⁹

There can be a variation on the theme. In some cases, the Producer will license all rights outside the United States to a master distributor in another country, and that distributor will in turn make sublicenses to territorial licensees. This is often done to take

176. The licenses typically provide that no exploitation materials are delivered until payment of the Minimum Guarantees, limiting the ability to meaningfully exploit the rights. The lender takes the credit risk for later overages.

177. *E.g. South Bay Enter.*, 957 S.W.2d at 289 (royalties under technology license not an account); *In re Lady Madonna Indus., Inc.*, 99 B.R. 536, 541 (Bankr. S.D.N.Y. 1989) (trademark license not an account); *In re Specialty Foods of Pittsburgh, Inc.* 98 B.R. 734, 736 (Bankr. W.D.Pa. 1989) (security interest in "rights to payment of money" from general intangibles did not cover trademark license); *Morrison v. Helms* 28 UCC Rep Serv. 172 (Tenn. App. 1979) (royalties from license to reproduce and distribute sound recordings not an account); *generally* 6 Am. Jur. 2d *Attachment and Garnishment* § 502 (1999) (As to intangible property. . . an assignment prior to an attachment or garnishment is all that is necessary to preserve the lien priority of the assignee."); *but see In re C Tek Software, Inc.*, 117 B.R. 762, 771 (Bankr. D.N.H. 1990) holding that software source code is an "ordinary good" for perfection purposes, a result that is plainly wrong.

178. *See* Federal Financing, *supra* n. 3, § III.B.2.

179. *See* Federal Financing, *supra* n. 3, § III.B.3.

advantage of applicable remittance tax treaties. In this case, the distributor will often execute an Inter-Party Agreement with the Producer and the Lender in which the distributor acknowledges the priority of the Lender's security interest and agrees to require each sublicensee to execute a Notice and Acknowledgement directing their payments to the Lender. Original Article 9 also easily accommodates this structure in the following provision:

Current 9-103(3)(c)

In the alternative, if the debtor is located in a jurisdiction which is not a part of the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the security interest may be perfected by notification to the account debtor.

Under this provision, the Notice and Acknowledgement procedure also perfects the Lender's interest in the payments from the sublicensees of the non-U.S. distributor.

Prof. Gilmore describes the reason for these rules in some detail.¹⁸⁰ During the drafting process for the original statute, New York lenders argued that under the proposed language in Article 9-103(1), a bank loaning on a foreign debtor's receivables was required to look to the law where the debtor's records were kept to determine validity and perfection. In that case:

Obviously, if a New York Bank makes a loan to a Congolese corporation and, on default, has to go into the Congo to realize on its security, it must take its chances on whatever state of law it must find there. On the other hand, is for example, remittances are made to New York and bank accounts are kept in New York, it is not unreasonable to say that New York courts should apply New York law to litigation which arises in New York.¹⁸¹

In such a situation, "a moments reflection makes it clear that if the underlying transaction is a loan by a New York bank against the security of Congolese receivables, it makes no sense whatsoever to require filing in New York."¹⁸² Original Article 9-103(3)(c) thus allowed perfection – at least with regard to the receivables – by the classic method of notice to the account debtor. New York evidently decided not to bother with notification at all but to let the security interest achieve perfection when it attached.¹⁸³ Revised Article 9 does the opposite.

180. See Gilmore, *supra* n. 4, at 330-332.

181. *Id.* at 330.

182. *Id.* at 331.

183. *Id.* at 332.

c. Impact of Revised 9

Revised 9-102(a)(2) expands the definition of “account” to include a right to payment “for property that has been or is to be . . . licensed, assigned or otherwise disposed of.” This now sweeps in royalty payments due under information licenses.¹⁸⁴ This means that an assignment of royalties is no longer perfected by notice to the licensees. Under Revised 9-310(a), a financing statement must be filed.

But filed where? Revised Article 9-301(1) says that the local law “where the debtor is located” determines the necessary perfection procedures. Revised 9-102(a)(28) now expands the definition of “debtor” to include any person “having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor.” According to the Official Comments, this picks up “those persons who may have a stake in the proper enforcement of a security interest by virtue of their non-lien property interest (typically an ownership interest) in the collateral. . . . by including in the definition of ‘debtor’ all persons with a property interest (other than a security interest in or other lien on collateral), the definition includes transferees of collateral, whether or not the secured party knows of the transfer or the transferee’s identify.”¹⁸⁵ Under Revised 9, a “debtor” thus includes assignees and licensees – transferees – of the information, or a divisible part of it.

The problem with the expanded definition is that it creates a confusing overlap where information transfers are concerned. A transferee is now both a “debtor” and an “account debtor.” A lender loaning to an information transferor wants to ensure priority in the transferor’s right to *receive* royalties against other creditors of the transferor, and in the transferee’s obligation to *remit* payments against other creditors of the transferee. Start with the transferor’s right to receive royalties. For these purposes, the transferee is an *account debtor* and the lender perfects against other creditors of the transferor by filing against the transferor-debtor.

But what of the transferee’s obligation to *remit* royalties? For

184. See U.C.C. § 9-102, cont. 5(a) (Rev. 1998): (“The definition of ‘account’ has been expanded and reformulated. It is no longer limited to rights to payment relating to goods and services. Many categories of rights to payment that were classified as general intangibles under former Article 9 are accounts under this Article.”).

185. *Id.* at cmt. 2(a). See also Weise, *supra* n. 32, n. 6 (“Although the copyright is not transferred by the [nonexclusive] license, the rights created by the license are ‘property’ for Article 9 purposes, and can serve as collateral should the licensee grant a security interest in them.”).

these purposes, the transferee now becomes a *debtor* and so the transferor, or its lender, apparently must perfect against the transferee as it would against any debtor. Under current law, the Notice and Acknowledgement sent to the transferee is sufficient to perfect. The legal theory is that the royalty payment has been assigned to the transferor's lender, so that a lien against the transferee does not attach to the transferor's right to royalties, or is junior to the prior assignment to the transferor's lender in any case.¹⁸⁶ Revised 9 has changed this approach, now requiring separate perfection against each transferee.

This has far reaching consequences. Assume a judicial creditor of the transferor seeks to garnish the royalty obligation in the hands of the transferee. If the judicial creditor is successful, it can take the royalty payment from the transferee before it ever reaches the transferor, and the security interest in royalties received is only perfected in an empty bucket.¹⁸⁷ Under current law the Notice and

186. See Federal Financing, *supra* n. 3, § II.B(3). The leading case is *Septembertide Publ., B.V. v. Stein and Day, Inc.*, 884 F.2d 657 (2nd Cir. 1989). An author granted an exclusive license to a publisher, reserving a royalty from sublicenses. The publisher later encumbered its assets with a floating lien. When the publisher went belly-up, the issue was who was entitled to a large payment from a sublicensee. The lender argued that since the author had not filed a financing statement, it was an unsecured creditor. The Court held, however, that under Article 9-318(1)(a) the security interest was subject to "all the terms of the contact between the account debtor and assignor," meaning that the security interest only attached to publisher's right to net income after payment of the royalties. *Septembertide* involved a security interest taken after the license. What if the licensee was subject to a pre-existing floating lien? The same reasoning would seem applicable. The first argument would be that since the licensed rights were transferred to the licensee already net of royalties, the floating did not *attach* to the licensor's share. The second argument would be that even if the floating lien did attach, at least as far as federal information goes, a floating lien does not have priority unless it is recorded in the federal filing offices with a specific description of the information, and obviously, such a recording cannot take place until after the license is made. Prof. McDonnell argues that the expanded definition of "account" in Revised Article 9-102(a)(2) is intended to reverse *Septembertide*, requiring the author to file to perfect against the publisher, "[a] result which might well surprise authors of the world." Coogan, *supra* n. 25, § 2B.07[5], at 2B-50.

187. This issue has arisen in a number of cases where a judicial creditor of a debtor seeks to garnish payments owed by an account debtor to the debtor. There are two situations to consider: garnishing creditor of a *debtor* versus secured creditor of the *debtor*; and garnishing creditor of a *debtor* versus secured creditor of the *account debtor*. In the first case, the garnishing creditor has priority in the account payments ahead of a debtor's creditor who has failed to perfect against the *debtor*. *Gen. Lithographing Co. v. Sight & Sound Projector, Inc.*, 128 Ga. App. 304 (1973); *Vittert Constr. & Inv. Co v. Wall Covering Constr. Co.*, 473 S.W.2d 799 (Mo. App. 1971). In the second case, the garnishing creditor has priority ahead of the account debtor's creditor who has failed to perfect against the account debtor. *Rocky Mountain Assoc. of Credit Mgt. v. Hessler Manuf. Co.*, 37 Colo. App. 551, 533 (1976) (noting rule, but finding the creditor duly perfected); *Welbourne Dev. Co. v. Affiliated Clearance Corp.*, 472 P.2d 684 (Colo. App. 1970). An ominous

Acknowledgement to the transferees for the *royalties* (which are not accounts) would have been sufficient to perfect against the garnishing judicial creditor. Under Revised 9, this approach is no longer effective. Evidently, with the expanded definition of “debtor,” and, as discussed in the next section, the changes in the duration rules in Revised 9-316, a lender must file against the transferor-debtor and each new transferee-debtor as well, to ensure priority in the royalty income against (garnishing) creditors of the transferor.

If an information transferee is now a “debtor,” then under Revised 9-301(a), a security interest must now be perfected where the “debtor” is “located.” Under Revised 9-307(c), a debtor is located in a jurisdiction if it maintains a filing system for a security interest to obtain priority over a lien creditor; otherwise the debtor is located in the District of Columbia. The test applies both to domestic and international debtors.¹⁸⁸ Thus, it appears that a financier of royalties under international information licenses must examine the laws of each country where a licensee is located to determine whether it has a filing system that meets Revised 9’s “priority over a lien creditor” test. Most do.

d. National Information Filing Requirements

Scores of countries require a local filing for nonpossessory security interests to gain priority over creditors and insolvency representatives. A leading source, *Intellectual Property in the Global Marketplace*,¹⁸⁹ identifies the requirements in more than 20 countries for security transfers in intellectual property. Many other sources have long documented these systems, so we need only briefly review them here.¹⁹⁰

decision, *Stanley v. Fabricators, Inc.* 459 P.2d 467 (Ala. 1969), held that a lessor’s reserved interest under a financing lease for personal property was superior to a garnishing creditor of the sublessee but only because the garnishing creditor had knowledge of the security interest, and the statute then required lien creditors to be without notice. Certainly, if any judicial creditor can obtain priority by garnishment, then so could the bankruptcy trustee. For further discussion of the international implications, see Spiro V. Bazinas, *An Intl. Legal Regime for Receivables Financing: UNCITRAL’s Contribution*, 8 Duke Intl. & Comp. L. Annual 315, 345-353 (1998) (discussing proposed priority rules for international receivables refinancing).

188. See U.C.C. § 9-310, cmt. 8 (Rev. 1998) “The Article applies the same choice-of-law rules to all debtors, foreign and domestic. . . . This rule appears in Section 9-307.”

189. Melvin Simensky, Lanning Bryer, Neil J. Wilkof, *Intellectual Property in the Global Marketplace* (2nd ed. 1999) [“Global Intellectual Property”].

190. Sources include: Dennis Campbell, *World Intellectual Property Rights and Remedies* (Oceana 2000) (country by country digest of patent, copyright and trademark laws); Geller, *supra* n. 173 (copyright transfer requirements, including mortgages and insolvency rules, discussed in § 4 for each country); McCarthy Trademark, *supra* n. 12, ch.

The national information registers fall roughly into three classes. The first class includes countries that require recording in a national register for a security transfer to be valid. In these countries, an improper or late filing invalidates the security transfer, even between the parties. These include many Latin Countries, such as France, Spain, Argentina, Colombia and Mexico, as discussed in the Notes following the Chart below.

The second class involves countries in which an unfiled security transfer is valid between the parties, but can be challenged by third parties who take in good faith and without notice. Unfortunately, there is scant indication in the treaties whether general creditors or insolvency representatives are included in the protected class. Whether such a law meets the “generally requires” test in Revised 9-307(c) is anybody’s guess.¹⁹¹

Finally, some countries require security interests to be filed in public registers other than the information systems. Most of the British Commonwealth countries fit this mold. For example, the United Kingdom requires every “charge,” including a “mortgage,” on the goodwill or intellectual property of a company registered in England or Wales to be filed with the Registrar of Companies in London.¹⁹² “Intellectual property” includes any patent, trademark, service mark, registered design, copyright or design right, including any license under or in respect of such right.¹⁹³ Any such charge is

32; Morag MacDonald, Spyros Maniatis & Uma Suthersanen, *Design and Copyright Protection of Products* (Street & Maxwell 2000); Lester Nelson, editor, *Digest of Intellectual Property Laws of the World*, (Oceana 1998); Prof. Dr. Hendrick Vanhess, editor, *International Encyclopedia of Laws*, Vol. 1, *Intellectual Property* (1997); Jerome Gilson, *Trademark Protection and Practice*, ch. 10 (Lexis 2000). Copies of relevant laws and treaties can be found in Paul Goldstein, *International Legal Materials on Intellectual Property* (2000); UNESCO, *Copyright Laws and Treaties of the World* (Current through 1998); A. Leaffer, *International Treaties on Intellectual Property* (BNA 1997). A study that will have new importance is J.H. Dalhuisen, *Dalhuisen on International Insolvency and Bankruptcy* (1986).

191. For an illustration of the problem, see Geller, *supra* n. 173, *Spain* § 4[2][d]. Spanish law provides what is in effect an evidentiary presumption of priority from a recording in the copyright register. While this might seem not to meet the test in Revised 9, note that registration of a copyright under Section 410(c) of the Copyright Act is only prima facie evidence of validity. Spanish law also prevents an author’s rights from being “attached.”

192. Companies Act of 1985, ch. 6 § 396(1)(d); see Lord Hailsham of St. Marylebone, *Halsbury’s Laws of England, Co.*, ¶ 1299 (4th ed. Reissue 1998) [“Halsbury”]. For a copy of the Companies Act, see Peter Allsop et al., *Current Law Statutes Annotated* (1985, vol. 1, pgs. 6 et seq.) [“Allsop”].

193. An enlarged definition of “intellectual property” was added by the Copyright, Designs and Patent Act of 1988, § 303(1), ch. 7 para. 31(1) (1988). Halsbury, *supra* n. 192, ¶ 1299, n. 17. For a copy, see Allsop, *supra* n. 192, 1988 vol. 4, at 48-306.

void against the liquidator or administrator (insolvency representatives) or any creditor (including general creditors) unless the prescribed particulars of the charge, together with the instruments by which its is created, are received by the Registrar within 21 days of its creation.¹⁹⁴ Company directors who fail to effect proper registration are liable on conviction for severe fines.¹⁹⁵ Nearly identical requirements exist in Australia, New Zealand, Hong Kong, Singapore and Ireland.¹⁹⁶ Canada has a system of provincial Personal Property Security Acts modeled on Article 9, that could apply to intangibles, as well as a federal system for recording interests in intellectual property.¹⁹⁷

e. Filing Requirements for Information Chart

The following chart indicates filing requirements in various countries. It is based on a brief review of the corresponding country sections in *Intellectual Property in the Global Marketplace and World Intellectual Property Rights and Remedies*. Several countries allow different kinds of security transfers, such as a "pledge," "hypothec," "hipoteca," "mortgage," or "trust." If any of these require a filing, the chart lists "required." The chart does not distinguish whether a filing is necessary for validity against third parties or for mere effectiveness; either one is listed as "required." It also does not indicate whether security transfers in licenses are possible. The purpose of this chart is not to provide definitive answers, but to indicate areas where further investigation is *prima facie* warranted.

194. Companies Act § 395; Halsbury, *supra* n. 192, ¶ 1299; Allsop, *supra* n. 192, 1985 vol. 1 at 6-365.

195. Companies Act § 399; Halsbury, *supra* n. 192, ¶ 1309; Allsop, *supra* n. 192, 1985 vol. 1 at 6-369.

196. See Global Intellectual Property, *supra* n. 189, Australia § 31.3; New Zealand § 53.1; Hong Kong § 43.3; Singapore § 56.1; Ireland § 46.5(f). The Irish and Singapore acts apply to licenses of patents and copyrights, although inexplicably trademark licenses are not mentioned.

197. See Global Intellectual Property, *supra* n. 189, Canada.

COUNTRY	PATENT	COPYRIGHT	TRADEMARK
Argentina	Required	Required	Required
Australia	Required	None	Optional
Austria	Required	None	Required
Belgium	Required	None	Required
Brazil	Required	Some	Required
Canada	Required	Required	Required
Chile	Required	None	None
China	Required	None	Required
Colombia	Required	Required	Required
Czech Republic	Required	None	Required
Denmark	Permissive	None	Permissive
Ecuador	Required	Required	Required
Egypt	Required	None	Required
Finland	Required	Required	Required
France	Required	Some required	Required
Germany	Required	None	None
Hong Kong	Required	Required	Required
Hungary	Required	None	Required
India	Required	None	None
Indonesia	Required	Required	Required
Ireland	Required	Required	Required
Israel	Required	Required	Required
Italy	Required	None	Required
Japan	Required	Required	Required
Korea	Required	Required	Required
Mexico	Required	Required	Required
The Netherlands	Required	None	None
Norway	Required	None	Required
New Zealand	Required	Required	Required
Peru	Required	None	Required
Russia	Required	None	Required
Singapore	Required	Required	Required
South Africa	Required	Required	Required
Spain	Required	Required	Required
Sweden	Required	None	Required
Switzerland	Required	None	Required
Taiwan	Required	None	Required
Thailand	Required	None	Required
United Kingdom	Required	Required	Required
Venezuela	Required	Required	Required

Chart of Filing Requirements¹⁹⁸

198. The following comments are derived from the corresponding country section in *Global Intellectual Property*:

Argentina: Under the Argentine registered pledge procedure, a nonpossessory pledge of information must be filed in appropriate patent, copyright and trademark registers or it is void against creditors, including in bankruptcy.

Australia: Follows U.K. practice.

Brazil: Special recording requirements exist for computer programs. See Geller, *supra* n. 173, *Brazil* § 4[2][d].

Canada: Dual federal and provincial filing may be required.

Chile: Chilean law is inadequate for pledges of copyrights or trademarks, but may be amended by allowing national registration.

Colombia: To prevail against “third parties” a “pledge without dispossession” of a patent or trademark must be recorded with the Superintendency of Industry and Trade, and of a copyright in the Office of the General Director of Author’s Rights.

Denmark: Filing in the information registers is permissive and confers no legal benefits. However, a secured creditor can record at the court in Aarhus for priority against later transferees, for a fee of 1.5% of the total value of the transfer. World Intellectual Property, *Denmark* § C.i.i.e, says that in Denmark that copyrights are not subject to execution.

Ecuador: Information security interests must be recorded in the National Bureau of Industrial Property or Copyright Office of the Minister of Education to be valid.

Finland: All “floating charges” on intellectual property must be registered in appropriate title registry for validity. Patent and trademark pledges must be registered on patent or trademark registers or they are invalid against third parties, including the bankruptcy trustee. The author believes copyright pledges are also invalid absent registration in the pledge registry.

France: To be valid, pledges of patents must be recorded in the National Patent Register; of trademarks in the National Trademark Register; and of industrial designs in the National Register of Designs and Models. Security transfers for audiovisual works must be filed in the National Center of Cinema to have validity against third parties. Geller, *supra* n. 173, *France* § 4[3][a][i]. A “pledge without loss of possession” that operates as a “floating lien” over the debtor’s business must be filed in the registry office of the local commercial court of the debtor’s place of business within 15 days of the date the pledge is signed or it is invalid.

Germany: Germany distinguishes a pledge from a *sicherungsübereignung* (chattel mortgage). A pledge of information does not extend to royalties; a separate pledge of the royalties is required. A patent *sicherungsübereignung* must be recorded in the Patent Office. Copyrights may not be transferred for security, but licenses may with the licensor’s consent. No filing is required.

Hong Kong: Follows U.K. practices.

Hungary: Patents and trademarks must be recorded for priority against a “buyer in good faith,” including a mortgagee.

Ireland: Follows U.K. practices.

Israel: To be effective against a third party, patent security interest must be registered on Patents Register within 21 days after the security interest was granted; trademark and copyright security interests must be registered in local districts under Pledges Law.

Italy: Patent and trademark security interests must be filed in respective registers. The author questions whether a pledge of copyrights is even possible. In any case, foreclosure only gives a right to royalties, not to use.

Japan: In Japan, a “pledge” operates more like a mortgage or security interest. It must be registered in the patent and copyright registers for the creditor to “claim rights against third parties.” The cost is 4% of the amount of the credit covered by the pledge for filing in each register. The high price makes security interests in information rare in Japan. *Intellectual Property in the Global Marketplace* asserts that trademark filings are also required. *World Intellectual Property Rights and Remedies*, Japan, § D.i.d. p. 22, however, claims that the requirement of registering trademarks in the Patent Office was abolished in 1996.

Korea: In Korea, the Korean Industrial Property Office must approve a pledge on intellectual property before it can be filed.

Mexico: The law is uncertain on whether security interests in information are possible. If so, the pledge law requires that pledges be registered in the “appropriate registry for the

As this brief survey indicates, nearly every country requires a filing for a patent security interest. This requirement has been formalized in the recent Patent Law Treaty, which requires all signatory countries to allow filing "security interests" in their national patent registers.¹⁹⁹ The United States has signed the treaty and it will be submitted for Senate approval in 2001. Many countries also require a filing for trademark security transfers due to the Trademark Law Treaty, to which the U.S. has adhered.²⁰⁰ Most countries make

title" to be valid. That would be either the Commercial Public Register, for commercial loans in general, or more probably the specific Patent and Trademark Registry and Copyright Registry.

New Zealand: Follows U.K. practices.

Russia: Russian pledge law is largely untested. However, pledge law does require recording to establish priority over creditors.

Singapore: Follows U.K. practices.

South Africa: Security interests must be filed in the Patent office and Trademark Office to get priority over creditors. A judgment creditor reaches a patent by recording the warrant of execution or attachment in the register. Cinematographic films must be filed in a special office for such purpose. Otherwise security transfers of copyrights apparently are perfected by use of a Notarial Bond registered with Register of Deeds in the Deeds Office.

Spain: Spanish law provides that "[t]he lack of registration of the mortgage or pledge in the Register will deprive the creditor of the rights granted by this law." The law specifically requires filing patent and trademark in the appropriate Spanish information registers. Spanish law does not require an author's interest in a copyright to be "attached." See Geller, *supra* n. 173, Spain § 4[3][d].

Sweden: Patent and trademark "pledges" (security transfers) must be filed in the appropriate office for validity. Since there is no filing office for copyrights, the author questions whether a copyright pledge is possible under Swedish law.

Taiwan: With the abolishment of recording provisions, a copyright pledge is no longer feasible.

United Kingdom: Security transfers of information must be registered under Companies Act or they are void against liquidators and creditors. Patent and trademark mortgages must be registered in the applicable patent and trademark registers.

Venezuela: A chattel mortgage without change of possession must be registered in the Subaltern Registry Office for validity.

199. 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> (visited Dec 22, 2000). Note in particular Article 14 (registration of security interests). To the extent federal law does not expressly preempt Revised 9 and require all security interests be filed in the PTO, U.S. law will be incompatible with the requirements of the Patent Law Treaty.

200. See McCarthy Trademark, *supra* n. 12, ch. 32. For the text of the Treaty, see the WIPO Web site <http://www.wipo.int/treaties/ip/trademark-law/articles.html#11> (visited 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 recording 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? Arguably not.

information transfers void against any creditor, which would certainly include lien creditors, unless filed in a local register.

So a filing in most countries will be required under Revised 9-307(c) for information collateral. This will be expensive. Typically, security transfers of a patent or a trademark cannot be filed unless the patent or trademark is first registered. Extensive paperwork may also be required. Speaking from experience, for cinematographic works France requires filing the entire chain of title, including all contracts for writers, directors and composers, each of which must be translated into French by a certified translator whose translation must be notarized, authenticated and consularized. Many countries also charge high filing fees, such as in Japan, which charges 4% of the loan amount for each register. Finally, one can politely say that in practice the registers in many countries do not always operate with the transparency indicated by the treaties.

f. The Reason for the Change

Why did Revised 9 adopt such a complex system? According to Official Comment No. 8 to Revised 9-301, the former system of notification financing was eliminated because it had “proved unsatisfactory.” There is no indication of to whom it proved unsatisfactory, nor any examples of unsatisfactory results. Elsewhere, some of the Drafters say that some financiers of international accounts preferred non-notification financing because they found it burdensome to give notice to each account debtor.²⁰¹ This would certainly justify allowing an alternative procedure for traditional accounts, while still allowing those parties that relied on notification financing for non-account intangibles, such as intellectual property royalties, to continue their practice. It hardly justifies eliminating notification financing altogether.

In fact, it seems the Drafters had something else in mind. During the floor debates on Revised Article 9, it was represented that a study had found that, except for Canada, no other country used a filing system like Revised 9 for nonpossessory personal property security interests. Thus, the adoption of the location of the debtor rule in Revised 9-307(c) was intended as something of a slight of hand. The expectation was that, outside of Canada, international debtors would be “located” in the District of Columbia.²⁰² Filing in the District would then become a convenient method for trumping the U.S. bankruptcy

201. See Cohen & Smith, *supra* n. 103, at 1198-1199.

202. See Cohen & Smith, *supra* n. 103, at n. 41.

trustee in international financing transactions. When intellectual property practitioners pointed out the scores of recording systems around the world, the Drafters declined to make changes.

Many countries do maintain personal property filing systems. Most Latin countries have pledge laws that may well require local filing for nonpossessory personal property security interests. The Commonwealth countries require filing under their Company Acts. Whether these systems do, or will meet the “against a lien creditor” test in Revised 9 will demand careful, case by case analysis. For those that do, what Revised 9 has really done is internationalize the U.S. bankruptcy trustee. Under Section 544(a) of the Bankruptcy Code, the trustee is given the power of any involuntary creditor under any applicable non-bankruptcy law to avoid secret liens.²⁰³ For debtors outside the United States, the trustee should have the avoidance powers under the laws of the debtor’s country. Lenders who believe they can perfect a security interest in information against debtors outside the U.S. by filing in the District may be disappointed.

g. More Filing Confusion

So far we have been looking at royalties remitted from international licensees to a U.S. borrower. What happens if a borrower located in another country wants to grant intellectual property rights to a licensee in the U.S., and a U.S. based lender would now like to perfect a security interest against the borrower? As Official Comment No. 3 to Revised 9-307 tells us, “[u]nder the general rules of this section, a non-U.S. debtor normally would be located in a foreign jurisdiction and, as a consequence, foreign law would govern perfection.”²⁰⁴

Depending on the type of intellectual property involved, in many other countries there are filing systems. This means that, at least as far as Revised 9 goes, a lender perfects a security interest in a patent, trademark or copyright to be exploited in the United States against an owner-debtor “located” in another country by recording – in the other country. The filing systems in the Copyright Office and Patent & Trademark Office are, absent federal preemption, displaced as sources of public information about intellectual property interests in this country. It seems bizarre to provide that one perfects a security interest in a copyright, patent or trademark owned by a Japanese

203. See Federal Financing, *supra* n. 3, § III.F.

204. Licensees in other countries have been known to take umbrage at being called “foreign.” In their country, they are not “foreign.” Americans are. We will therefore use the preferred designation of “international” licensees.

debtor but exploited in the United States in Tokyo rather than Washington, D.C. Yet, absent federal preemption, Revised 9 so provides.

Some countries prohibit security interests from attaching to certain intellectual property rights. For example, Spain has a filing system for copyrights, but by law prohibits a security interest from attaching to an author's rights; it may only attach, if at all, to royalties.²⁰⁵ Italy has a similar rule.²⁰⁶ Revised 9-301(1) says that one looks to the law of the country where the debtor is located to determine questions of perfection and priority. It does not mention attachment. Can one argue that since the security interest could not even attach under Spanish law, it certainly could not be perfected under such law? Or would the security interest attach for purposes of U.S. law but merely be unperfected – and unperfected – because there is no place in Spain to file such an unattachable security interest? Revised 9 has no answer.

Revised 9 comes to this impasse because it ignores the national policies for intellectual property that have long been set by Congress. For several decades, the U.S. Government has been engaged in an extraordinary effort to secure harmonization and improvement of intellectual property protection worldwide. The result has been a complex web of international obligations that bind the United States as a single nation.²⁰⁷ The basic conflicts rule in the information treaties is the territorial principle: the law of the protecting country determines the scope of protection.²⁰⁸ Questions of priority of transfers are matters for the law of the protecting country under this principle.²⁰⁹ Revised 9-307(c) instead resorts to a conflicts rule based

205. See Geller, *supra* n. 173, at *Spain* § 4[3][d].

206. See Geller, *supra* n. 173, at *Italy* § 4[3][e].

207. For discussion see Geller, *supra* n. 173, *Introduction* § 3[3]; Nimmer & Nimmer, *supra* n. 47, ch. 18, *World Trade*; Lorin Brennan, *The Copyright Wars: The WIPO Treaties and the New Information Economy*, 2 PLI Fourth Annual Institute for Intellectual Property Law 623 (1998) on-line at Carol A. Kunze, *A Guide to the Proposed Uniform Computer Information Transactions Act* <<http://www.2bguide.com/>>; also André Lucas, *Intellectual Property and Global Information Infrastructure*, 32 *Unesco Copyright Bulletin* 3 (1998).

208. For example, Article 5(2) of the Berne Convention, Paris Act, provides: "The enjoyment and the exercise of these rights shall not be subject to any formality; *such enjoyment and such exercise shall be independent of the existence of protection in the country of origin of the work.* Consequently . . . the extent of protection, as well as the means of redress afforded to the author to protect his rights, *shall be governed exclusively by the laws of the country where protection is claimed.*" (emphasis added).

209. See Geller, *supra* n. 173, *Introduction* § 6[3][c], at INT-248 ("Professor Ulmer concludes that each protecting country is free to fashion a rule of priority for transfers of rights effective within the national territory in accordance with its perceptions of interests

on the “law of the country where the debtor is located,” a rule akin to the widely discredited “country of origin” principle where intellectual property is concerned.²¹⁰ The appropriate conflicts rule is that national law in the United States, *i.e.*, federal intellectual property law with its requirement of a federal filing, should determine priority of security interests in federal information in the U.S., regardless of the nationality or “location” or the owner-debtor.

Revised 9-302(3)(a) does say that a state filing is not necessary for property subject to a “treaty of the United States . . . which specifies a place of filing different from that specified in this Article for filing of the security interest.” Would the conflict rules in the international treaties that adopt the territorial principle meet this test? They do not specify “a place of filing” *per se* but do specify the

in regulating copyright commerce within that territory. Jurisdictions such as the United States might and do choose to maintain systems of recordation because their territories are so large, and copyright commerce so multifarious within national borders, that recordation rather than common knowledge within the local trade will best protect third parties acquiring rights.”).

210. For a thorough vetting of the “country-of-origin” principle as an erroneous copyright-conflicts rule *see* Geller, *supra* n. 173, *Introduction* § 4[2][a][ii] (approach “disfavored”). It has been widely rejected in U.S. practice in favor of the territoriality principle embodied in the international conventions. *See e.g. Twin Books v. The Walt Disney Co.*, 83 F.3d 1162 (9th Cir. 1996) (holding that since U.S. copyright law does not have extra-territorial effect, publication of *Bambi, A Life in the Woods* in Germany without requisite U.S. copyright notice did not inject work into public domain in U.S.); *Subafilms Ltd.*, 24 F.3d at 1095; Geller, *supra* n. 173, *Introduction* § 3[1][a][i]; Nimmer & Nimmer § 17.02. *Twin Books* follows the earlier decisions in *Ferris v. Frohman*, 223 U.S. 424 (1912) (1909 Copyright Act) and *United Dictionary Co. v. G & C. Merriam Co.*, 208 U.S. 260 (1908) (1870 Act). Unfortunately, two recent decisions, *Radio Television Espanola S.A. v. New World Ent.* 183 F.3d 922 (9th Cir. 1999) and *Itar-Tass Russian v. Russian Kurier, Inc.*, 153 F.3d 82 (2nd Cir. 1998) have confused the issue. *Radio Television* decided that the U.S. Copyright Act determined whether a writing was required for transfer of copyright interest in *Spain* because the works were “of U.S. origin,” a plainly spurious result. *Itar-Tass* believed that the question of copyright ownership necessary to determine standing in the protecting country (the U.S.) should be determined by the law of the country of origin (Russia), a result criticized as a “detour and a frolic,” and rightly so. Geller, *supra* n. 173, *Introduction* § 3[1][a][i], n. 11 & § 4[2][a][ii] (discussing appropriate conflicts rules under international conventions). *See also* Paul Edward Geller, *Overcoming Insularity: Lessons from New British Books for Intl. Intellectual Property*, 46 *Journal of the Copyright Society* 615, 625 (1999), using *Itar-Tass* as illustration of analytical error of ignoring treaty requirements in determining choice-of-law rules. *But see* Cohen & Smith, *supra* n. 103, at 1224-1226, acknowledging that a court may decline to apply the law of another state that violates a fundamental public policy of the forum state. The authors find it regrettable that a court in another country might on this basis decline to recognize the anti-assignment rules in Revised 9 where the license agreement is governed by the law of another country. They do not consider the case where the informational property interest is governed by the law of another state, despite the *lex contractus*. In any case, the territorial principle is a broader conflicts principle than the *ordre public* exception.

law that determines the place of filing. Application of such a rule to the United States would seem to require looking to U.S. national law, which would direct one to the federal filing offices for federal information. Again, this is an open question for the courts to decide.

h. The Conflicts Analysis

Secured creditors seeking to loan against intellectual property interests with an international component might consider the following check-list:

For loaning against a debtor in the United States receiving royalties from other countries:

Step 1: Identify the type of information involved, *e.g.* copyright, patent or trademark.

Step 2: Determine whether each transferee has an “interest” sufficient to be a “debtor.”

Step 3: Identify the country where each transferee is located under Revised 9-307(b). Examine its laws to see if it has a filing system for the information identified under Step 1. If so, determine whether it requires a filing to perfect a security interest in the information against a creditor, including a “lien creditor.” It probably does, but obtaining an opinion from local counsel is advisable. If it does not, examine the international conventions (*e.g.* WIPO Copyright Treaty, Patent Law Treaty, Trademark Law Treaty) and U.S. bilateral treaties to determine whether they have such a filing requirement. If not, examine U.S. conflicts law to determine whether federal law may preempt Revised 9 anyway and direct that the law of such country determine perfection requirements.²¹¹

Step 4: Determine whether the territory includes countries other than those identified under Step 3, *e.g.* the transfer has granted a British company rights throughout Europe. If so, examine the conflicts law of the country identified in Step 3 to see if it requires reference to each country in the licensed territory to perfect, and, if so, repeat Steps 1 through 3 for each one.²¹²

Step 5: Repeat Steps 1 through 4 for each country for which a transfer will be financed.

Step 6: After determining where to file, undertake the steps necessary to do so. This could require translating the entire chain of title into the local language, with the translation notarized,

211. See *supra* n. 173 and accompanying cases.

212. See Geller, *supra* n. 173, *Introduction*, § 6[1][b] (choice of law rules for acts outside forum country).

authenticated and counsularized. It may also require insuring that the underlying work, invention or mark has already been registered. Be prepared for significant fees.

For loaning against information in the United States with a debtor in another country:

Step 1: Identify the type of information involved, e.g. copyright, patent or trademark.

Step 2: Determine where the borrower is located under Revised 9-307(b).

Step 3: Examine the laws of this country to see if it has a filing system for the information identified under Step 1. If so, determine whether it requires a filing to perfect a "lien creditor." If it does not, examine the applicable treaties to determine whether they have filing rules. Then examine U.S. information law to determine whether it would preempt Revised 9 and require filing in an appropriate federal information office. Note the different court decisions for copyrights, patents and trademarks.²¹³

Step 4: After determining where to file, undertake the steps necessary to do so. This will mean searching a registry in another country, often in another language, to determine priority. Undertake the steps necessary to file, including translating, notarizing, authenticating and counsularizing documents in the chain of title as required, along with registering the underlying work, invention or mark.

If all this is too much, simply transfer the information to a debtor located in another country and finance the transaction under its law.

F. R 9-316(a): Duration Rules

1. Original Article 9

How long does a perfected security interest remain perfected? Where the collateral is information, original Article 9 addresses that question in two sections.

Original 9-103(3)

(e) A security interest perfected under the law of the location of the debtor is perfected until the expiration of four months after a change of the debtor's location to another jurisdiction, or until perfection would have ceased by the law of the first jurisdiction, whichever period occurs first. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a

213. See Federal Financing, *supra* n. 3, § III.G.

person who becomes a purchaser after the change.

Original 9-302

(4) Compliance with a statute or treaty described in subsection (3) is equivalent to the filing of a financing statement under this Article, and a security interest in property subject to the statute or treaty can be perfected only by compliance therewith except as provided in Section 9-103 on multiple state transactions. Duration and renewal of perfection of a security interest perfected in compliance with the statute or treaty are governed by the provisions of the statute of treaty; in other respects the security interest is subject to this Article.

Under original 9-302(4), for copyrights, certainly, patents, probably, and trademarks, arguably, filing in the appropriate federal office is the proper place to perfect. Once filed there a security interest remains perfected because federal law does not provide for lapse. This result should also apply to information interests outside the U.S., since under national filing laws information security interest typically need not be refiled against transferees.²¹⁴

2. Revised Article 9

Revised 9 takes a different approach, providing that a perfected information security interest endures for no more than one year unless refiled against each transferee. The relevant sections provide:

Revised 9-311:

(b) Compliance with the requirements of a statute, regulation, or treaty described in subdivision (a) for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this division. . . . [A] security interest in property subject to a statute, regulation, or treaty described in subdivision (a) may be perfected only by compliance with those requirements, and a security interest so perfected remains perfected notwithstanding a change in the use or transfer of possession of the collateral.

Revised 9-316

(a) A security interest perfected pursuant to the law of the jurisdiction designated in Section 9-301(1) . . . remains perfected until the earliest of any of the following:

- (1) The time perfection would have ceased under the law of that jurisdiction;
- (2) The expiration of four months after a change of the debtor's location to another jurisdiction;
- (3) The expiration of one year after a transfer of collateral to a person that thereby becomes a debtor and is located in another jurisdiction.

214. Under original Article 9-306(2) a security interest continues notwithstanding disposition of the collateral, unless the secured creditor consents to a release.

(b) If a security interest described in subdivision (a) becomes perfected under the law of the other jurisdiction before the earliest time or event described in that subdivision, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earliest time or event, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

These provisions change the duration rules significantly.

3. *Detailed Analysis:*

a. The Conflicts Issue

Buried in the duration rules are two distinct issues. The first is a choice of law question: which law determines duration of a security interest? The second is a timing issue: how long does a perfected security interest endure under that law? Let us begin with the conflicts issue. The operative language in the original and revised statutes says (emphasis added):

Original 9-302(4)

Duration and renewal of perfection of a security interest perfected in compliance with the statute or treaty *are governed by the provisions of the statute of treaty.*

Revised 9-311(b)

[A] security interest in property subject to a statute, regulation, or treaty described in subdivision (a) may be perfected only by compliance with those requirements, and a security interest so perfected remains perfected *notwithstanding a change in the use or transfer of possession of the collateral.*

Under original Article 9-302, where a statute or treaty governed perfection, it also governed all questions of duration and renewal. For federal information interests within the United States, this meant that the federal statutes did (or should) govern duration. For information interests outside the United States, the local law of each protecting country would govern duration because the international conventions contain conflicts rules that refer to local law.²¹⁵

Revised Article 9 changes both rules. For federal information interests within the United States, Revised 9-311(b) only defers to a federal statute that requires a filing for perfection against a lien creditor. The federal information statutes cover bona fide purchasers, not lien creditors, so Revised 9-311(b) is inapplicable to them. Absent federal preemption, the law determining duration for U.S. information licenses is Revised 9-316.

215. See *supra* n. 173 and accompanying text.

For information interests outside the United States, the laws of many countries require local filing to perfect against all creditors, including lien creditors, so Revised 9-311(b) is facially applicable. Revised 9-311(b) treats perfection differently from duration. Under the first clause, perfection occurs by compliance with local national law. Under the second clause, however, the duration of that perfection only continues “notwithstanding a change in the use or transfer of possession of the collateral.” Neither an assignment nor a license constitutes a “change in use;” they are transfers. Nor are they a “transfer of possession” because intangible interests are incapable of physical possession. Certainly, the local law of each protecting country will determine the duration of an information security interest against creditors in that country. For U.S. information licensors, however, the real issue comes when the royalties are remitted to the United States. A creditor lending against such royalties wants to ensure priority over creditors of the U.S. licensor when the royalties come home, and at that point Revised 9 would apply. Since Revised 9-311(b) is inapplicable, Revised 9 will not look to the law of the country where the royalties arose to test duration, but instead use the rules in Revised 9-316. This result appears intentional. Revised 9-311(b) refers to “transfer of possession of the collateral,” while Revised 9-316(a)(3) refers to “transfer of collateral.” Since Revised 9-311(b) is an exception to the application of the duration rules in Revised 9, it evidently is drafted narrowly; the rule in Revised 9-316(a)(3), since it applies within Revised 9, is drafted broadly.

b. The Duration Rules

Now let us examine the duration rule. Compare again the operative language (emphasis added):

Original 9-103(3)

(e) A security interest perfected under the law of the location of the *debtor* is perfected until the expiration of four months after a change of the debtor’s location . . .

Revised 9-316

(a) A security interest perfected pursuant to the law of the jurisdiction designated in Section 9-301(1) . . . remains perfected until the earliest of . . .:

(3) The expiration of one year after a transfer of collateral to a person that thereby becomes *a debtor and is located in another jurisdiction*.

Under original Article 9-103(3), a security interest perfected against a “debtor” remains perfected until a change in the location of

a “debtor.” Since a transferee is not a “debtor” under original Article 9, a security interest perfected against a transferor would remain perfected against a transferee under original Article 9-306(2) unless the secured creditor consented to the transfer free of the security interest.

Revised 9-316(a)(3) changes this result by adding a new rule that a secured creditor must perfect within one year after “transfer of collateral to a person that thereby becomes a debtor and is located in another jurisdiction.” “Collateral” certainly includes interests under information licenses, and a “debtor” now includes transferees of information. If the transferee is located in “another jurisdiction” than that of the transferor-debtor, the secured creditor must perfect against that transferee in its jurisdiction within one year of making the transfer. If not, then under Revised 9-316(b), the security interest is prospectively unperfected against all parties and retroactively against any “purchaser of the collateral for value.”

An initial question is what security interest becomes unperfected? Recall that in information financing one security interest can cover four items of collateral: the debtor-transferor’s rights; the debtor-transferor’s royalty receipts; the transferee’s rights; and the transferee’s royalty obligation. Since the lender in theory only has *one* security interest, is it unperfected against all items of collateral or only some? If only some, which ones? It certainly would appear to be unperfected against the information interest conveyed to the transferee and by the same token the royalty payment obligation of the transferee. The problem is that Revised 9-316 seems to contemplate transfer of a single item of indivisible collateral that can only be in one place at a time, as opposed to divisible information collateral. Again the courts will need to sort out these matters.

Prospective unperfection will certainly be a concern for lenders to information owners who engage in customary transfers to exploit their information. Such a lender typically wants to ensure it is perfected in the information rights granted to the transferees as well as the royalties payable from the exploitation of those rights. Under Revised 9-316(b), such lenders must now ensure that every time the information owner makes a transfer to a transferee in another jurisdiction, the lender files against that transferee in that jurisdiction within one year. If not, the lender could become prospectively unperfected against any secured creditor of the transferee taking after one year from the making of the transfer. Since Revised 9 prohibits any restrictions on a transferee granting a security interest in its rights, such a secured creditor could arise at any time. Moreover,

since Revised 9 tries to categorize a transferor's reserved rights as a security interest, the same filing burdens will apply to a transferor trying to protect its right to collect royalties.

For information transfers outside the United States, the results will also be severe. A transferee in another country will qualify as a "person that becomes a debtor." Revised 9-316(b) is then explicit that the security interest must be perfected "under the law of the other jurisdiction," – *i.e.*, the law of the country where the transferee is located. Most countries have filing requirements for perfection against a local licensee.²¹⁶

Retroactive unperfection will be the real heartburn. It applies to "purchasers for value," which includes buyers and secured creditors, but not donees and lien creditors.²¹⁷ This means if a transferor, or the transferor's lender, fails to file within the one-year period, they will become unperfected retroactively against any floating lienor of a transferee who filed after they did.²¹⁸

Then looms the bankruptcy trustee. As discussed in the companion article, it is inaccurate to say that the trustee is merely a lien creditor; the correct rule is that the trustee has the lien avoidance power of any involuntary creditor under applicable non-bankruptcy law, so that the U.S. federal information acts should be treated as giving the trustee the avoidance powers of a bona fide purchaser.²¹⁹ For information transfers outside the United States, most countries provide that unfiled information security transfers are avoidable even by general creditors, so the trustee must have that power as well.²²⁰ What this means to the lender of an information owner is significant. If each transferee is now a debtor, the right to collect the royalties payable by such a debtor must be perfected by filing in each country where the debtor-transferee is located to gain priority against the trustee. Filing merely against the transferor in the U.S. will not do, since the trustee has at least three different grounds for seizing the royalties from abroad before they ever reach the U.S. transferor in case of that transferor's bankruptcy. The first is the plain language of

216. See *supra* n. 189.

217. U.C.C. § 9-316, cmt. 3 (Rev. 1998).

218. If the licensee is subject to a floating lien filed before the licensor's lender filed, then R 9-322(a)'s first to file or perfect rule, the floating lien would have priority anyway, absent, of course, any federal preemption.

219. See Federal Financing, *supra* n. 3, § III.F.1.

220. Another issue is how Revised 9 will work in case of transnational bankruptcies in multiple countries. Recently, Congress proposed legislation to co-ordinate these matters, a matter beyond the scope of this article. See *In re Maxwell Comm. Corp.*, 93 F.3d 1036 (2nd Cir. 1996) (discussing comity in transnational bankruptcies).

Revised 9 that a transferee is a “debtor” and a security interest must be perfected against a “debtor.” The second is to claim that the trustee is a garnishing creditor who must be deemed to have perfected an appropriate lien on the royalty payments in each country where a transferee is located. Such a garnishing creditor is now superior to the lender who has failed to perfect against the garnished transferee-debtor-account debtor. The third is to claim that under the international intellectual property conventions the transferor-debtor is located in each country with regard to its residual intellectual property interest, including the right to royalties, and that the trustee must be deemed to have perfected a claim against the debtor in each country as to that interest.

c. Questionable Justifications

One of the Drafters of Revised 9 describes the reasoning behind Revised 9-316 as follows:²²¹

Section 9-316 provides (in part) that when a debtor transfers the “collateral” to a person “located” in another state, a security interest perfected by the filing of a UCC financing statement in the debtor’s state becomes unperfected if the secured party does not file a UCC financing statement in the second state within one year. *See* R. 9-316(a)(3). Some concern has been expressed that a secured party in a transaction would file a financing statement against an owner of intellectual property in the state of the debtor’s location. . . . The owner of the intellectual property would then enter into an exclusive license with a licensee in another state, and concern was expressed that the license would trigger this rule as involving the transfer of the *copyright* itself. If that were correct, the secured party would have to file a UCC financing statement in the new state within one year for every license. . . . Some intellectual property lawyers have expressed concern that, as a matter of copyright law, under the Copyright Act, the grant of an exclusive license transfers a “property” right to the licensee. *Nimmer on Copyright* analyzes the Copyright Act in a manner consistent with the Article 9 analysis. *See* 3 Melville B. Nimmer & David Nimmer, *Nimmer on Copyright* § 10.02[C][2] & n.51 (1999) (commenting “there is never more than a single copyright in a work notwithstanding the author’s exclusive license of certain rights”; “an exclusive licensee owns ‘separately’ only ‘the exclusive rights comprised in the copyright’ that are the subject of his license”; “particular ‘exclusive rights under a copyright’ do not in themselves constitute a ‘copyright’”; and “there is but one copyright in a work regardless of whether and how many exclusive licenses of particular rights thereunder have been granted.”) Thus, for Article 9 purposes, the licensee’s property interest is in it rights under the license, not in the copyright itself. *Nimmer* makes clear that the

221. Weise, *supra* n. 32, at 1079-1080, n. 6.

licensor remains the “owner of the copyright” and has not transferred its property interest by entering into the license. Accordingly, Revised Article 9 produces the same result as copyright law – no filing is necessary by the secured party of the licensor against the exclusive licensee because the *copyright* itself has not been transferred to that person.

This reasoning, however, misses the mark for copyrights and fails to consider the effect of Revised 9-316 on patents, trademarks, or licenses outside the United States.

With regard to copyrights, as far as I am aware, no one ever claimed an exclusive copyright license transferred the entire copyright. The concerns with Revised 9-316(a)(3) come from the definition of “collateral” and “debtor.” Under the Copyright Act, a divisible copyright interest under an exclusive license is a copyright “ownership” interest.²²² The question is whether a security interest filed against the entire copyright endures against a divisible part exclusively licensed in another jurisdiction. If a creditor has a perfected security interest against three trucks in one jurisdiction, and the debtor transfers one of them to a buyer not in the ordinary course in another jurisdiction, must the creditor refile against the one moved truck? It certainly seems so.²²³ Nothing in Revised 9-316(a)(3) says the entire collateral must be transferred. Revised 9-316(a)(3) requires refiling in the jurisdiction where the transferee-debtor is located if the secured creditor wants to maintain its perfected position *in the interest transferred*.

The assertion that “Nimmer makes clear that the licensor remains the ‘owner of the copyright’ and has not transferred its property interest by entering into the license” misreads Nimmer. Although there is only one copyright, with the elimination of the indivisibility doctrine, any of the exclusive rights comprised in a copyright may be transferred and owned separately.²²⁴ This means that a copyright owner has definitely transferred a property interest when making an exclusive license or a partial assignment, not the whole copyright, but a divisible part. To see the limitations in the quoted analysis, assume a party has obtained an exclusive license to broadcast a motion picture by means of free television in the United States. This is certainly less than the entire copyright. The party now grants a security interest in its rights under the exclusive license, and

222. 17 U.S.C. § 101 (definition of ownership), § 201(d)(2) (divisibility of ownership interests) (1994).

223. Gilmore, *supra* n. 4, § 10.10, at 328; *see also* Clark, *supra* n. 96, ¶ 9.04 (discussing need to refile when certain collateral is moved to new jurisdiction).

224. 17 U.S.C. § 201(d)(2) (1994).

then proceeds to grant exclusive broadcast licenses to local television stations around the country. This is just what the debtor did in *Peregrine*. Is a security interest perfected against the exclusive license also perfected against the sublicenses to the local television stations under Revised 9-316(a)(3)? The quoted analysis is inapplicable here because the collateral is not *the* copyright but a divisible ownership interest.

The quoted analysis is also inadequate when dealing with interests outside the United States. Nimmer is quite correct that there is only one *U.S.* copyright. But there is also a separate national copyright in each protecting country where the copyright is recognized. Filing in the U.S. does not cover them. Assume a debtor grants a lender a security interest its “worldwide copyright,” *i.e.*, in each national copyright in every country where the work is protected. Although most countries will recognize the effectiveness of the transfer,²²⁵ their local law will determine its priority against other transferees within their territory. This means that filing against the copyright in the United States has no effect on the copyright in any other country.

Finally, the analysis does not address what happens under the Patent Act or the Lanham Act. Unlike the Copyright Act, the Patent Act provides for recording of assignments and grants (partial assignments), not licenses. The “single copyright reasoning” in the quoted text is inapplicable to patent licenses. Apparently, for patent licenses, a secured creditor must refile in each state where its debtor makes a license in order to preserve its perfected status against each licensee. The Lanham Act raises another problem. Since the courts have held (erroneously) that a security interest in federal trademark is perfected only under state law, Revised 9-316 would apply without resort to any federal preemption argument. A lender to the owner of a federal trademark would apparently need to refile against each transferee in a new jurisdiction.

For a U.S. trademark, there could be a small escape hatch. Revised 9-316(b) refers to the law of the jurisdiction where the transferee is located. If that jurisdiction has adopted Revised Article 9, then under Revised 9-307(c) that new “debtor” could be “located” in the District of Columbia with a new filing required under the

225. See Geller, *supra* n. 173, *Introduction* § 6[3][c], *esp.* INT-249, (discussing conflicts issues involved in grant of a “worldwide” copyright interest. For example, in Germany a *copyright* cannot be assigned for security or otherwise, although the security instrument may be interpreted as an assignment of a right to royalties.); *see also* Geller, *supra* n. 173, *Germany* § 6.

District's version of Revised 9, if adopted. Since all filings are now in the same jurisdiction, would the original filing against the debtor-transferor be enough, or must the creditor make a new filing naming the new debtor-transferee? Revised 9 has no answer. In any case, it is bewildering why Revised 9 would make the local UCC filing office in the District the national repository for information security interests when the more experienced, better equipped and higher funded federal filing offices are just down the street.

d. No Escape through "Proceeds"

What about characterizing the royalties from transferees as "proceeds" and seeking to perfect them separately?²²⁶ Under Revised 9-102(a)(64), "proceeds" means "whatever is acquired upon the . . . license . . . or other disposition of collateral." Royalties from transferees would qualify as proceeds. In that case, the following provision rolls into play:

Revised 9-315

(a) Except as otherwise provided in this article . . . :

(1) A security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien.

(2) A security interest attaches to any identifiable proceeds of collateral.

(c) A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.

(d) A perfected security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds unless any of the following . . . is satisfied:

(1) All of the following are satisfied:

(A) A filed financing statement covers the original collateral.

(B) The proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed.

(C) The proceeds are not acquired with cash proceeds.

(2) The proceeds are identifiable cash proceeds.

(3) The security interest in the proceeds is perfected other than under subdivision (c) when the security interest attaches to the proceeds or within 20 days thereafter.

Under Revised 9-315(a)(1), a security interest filed against the transferor would attach to and continue in the information collateral transferred along with, per Revised 9-315(a)(2), the royalty proceeds.

226. See Federal Financing, *supra* n. 3, § III.B.3.

Under Revised 9-315(c), a security interest in proceeds is automatically perfected if the security interest in the original collateral was perfected. That's the rub. Since the information interest granted to each transferee-debtor constitutes collateral, Revised 9-316(c) requires the lender to perfect against each transferee in their collateral. For transferees located outside the U.S., this will typically require perfection in the transferee's home country.

Even if this hurdle is met, under Revised 9-315(d), a security interest perfected in proceeds because it was perfected in collateral becomes unperfected within 21 days unless one of three listed exceptions in Revised 9-316(d) applies. Inside the U.S., Revised 9-315(d)(1) would be inapplicable under subpart B unless the filing office for the information was the same filing office for the proceeds. Washington D.C. could be such a place, if federal preemption directs us to the national filing offices or Revised 9-307(c) directs us to the local UCC office. Outside the U.S., however, to perfect in the royalties from transferees a creditor will often need to file in the transferee's home country. A filing against the transferor in the U.S. would not be sufficient.

The alternative would be to perfect separately in the proceeds under Revised 9-315(d)(3) when they were remitted to the United States. For example, a lender could direct the royalties to be paid to a lock box deposit account and perfect in it. A trustee of a U.S. transferor-debtor, however, could still attack this lender's position as a voidable preference if the royalties were received within the preference period. The trustee could also argue that due to Revised 9-316(b), the lender is retroactively unperfected in the royalties before they reached the deposit account. In other words, the lender has perfected in an empty bucket.

In sum, Revised 9-316 lays yet another trap for unwary information creators and lenders, requiring extraordinary efforts on a global scale to ensure continued perfection for royalties remitted to the United States.

G. R 102(a)(2): Exclusive Licenses as Security Interests

1. Original Article 9

Is an assignment or an exclusive license of information a "security interest"? No one has ever thought so before. U.C.C. Article 1-201(37) says:

Current 1-201(37)

"Security interest" means an interest in personal property of

fixtures which secures payment of performance of an obligation.”

The definition then contains elaborate provisions for what is and is not a security interest, including whether a personal property lease is a security interest. Under this definition, however, the obligation of a party on a general intangible is not a security interest.²²⁷

2. Revised Article 9

The Drafters of Revised 9 now claim that assignments and exclusive licenses of information have become security interests due to the expanded definition of account:

Revised 9-102(a)

(2) “Account” . . . means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered

As one of the Drafters argues:²²⁸

The broader definition of ‘account’ expands the scope of [Revised] Article 9 by bringing into Article 9 more transactions through the continued application of Article 9 to the sale of ‘accounts’ (as newly defined). . . . The sale of a licensor’s rights *is* a “security interest” under Revised 9 because a licensor’s rights under a license would come under the expanded definition of “account.”

This reasoning is elaborated in greater detail thus:²²⁹

A licensor’s right under a *nonexclusive*^[fn] license on default to terminate the license is *not* a “security interest.” [Fn: The analysis might well be different for an “exclusive” license. There the secured party of the licensee may have something of value to dispose of on the licensee’s default.] . . . There are, to be sure, transactions that the parties label a license that *do* constitute a “security interest.” For example, an agreement labeled an exclusive “license” that functions as an outright transfer of the licensor’s intellectual property (e.g. a copyright) would likely constitute a transfer of ownership and, if the transferee were paying over time, a “security interest.”

3. Detailed Analysis:

In treating a transfer of intellectual property rights as akin to the “sale” of an “account,” Revised 9 confounds the difference between a security interest and a general intangible and between a sale and an executory transfer. The justification given for doing so focuses primarily on exclusive copyright licenses, so we can confine the discussion to copyrights. For patents and trademarks, there will be corresponding application for partial assignments.

227. Anderson, *supra* n. 99, at § 1-201:522.

228. Weise, *supra* n. 32, at 1087-1088.

229. Weise, *supra* n. 32, at 1083-1084.

a. A Transferor's Retained Ownership Interests

In a sale of goods, any retention of "title" by the seller is statutorily reduced to only a security interest. There is nothing the parties can do to prevent this.²³⁰ Information does not work this way. It has a chain of title. A transferee under an exclusive copyright license, for example, certainly obtains an ownership interest within the scope of the transfer.²³¹ But the transferor nonetheless retains the following ownership interests:

- A residual divisible interest in all copyright rights outside the scope of the license;²³²
- A statutory termination right with regard to the rights granted allowing termination of the transfer and recapture of the rights under certain conditions;²³³
- A beneficial ownership interest in the rights transferred, *i.e.*, a right to sue for infringement as this may effect royalties due;²³⁴
- A reversionary interest with respect to the rights granted allowing the transferor to reclaim the rights if the transfer is cancelled for breach.²³⁵

The transferor's retained interests are true ownership interests and not mere security interests. This means the transferor can exercise its rights directly upon the happening of the triggering event without the necessity of conducting a foreclosure sale to "recover" its rights. A transferor can sue for any use by a transferee outside the scope of the grant, *i.e.*, for infringement of its divisible reserved interest.²³⁶ As a beneficial owner who has transferred a copyright ownership interest in exchange for royalties, the transferor has immediate standing to sue for infringement if the transferee does not

230. Article 2-401; *see* Federal Financing, *supra* n. 3, § III.D.3.

231. 17 U.S.C. § 101 (1994) (definition of "transfer of ownership"); *see* Nimmer & Nimmer, *supra* n. 47, at § 12.02[C]; for discussion of the concept of scope, *see* Article 2 and Software, *supra* n. 60, at 490-491.

232. 17 U.S.C. 201(d)(2) (1994).

233. For pre-1978 works the right can arise if the author-assignor was an individual who died before the copyright renewal term vested. *Stewart v. Abend*, 497 U.S. 207, 110 S. Ct. 1750 (1990). *See* Nimmer & Nimmer, *supra* n. 47, § 10.15[A]. For post-1977 works, a statutory right is granted in 17 U.S.C. § 203. *See* Nimmer & Nimmer, *supra* n. 47, § 11.02.

234. 17 U.S.C. § 501(b) (1994); *see* Nimmer & Nimmer, *supra* n. 47, § 12.02[C].

235. *See Schoenberg v. Shapolsky Publishers, Inc.*, 971 F.2d 926, 932 (2d Cir. 1992); *also* Nimmer & Nimmer, *supra* n. 47, at § 10.15[A].

236. *See Sun Microsystems, Inc. v. Microsoft Corp.*, 188 F.3d 1115 (9th Cir. 1999); *Schoenberg*, 971 F.2d at 926; *S.O.S., Inc. v. Payday, Inc.*, 886 F.2d 1081 (9th Cir. 1989).

act.²³⁷ The transferor's termination right, unlike a mere security interest that would be lost to a foreclosing senior creditor, cannot be contracted away prior to its vesting.²³⁸ Finally, if the transfer is cancelled for material breach, the transferor may immediately pursue all available remedies against the transferee for infringement without the necessity of conducting a foreclosure sale.²³⁹

For none of these rights must the transferor accord the transferee a right of redemption. Yet a right of redemption is the essential characteristic of a security transfer.²⁴⁰ For an information security transfer, mere cancellation of the debt instrument is not enough; one also needs a reconveyance of the security transfer.²⁴¹ In contrast, for an ownership transfer cancellation of the instrument of transfer immediately revests the rights in the transferor.²⁴² At transferor's reserved rights under an information ownership transfer are a general intangible, not a security interest.²⁴³

Certainly, a transferor can create a security interest in its reserved rights. It is also possible for an instrument of transfer to be a security interest if the parties so intend. But this does not mean that every ownership transfer in which the transferor retains a right to royalties is automatically a security interest – at least not under current law.

237. H.R. Rep. No. 94-1476, at 159 (1976); see *Wildlife Intl., Inc. v. Clements*, 591 F. Supp. 69 (S.D. Ohio 1984); *Nimmer & Nimmer*, *supra* n. 47, at § 12.02[C].

238. 17 U.S.C. § 203(a)(2)(5) (1994) ("Termination of the grant may be effected notwithstanding any agreement to the contrary, including an agreement to make a will to make any future grant."). This limitation reflects a Congressional intent to protect authors against unremunerative transfers. See *Mills Music v. Snyder*, 469 U.S. 153, 173 (1985); see generally *Nimmer & Nimmer*, *supra* n. 47, § 11.01[B].

239. 17 U.S.C. § 503; e.g. *Columbia Pictures Television v. Krypton Broad.*, 106 F.3d 284 (9th Cir. 1997).

240. *Sheldon v. McFee*, 216 N.Y. 618, 111 N.E. 220, 221 (1916) ("The right to redeem is the essential characteristic of a mortgage."); 5 C.J. *Assignment* § 6 (assignment not a mortgage because no right of redemption).

241. *Magnuson Indus., Inc. v. Co-Rect Prod., Inc.*, 213 USPQ 652, 657 (1981); *Raillex Corp. v. Joseph Guss & Sons, Inc.*, 40 F.R.D. 119 (D.C. Col. 1966)

242. See e.g. *Columbia Pictures Television*, 106 F.3d at 284; *Kama Krippa Music, Inc. v. Schekeryk*, 510 F.2d 837, 844 (2d Cir. 1975) (provision for automatic reversioning for failure to pay songwriter's royalties enforced); *Frankel v. Stein and Day, Inc.*, 470 F. Supp. 209 (S.D.N.Y. 1979) (provision that rights "shall automatically" revert on publisher's failure to perform enforced).

243. See e.g. *Newcombe v. Sundra*, 274 Ill. App. 3d 590 (1995) (limited partnership interest is a general intangible, not a security interest); *Anderson*, *supra* n. , § 1-201:522. ("The obligation of a debtor on a general intangible is not a security interest.")

b. Confusing Sales With Transfers

In equating an information transfer with a sale of accounts, Revised 9 is collapsing two very different transactions. In account financing, there are two contracts: the original one between the assignor and account debtor; and the assignment from the assignor to the assignee. It is possible for the assignment to be a “sale,” *i.e.*, non-executory, while the original account contract remains executory. In fact, Revised 9-102(a)(2) defines an “account” as “a right to payment, whether or not earned by performance,” thus contemplating executory account contracts.²⁴⁴ In information transfers, on the other hand, there is only the one contract: the transfer agreement between the owner and the transferee. As discussed above,²⁴⁵ it is quite possible for information assignments and exclusive licenses to be executory. Indeed, in a bankruptcy context, the courts have typically classified exclusive licenses for limited rights or duration that require the payment of royalties as executory contracts.²⁴⁶ The Drafters of Revised Article 9 nonetheless treat these executory contracts as executed “sales.”

When original Article 9 was adopted, there was a significant debate whether a “sale” of accounts – factoring – should be included in the statute at all.²⁴⁷ It was eventually included because the financing structures at the time had left little difference between factoring and non-notification financing. Factoring was being done both on a non-recourse basis, leaving the factor with the credit risk of bad accounts, and on a recourse basis, leaving the debtor with the credit risk by requiring a buy-back of bad accounts. The latter had the same economics as non-notification or “security” financing.²⁴⁸ Since there was little practical difference, the drafters elected to cover both with a filing requirement.²⁴⁹ They did not, however, include executory obligations and certainly not royalties under licenses of information. Indeed, the original version of Article 9 did not even cover executory accounts.²⁵⁰ The drafters recognized that it was inappropriate to treat

244. See Clark, *supra* n. 96, ¶ 11.01[1]. The original version of Article 9 defined executory accounts as “contract rights.” This category was removed and included in “accounts” in the 1972 Amendments.

245. See *supra* n. 72 and accompanying text.

246. See *supra* n. 75 and cases cited therein.

247. See Plank, *supra* n. 64, at 410; see also Federal Financing, *supra* n. 3, § III.B.2.

248. Dan T. Coenen, *Priorities in Accounts: The Crazy Quilt of Current Law and a Proposal for Reform*, 45 Vand. L.Rev. 1061, 1067 (1992).

249. Gilmore, *supra* n. 4, § 10.5.

250. This was not done until the 1972 amendments, merging the “contract rights” category, which covered executory contracts, into the definition of “accounts.” See Clark,

information rights under executory contracts and their accompanying royalties as akin to a “sale” (executed contract) of an “account” (fully matured right to payment).

c. Impaired Cancellation Rights

The apparent reason for the changed treatment in Revised 9 is to restrain a transferor from canceling an exclusive license or assignment since this could reduce the value of the transferee’s rights as collateral. Instead, treating the transferor’s reserved rights as “really” a security interest forces the transferor to utilize the foreclosure rules in Revised 9 to recover the rights.²⁵¹ A full discussion of the foreclosure rules in Revised 9 is beyond the scope of this article.²⁵² However, two rules are of particular interest:

Revised 9-610

(c) A secured party may purchase collateral at either of the following:

(1) At a public disposition.

(2) At a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

Revised 9-625

(a) If it is established that a secured party is not proceeding in accordance with this division, a court may order or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions.

(b) Subject to subdivisions (c), (d), and (f), a person is liable for damages in the amount of any loss caused by a failure to comply with this division.

Under Revised 9-611, a foreclosing creditor must give a debtor prior notice of any disposition of the collateral. If an exclusive license is “really” a security interest, then an attempted recapture of the information rights by cancellation would be such a disposition. Under Revised 9-610(c)(1), such a “repurchase” requires the transferor, or rather “secured creditor,” to conduct a public foreclosure sale. A private disposition – recapture of rights by cancellation – is only possible where “the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.” This will rarely apply to information. Instead the

supra n. 96, ¶ 11.01[1].

251. See Weise, *supra* n. 32, at 1085 (arguing in the negative that if a reserved termination right is not a security interest then a transferor would not have to comply with the foreclosure rules in Revised 9).

252. For discussion see Donald J. Rapson, *Default and Enforcement of Security Interests under Revised Article 9*, 74 Chi.-Kent L. Rev. 893, 936-937 (1999) [“Rapson”].

transferor must “sell” them to third parties at public auction. And if the transferor fails to do so? Under Revised 9-625, the transferee – or its lender – can sue to enjoin the cancellation as a “wrongful foreclosure” and seek damages to boot.

Compare this approach with cases like *Columbia Pictures Television v. Krypton Broadcasting*.²⁵³ Krypton was a broadcast station that had licensed numerous television programs from Columbia under exclusive broadcast licenses. For Krypton’s failure to make timely payments, Columbia canceled the licenses. When Krypton continued broadcasting, Columbia sued for copyright infringement. The Court affirmed, rejecting Krypton’s defense that it was still entitled to broadcast but was merely in default of payment. Obviously, cancellation of an exclusive program license can impair the collateral value of the broadcast station to its lender, but this is necessary to protect the copyright owner’s rights.

H. R 9-408(a): Anti-Assignment Prohibitions

1. *Original Article 9*

Are royalties under an information license assignable? Are information rights [assignable]? Original Article 9 contains a narrow rule on this issue:

Current 9-318

(4) A term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in a general intangible for money due or to become due or requires the account debtor’s consent to such assignment or security interest.

Prior to the adoption of Original Article 9, there was authority for the proposition that an express contractual prohibition on the assignment of an executed right to payment was enforceable.²⁵⁴ Case law, however, had substantially eroded the practical effect of the rule where the assignment was simply of money due or to become due, and Article 9 adopted this approach.²⁵⁵

253. 106 F.3d 284 (9th Cir. 1997).

254. The leading case was *Allhusen v. Caristo Constr. Co.*, 103 N.E.2d 891 (1952). But see *Sillman v. Twentieth Fox Film Corp.*, 144 N.E.2d 387 (1957) (allowing assignment of a right to payment under a motion picture distribution agreement despite the no-assignment clause where the account debtor demonstrated a waiver of its requirements).

255. Prof. Gilmore argues that *Sillman* effectively declawed *Alhusen*, leading the drafters of Article 9 to do the same. See Gilmore, *supra* n. 4, § 7.4.

2. Revised Article 9

Revised Article 9 adds a new section that prevents any restrictions on any assignment of rights or royalties arising from general intangibles. It provides:

Revised 9-408

(a) . . . a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health care insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or the creation, attachment, or perfection of a security interest in, the promissory note, health care insurance receivable, or general intangible, is ineffective to the extent that the term does, or would do, either of the following:

(1) It would impair the creation, attachment, or perfection of a security interest.

(2) It provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health care insurance receivable, or general intangible.

...
(c) A rule of law, statute, or regulation, which prohibits, restricts, or requires the consent of a government, governmental body or official, person obligated on a promissory note, or account debtor to the assignment or transfer of, or the creation of a security interest in, a promissory note, health care insurance receivable, or general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor, is ineffective to the extent that the rule of law, statute, or regulation does, or would do, either of the following:

(1) It would impair the creation, attachment, or perfection of a security interest.

(2) It provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health care insurance receivable, or general intangible.

(d) To the extent that a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health care insurance receivable or general intangible or a rule of law, statute, or regulation described in subdivision (c) would be effective under law other than this division but is ineffective under subdivision (a) or (c), the creation, attachment, or perfection of a security interest in the promissory note, health care insurance receivable, or general intangible:

(1) is not enforceable against the person obligated on the promissory note or the account debtor;

- (2) does not impose a duty or obligation on the person obligated on the promissory note or the account debtor;
- (3) does not require the person obligated on the promissory note or the account debtor to recognize the security interest, pay or render performance to the secured party, or accept payment or performance from the secured party;
- (4) does not entitle the secured party to use or assign the debtor's rights under the promissory note, health care insurance receivable, or general intangible, including any related information or materials furnished to the debtor in the transaction giving rise to the promissory note, health care insurance receivable, or general intangible;
- (5) does not entitle the secured party to use, assign, possess, or have access to any trade secrets or confidential information of the person obligated on the promissory note or the account debtor;
- (6) does not entitle the secured party to enforce the security interest in the promissory note, health care insurance receivable, or general intangible.

Given the complex drafting, the language for assignments of intangibles is highlighted. Official Comment No. 2 to Revised 9-408 elucidates the statutory intent:

2. Free Assignability. This section makes ineffective any attempt to restrict the assignment of a general intangible . . . whether the restrictions appears in the terms of the . . . agreement between an account debtor and a debtor (subsection (a)) or in a rule of law, including a statute or governmental rule or regulation (subsection (c)).

What was the reason for this change? As one of the Drafters says:²⁵⁶

Section 9-408 permits a secured party to *create and perfect* a security interest in a licensee's *rights* under a license despite otherwise enforceable prohibitions in the license or under other law against transfers. The Drafting Committee designed section 9-408 to make the value of otherwise nonassignable rights under a license available to licensees so that they can obtain more credit (and be more likely to pay their debts, including license fees).

So, the free transferability policy for industrial goods should now apply to intellectual property.

3. Detailed Analysis

a. Scope of Current Law

Before looking at the changes brought about by Revised 9, a

256. See Weise, *supra* n. 32, at 1093-1094 (emphasis in original). See also Schwarcz, *supra* n. 63, at 959: "An implicit rational [for nullifying anti-assignment clauses] however, might be that the obligor on the account or general intangible is not prejudiced by the assignment, whereas enforcing the anti-assignment clause would impair the *free alienability of property rights*." (emphasis added).

brief review of current law is in order. There is a distinction between an assignment of rights and a delegation of duties, but for purposes here, we can treat both under the "assignment" rubric. There are two cases to consider: (i) an express prohibition; and (ii) contractual silence.

An express restriction on assignment is enforceable unless prohibited by statute.²⁵⁷ Sometimes courts find the anti-assignment clause was waived by conduct, or only applied to an assignment of rights as opposed to a delegation of duties, or is inapplicable where the obligations are no longer executory.²⁵⁸ Outside these narrow limits, however, anti-assignment provisions are routinely enforced, absent statutory prohibition, as part of essential freedom of contract. Indeed, in a contract for a sale of goods, UCC Article 2-210 allows a delegation of duties or an assignment of rights *unless otherwise agreed*. The only exception is once a party's entire obligation is no longer executory, the party's contract rights may be assigned regardless of an anti-assignment clause.²⁵⁹

Where the contract is silent, the general rule is that a contract is assignable. An exception exists, however, for contracts that involve "personal services." The common law rule, originating in the venerable case of *Lumley v. Wagner*,²⁶⁰ is that a contract to supply personal services is *per se* not assignable.²⁶¹ As Justice Holmes put it:²⁶²

257. See e.g. *Delacroix v. Lublin Graphics, Inc.*, 993 F. Supp. 74 (D. Conn. 1997); *Rossetti v. City of New Britain*, 303 A.2d 714 (1972); *Paul v. Chromalytics Corp.*, 343 A.2d 622 (Del. Super. Ct. 1975) (anti-assignment provision in sale of business enforced; Article 9-318(4) inapplicable since case involved assignment of contract rights in sale of business); cf. *Wandler v. Lewis*, 567 N.W.2d 377 (1997) (stating rule, but noting that anti-assignment provision waived); 6 Am. Jur. 2d, *Assignments* § 20 (1999); Anno. *Validity of anti-assignment clause in a contract*, 37 A.L.R.2d 1251 (1999).

258. See e.g. *Sillman*, 165 N.Y.S. 498 (1957) (waiver by conduct); *Delacroix*, 993 F. Supp. 74 (D. Conn. 1997) (anti-assignment provision applied only to delegation of duties); 6 Am Jur. 2d *Assignments* § 29 (inapplicable where rights no longer executory).

259. Thomas A. Quinn, *Quinn's Uniform Commercial Code Commentary and Law Digest*, ¶ 2-210[A][6] 92nd Ed. 1991).

260. *Lumley v. Wagner*, 1 De G., M. & G. 604, 619 (ch. App. 1852) (contract to supply services of opera singer).

261. *Sally Beauty Co. Inc. v. Nexus Prod. Co., Inc.*, 801 F.2d 1001, 1008 (7th Cir. 1986) ("When performance of a personal services contract is delegated, the trier merely determines that it is a personal services contract. If so, the service is *per se* nondelegable. There is no inquiry into whether the delegate is as skilled or worthy of trust or confidence as the original obligor: the delegate was not bargained for and the obligee need not consent to the substitution.") See also *Am. Colortype Co. v. Continental Colortype Co.*, 188 U.S. 104, 107; *James v. Whirlpool Corp.*, 806 F. Supp. 835 (E.D. Mo. 1992) (franchise agreement); *Miller Constr. Co. v. First Indust. Tech. Corp.*, 576 So.2d 748 (Fla. 1991) (architectural services); *Rossetti v. City of New Britain*, 291, 303 A.2d 714 (1972) (architectural services); *Wired Music, Inc. v. Clark*, 168 N.E.2d 736 (1960) (contract to

“Service is like a marriage . . . [I]t may be repeated, but substitution is unknown.” An important reason is the lack of a meaningful remedy. As the New York Court of Appeals explained in *American Broadcasting Companies v. Wolf*:²⁶³ “Courts of equity have historically refused to order an individual to perform a contract for personal services. . . . Originally, this rule evolved because of the inherent difficulties courts would encounter in supervising the performance of uniquely personal efforts. During the Civil War era, there emerged a more compelling reason for not directing the performance of personal services: the Thirteenth Amendment’s prohibition of involuntary servitude. It has been strongly suggested that judicial compulsion of services would violate the express command of that amendment. . . . For practical, policy and constitutional reasons, therefore, courts continue to decline to enforce employment contracts.”

The jurisprudence for determining when a contract involves “personal services” is not entirely consistent.²⁶⁴ This led some courts to replace the *per se* rule with a test that looks to whether the assignment materially impairs the benefits expected by a party or deprives the party of adequate assurances of performance.²⁶⁵ UCC Article 2-210 adopts this approach for a sale of goods. Where the contract does not prohibit assignment, Article 2-210 provides that a party may perform through a delegate unless the other party has a “substantial interest” in having its original promisor perform. Similarly, where the contract is silent a party may assign its rights unless the assignment would “materially” change the other party’s duties, increase its risks or burdens, or impair its chance of obtaining performance. Courts have upheld express or implied prohibitions on assignments in contracts for the sale of goods where these conditions are met.²⁶⁶

Where intellectual property is involved, express contractual

supply music); 6 Am. Jur. 2d, *Assignments* § 29 (1999).

262. *Am. Colortype Co.*, 188 U.S. at 107.

263. 420 N.E.2d 363, 364 (1981) [citations omitted].

264. Larry A. DiMatteo, *Depersonalization of Personal Service Contracts: The Search for a Modern Approach to Assignability*, 27 Akron L. Rev. 407 (1994).

265. *Id.* at 420-422 (providing examples of case law in this area).

266. See e.g. *Sally Beauty Co. Inc.*, 801 F.2d at 1001 (holding that supplier of hair care products could terminate exclusive distribution contract for assignment to direct competitor under UCC 2-210(1)); *Berliner Foods Corp. v. Pillsbury Co.*, 633 F. Supp. 557 (D.Md. 1986) (finding manufacturer of ice cream could cancel distribution contract when distributor was bought by competitor); but see *Baxter Healthcare Corp. v. O.R. Concepts, Inc.*, 869 F. Supp. 606 (N.D. Ill. 1994) (anti-assignment provision not breached by acquisition of stock of buyer, distinguishing *Sally Beauty* because the case involved a nonexclusive license to supply products, not to sell them).

prohibitions on assignment or sublicensing are routinely enforced.²⁶⁷ Where the contract is silent, intellectual property must be analyzed under the “personal services” exception. The default rule is that an assignee of a patent, or an assignee or exclusive licensee of a copyright, may assign or sublicense its interest, since it is an “owner” of the rights.²⁶⁸ However, a non-exclusive license of a patent or a copyright is considered to be a personal privilege of the owner to be held free from infringement claims, and hence, is not assignable absent a specific provision in the license.²⁶⁹ This rule goes to the essence of the rights granted under federal law, and thus, preempts contrary state law rules.²⁷⁰

Trademarks involve a different calculus. Trademarks identify to the public the source of goods or services. Uncontrolled or “naked” licensing whereby a licensee can place the mark on any quality or type of goods or services results in the mark ceasing to have any

267. See e.g. *Delacroix*, 993 F. Supp. 74 (D. Conn. 1997) (stating rule, but finding it inapplicable on facts presented); *In re D.H. McBride & Co.*, 132 F.285 (S.D.N.Y. 1904); cf. *Network Solutions, Inc. v. Umbro Intl.*, __ Va. __ 529; S.E.2d 80, 86 (2000) (since right to a domain name involves non-assignable personal services under registration contract, domain name not subject to garnishment).

268. See e.g. *Nolan v. Sam Fox Publg. Co., Inc.*, 499 F.2d 1394, 1397 (2nd Cir. 1974) (involving a copyright assignee).

269. Patents: *Oliver v. Rumford Chem. Works*, 109 U.S. 75, 82 (1883) (“A mere [nonexclusive patent] license to a party, without having his assigns or words equivalent to them, showing that it was meant to be assignable, is only the grant of a personal power to the licensee, and is not transferable by him to another.”); *Troy Iron & Nail v. Corning*, 55 U.S. 193 (1852); *In re Catapult Ent., Inc.* 165 F.3d 747, 750 (9th Cir. 1999) (non-exclusive patent license not assignable); *In re CFLC, Inc.*, 89 F.3d 673, 679 (9th Cir. 1996); *PPG Indus. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1093, (6th Cir. 1979); (under federal law, patent licenses not assignable unless expressly made so); *Unarco Indus., Inc. v. Kelly Co.*, 465 F.2d 1303 (7th Cir. 1972) cert. denied, 410 U.S. 929, 93 S. Ct. 1365, 35 L.Ed.2d 590 (1973); *Radio-Craft Co. v. Westinghouse Electr. & Mfg. Co.*, 7 F.2d 432 (3rd Cir. 1924) (non-exclusive patent license not transferable to company who bought stock of licensee; “what the license does not expressly, or by fair implication, permit, it prohibits.”); *In re Patient Educ. Media*, 210 B.R. 237, 240 (Bankr. S.D. N.Y. 1997); Anno. *Assignment of licensee’s rights under patent license agreement*, 66 A.L.R.2d 606.

Copyrights: See *Harris v. Emus Rec. Corp.*, 734 F.2d 1329, 1334 (9th Cir. 1984) (non-exclusive master use license not assignable in bankruptcy); *Neva, Inc. v. Christian Duplications Intl., Inc.* 743 F. Supp. 1533, 1546, (M.D. Fla. 1990) (“Since the agreement was that the narration would be used for the non-profit purposes of the Episcopal Foundation, transfer to any entity that would exploit the narrations for profit of that would have any other purpose other than the non-profit purposes of the Episcopal Foundation would be improper.”); *Mills Music, Inc. v. Cromwell Music, Inc.*, 126 F. Supp. 54, 62 (S.D.N.Y. 1954) (“The license agreement involved a “relationship of personal credit and confidence.”); *Illyin v. Avon Publications, Inc.*, 144 F. Supp. 368, 372 (S.D.N.Y. 1956).

270. *In re CFLC, Inc.*, 89 F.3d at 679; *Harris*, 734 F.2d at 1334; see Reilly, *supra* n. 14, (“An encroachment on the patentee’s right to block transfer of license rights to an unauthorized user devalues the patent rights and reduces the incentives to innovate.”).

meaning and constitutes a fraud on the public.²⁷¹ Under the Lanham Act a trademark owner, therefore, must exercise control over any assignment of a license or risk losing its trademark rights.²⁷² Restrictions on assignments of a trademark license, exclusive or nonexclusive, have been repeatedly upheld as necessary to protect the integrity of the mark.²⁷³

Unlike industrial commodities, if the law does not enforce restrictions on unauthorized transfers of intellectual property, much of the value is destroyed. In *CFLC, Inc.* explained why the state policy of free transferability of goods is inappropriate for intellectual property:

Allowing free assignability – or more accurately, allowing states to allow free assignability – of nonexclusive patent licenses would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from the licensee. In essence, every licensee would become a potential competitor with the licensor-patent holder in the market for licenses under the patents. And while the patent holder could presumably control the absolute *number* of licensees in existence under a free-assignability regime, it would lose the very important ability to control the *identity* of licensees. Thus, any license a patent holder granted – even to the smallest firm in the product market most remote from its own – would be fraught with the danger that the licensee would assign it to the patent holder's most serious competitor, a party whom the patent holder itself might be absolutely unwilling to license. As a practical matter, free

271. *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358, 367 (2nd Cir. 1959); see McCarthy Trademark, *supra* n. 12, § 18:48; Anno. *Granting of "Naked" or Unsupervised License to a Third Party as Abandonment of Mark*, 118 A.L.R. Fed. 211.

272. *Super. Bedding Co. v. Serta Assoc., Inc.*, 353 F. Supp. 1143, 1149 (N.D. Ill. 1972); *U.S. Major League Baseball Promotion Corp. v. Colour-Tex, Inc.*, 729 F. Supp. 1035 (D.N.J. 1990) (unauthorized sublicense); *Denison Mattress Factory v. Spring-Air Co.*, 308 F.2d 403, 409 (5th Cir. 1962) (trademark owner who fails to control licensees risks losing mark); 87 C.J.S., *Trade-Marks, Trade Names & Unfair Competition* § 209; William M. Borchard & Richard M. Osman, *Trademark Sublicensing and Quality Control*, 70 Trademark Rep. 99 (1980).

273. See e.g. *Hawkins v. Holiday Inns, Inc.*, 624 F.2d 342 (6th Cir. 1960) (franchise agreement); *Denison Mattress Factory v. Spring-Air Co.*, 308 F.2d 403 (5th Cir. 1962); *Seligson v. Plum Tree, Inc.*, 361 F. Supp. 748, 753 (E.D. Pa. 1973) (upholding franchisor's right to consent to assignment of franchise, noting "[a] franchisor has a perfect right to consider the character, stability, reputation, business ability, etc., of those to whom it will trust its own good name, its mark and its products"); *Hanigan v. Wheeler*, 19 Ariz. App. 49 (1972) (restrictions on assignment of franchise agreement not against public policy); see generally Anno., *Validity, Construction and Effect of Clause in Franchise Contract Prohibiting Transfer of Franchise or Contract*, 59 A.L.R. 3d 244 (2000). Restrictions on assignment may also be necessary to protect the trademark licensor from liability for torts of its licensee, Gilson, *supra* n. 190, § 6.03[2] & [19], or against false advertising claims. McCarthy Trademark, *supra* n. 12, § 18:48, at 18-80, § 25:33.

assignability of patent licenses might spell the end of paid-up licenses as the one involved in this case. Few patent holders would be willing to grant a license in return for a one-time lump-sum payment, rather than for per-use royalties, if the license could be assigned to a completely different company which might make far greater use of the patented invention that could the original licensee.²⁷⁴

b. Scope of Changes in Revised 9

Revised 9-406(d) already renders ineffective prohibitions on the creation or enforcement of a security interest in an "account." Since under Revised 9-102(a)(2) an account includes a right to payment under a general intangible, Revised 9-406(d) already adopts original Article 9-318(4). Revised Article 9-408 is unnecessary if its only purpose is to continue current law. Instead, as the Official Comments say, it is an entirely new enactment without prior antecedents.²⁷⁵

Does Revised 9-408 prohibit any restrictions on assignment of a general intangible or only on security assignments? Official Comment 1 to Revised 9-408 says: "This section makes ineffective any attempt to restrict the assignment of a general intangible . . . whether the restrictions appears in the terms of the . . . agreement between an account debtor and a debtor (subsection (a)) or in a rule of law." This is not limited to security assignments. Official Comment No. 4, in an oblique double negative, says: "This section does not render ineffective a restriction on assignment that does not create a security interest." This Comment is not as narrow as it might appear. The Drafters now maintain that a "security interest" under Revised 9 includes assignments and exclusive licenses of information, so an "assignment that does not create a *security interest*," is narrow indeed. The reader should examine the emphasized parts of Revised 9-408 quoted above to trace the provisions dealing with an assignment of a general intangible to decide for himself or herself what the statute says. It does not appear limited merely to assignments for security.

Curiously, the underlined words in 9-408(a)(2) & (c)(2) referring to "assignment, transfer or" were added as Technical Amendments in 1999 after the Official Text was promulgated. The explanation is that they "eliminate needless inconsistencies."²⁷⁶ Whatever the reason, these additions seem to be quite specific that prohibitions on all assignments are *verboden*. Otherwise, there was no need to add them,

274. *In re CFLC, Inc.*, 89 F.3d at 679 (emphasis in original).

275. Larry Laurence, *Anderson on the Uniform Commercial Code*, vol. 10, § 948, 206-207 (3d ed. West 2000).

276. *See The New Article 9*, *supra* n. 2, at 435-437.

since Revised 9-408 as written already prohibited restraints on security assignments. It appears that Revised Article 9-408 prohibits any restriction on an assignment of both royalties and rights by transferors and transferees, whether or not for security.²⁷⁷

c. Assignments by Transferors

The reason for limiting any restrictions on assignments by transferors was apparently to relieve lenders engaged in securitization of their obligations of due diligence where information is concerned. As one of the Drafters maintains:

In financing and capital market transactions, holders of performed and unperformed rights to payment customarily finance and securitize those rights. Lenders and investors financing unperformed rights to payment account for the credit risk that the account debtor will not perform its obligations to pay. But the lenders and investors financing both performed and unperformed rights to payment would not normally account for the risk, at least without considerable due diligence and greater expense, that the assignment of the right to payment itself is *ineffective* by virtue of there being a material impairment.²⁷⁸

Effective securitization of a transferor's informational rights is certainly a legitimate interest. But many information transactions are executory with unfulfilled obligations on both sides. As discussed above, there are legitimate reasons why a transferee might restrict a transferor's ability to assign its rights, especially for security, where the contract is still executory.²⁷⁹ The risk that an assignment of contractual rights might be ineffective due to a material impairment exists today in the case of an executory contract for the sale of goods under Article 2-210. Revised 9, however, despite repeated requests to do so, does not adopt the same rule for information that Article 2 does for goods. In the world of Revised 9, every transfer of intellectual property for royalties must be conceptualized as a "sale,"

277. See Thomas E. Plank, *The Limited Security Interest in Non-Assignable Collateral under Revised Article 9*, 9 ABI L. Rev. 323 (2000) (discussing application of Revised 9-408 to "true" security interests as well as "sales" and other transfers of intangibles).

278. Weise, *supra* n. 32, at 1090 (emphasis in original). After the quoted section, the text continues: "There is no justification for applying a material impairment test that might nullify a security interest in a licensor's fully earned right to payment under a license. Even UCC Section 2-210(2) . . . would permit the assignment of 'a right arising out of the assignor's due performance of his entire obligation.'" But Revised 9-406(d) already prohibits creation of a security interest in a licensor's fully earned right to payment. The argument is made to justify Revised 9-408, which prohibits restrictions on an assignment of all rights, not just payment rights, even for executory obligations. Revised 9 does not adopt for licensors of information what Article 2-210 accords sellers of goods.

279. See *supra* n. 14, and accompanying text.

i.e., a fully executed contract, since anything less would impose the burden of due diligence on secured creditors. It is a curious policy that deprives licensees of their rights because it is considered too burdensome for lenders to conduct the professional due diligence necessary to find out what they are.

Under current law, an exclusive license is conceptualized as a contractual undertaking, not to transfer the same information within the same licensed scope to another party.²⁸⁰ Indeed, the bankruptcy courts have found exclusive licenses to be executory precisely because of the transferor's on-going contractual obligation to refrain from granting the same information interest to others.²⁸¹ Does Revised 9-408 now mean that a transferor can make a security assignment of the rights otherwise granted exclusively to the transferee, since it now invalidates both rules of law and contractual provisions, *i.e.*, the promise of exclusivity, that would prevent the security transfer? Since the statute treats information assignments and exclusive licenses as "security interests," does Revised 9-408 now effectively invalidate all exclusive information licenses by making the transferor's promise of exclusivity unenforceable? Absent preemption, evidently so. Revised 9-408(d) contains an elaborate list of what a *secured creditor* may not do with its security interest, but does not restrict the transferor.

Other questions involve the effect of Revised 9 on the traditional law that rights under personal service contracts are not assignable. In many cases, a transferee commissions a creator to create information, such as an architect commissioned to design a building. The rights and obligations under such contracts are traditionally non-delegable. Does the elimination of restrictions on "assignment or transfer" in Revised 9-408 include a delegation of duties? What if the parties intend a transfer of rights in the resulting work to the commissioning party, such as in the case of a work-made-for hire under the Copyright Act? What happens to shop rights for patents? What Revised 9-408 means in this regard, and how it comports with federal intellectual property law, will be another matter for the courts

d. Assignments by Transferee

The Drafters justified Revised-9408's elimination of any restriction on a transferee's assignment of both rights and royalties as

280. See *I.A.E., Inc. v. Shaver*, 74 F.3d 768, n. 8 (7th Cir. 1996) (an exclusive license is leave to do a thing, and a contract not to give leave to anyone else to do the same thing).

281. *Qintex*, 950 F.2d at 1496; *In re Select-A-Seat Corp.*, 625 F.2d 290, 291 (9th Cir. 1980) (exclusive software license); *In re Biopolymers, Inc.*, 136 B.R. 28, 29 (Bankr. D. Conn. 1992) (patent license).

follows:

Existing law generally permits creation and perfection of security interests in otherwise nontransferable rights. [Footnote: *See e.g.*, U.C.C. § 9-318(4).] The Drafting Committee modeled its approach on the law that applies to FCC licenses. Well-established law permits the creation, attachment, and perfection of a security interest in the licensee's rights under an FCC license and proceeds of that right, subject to the FCC's control over the actual enforcement of that security interest by the FCC's exercise of its power to approve or disapprove the transferee. The law that applies to FCC licenses permits the enforcement of the security interest in the *proceeds* Surely, the public policy supporting the interest of the FCC in supervising who acts under an FCC license is no less worthy of protection than the interest of a software licensor in supervising who acts under a software license.²⁸²

"Well-established law," however, does prohibit the creation, attachment and perfection of a security interest in otherwise nontransferable *rights*. Current Article 9-318(4) only prohibits restrictions on a security interest "for money due or to become due." It does not do so for contractual *rights*. Doing so confounds the property interest under an intellectual property license – the *rights* – with the monies arising from the exercise of those rights – the *royalties*. Article 2-210 has long made this distinction in a sale of goods, enforcing restrictions on an assignment of *rights* excepting only when the contract is fully executed. Revised Article 9 eliminates a comparable protection for transferors of information.

The invocation of public policy based FCC licenses is also questionable. *MLQ Investors, L.P. v. Pacific Quadracasting, L.P.*²⁸³ upheld a security interest in a broadcast license because the FCC itself had reversed its historic prohibition on them.²⁸⁴ The Commission did so by recognizing that a security interest in the proceeds from the sale of a license does not give the creditor any interest in the license itself.²⁸⁵ *MLQ Investors* does not hold a security interest can be created absent such policy reversal.²⁸⁶ Certainly, if an information licensor consents to a licensee security interest, of course the licensee can and should be able to make one. This does not mean that "public

282. Weise, *supra* n. 32, at 1092-1093 (emphasis in original).

283. 146 F.3d 746, 748 (9th Cir. 1998).

284. *Id.* The Commission announced this policy in *In re Cheskey*, 9 F.C.C.R. 986, 987 (1994).

285. *In re Cheskey*, 9 F.C.C.R. at 987.

286. In *In re Tak*, 985 F.2d 916, 917 (7th Cir. 1993), the Seventh Circuit, in reliance on what it believed to be the Commission's policy, held that a security interest could not attach to a security interest in proceeds from the sale of a broadcast license. *In re Cheskey*, 9 F.C.C.R. at 987, n. 8, decided the Commission had no such policy.

policy” does or should eviscerate all contractual restrictions on assignability for intellectual property where the licensor expressly withholds consent.

Moreover, the public policy behind FCC licenses and intellectual property is not the same. The purpose of the FCC is to regulate the airwaves for the public interest.²⁸⁷ The FCC is not in the business of licensing bandwidth in order to generate royalties necessary to create new bandwidth. It has little interest in who gets the proceeds from transfer of a broadcast license; it is concerned about who uses the limited broadcast frequencies. For intellectual property, however, collecting the royalties is an essential feature of what the law provides to encourage new creation.²⁸⁸ This distinction was discussed at length in *In re Ridgely Communications, Inc.*²⁸⁹ The court held that a secured creditor could take a security interest in a broadcast license, solely as necessary to confirm private rights against third parties, but not against the F.C.C. as the provider of the license interest. “Prudence dictates that the narrow holding of this opinion be emphasized. The holding is not a recognition of a general right of creditors to take blanket security interests in broadcast licenses... rights of the licensee vis-à-vis the F.C.C. may not be abrogated by private agreement.”²⁹⁰ A licensor of intellectual property is not a regulator of a limited public commodity indifferent to who gets the money.

287. *MLQ Investors*, 146 F.3d at 748.

288. See e.g. *Brulotte v. Thys Co.*, 379 U.S. 29, 33 (1964), *reh. den.* 379 U.S. 985 (1965) (“A patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly.”); *Waterman*, 138 U.S. at 260 (“The right conferred by letters-patent for an invention is limited to a term of years; and a large part of its value consists in the profits derived from royalties and license fees. . . . [T]he assignee of a patent by a mortgage duly recorded, whose security is constantly wasting by lapse of time, must be held (unless otherwise provided in the mortgage) entitled to grant licenses, to receive license fees and royalties, and to have an account of profits or an award of damages against infringers.” (emphasis added)); *Chem. Found., Inc.*, 29 F.2d at 600 (“Royalties to accrue and damages and profits for future infringement are incident to and accompany the patent unless separated by express reservation.”); *Crom*, 46 F. Supp. at 405.

289. 139 B.R. 375, 376-377 (Bankr.D.Md. 1992).

290. *Id.* at 379. A consistent problem in Article 9 has been its tendency to use words that have a common meaning in one context in an unanticipated way. An example is the use of “security interest” to include a “sale” of accounts. See *Plank*, *supra* n. 64 criticizing this tendency. Revised 9 does the same with “license.” A “license” in the sense used in *MLQ Investors* means a governmental privilege to engage in certain conduct granted pursuant to the police power. See 51 Am.Jur. 2d, *Licenses and Permits* § 14. This is not the same as a private license that accords a privilege to be free from suit for infringement of intellectual property rights that are granted to private parties under entirely different constitutional authority.

e. The Justification - Grabbing The Proceeds

The real reason for altering existing law is apparently to allow transferees to use security interests to access all the income earned from exploiting the intellectual property rights, including the share payable to a transferor as royalties. As one of the Drafters explains:

Grabbing the Proceeds: Once the licensee's rights have been transformed into money, the licensor no longer has an intellectual property interest to protect. If the licensee does transfer its rights (for example, with the consent of the licensor, pursuant to a bankruptcy court order, or otherwise), the secured party is entitled to enforce its security interest in the *proceeds* generated by the transfer of the licensee's rights. That does not interfere with the licensor's interest in controlling who uses the licensee's rights under the license.²⁹¹

The Official Comments emphasize that "grabbing the proceeds" is the goal of Revised 9-408. "By making available previously unavailable property as collateral, this section should enable debtors to obtain additional credit." This seems quite obvious. Transferees can now direct royalties otherwise payable to their transferors to the own lenders. The information was "previously unavailable" precisely because intellectual property law allowed creators to make it unavailable in order to ensure they could collect royalties for its use. Buyers of goods could also use "previously unavailable property as collateral" if they could be assured that use of a security interest would enable them to direct the purchase price to their secured creditors ahead of the seller. Example 5 in the Official Comments to Revised 9-408 illustrates the result when assigning a franchise: The franchisee's lender takes the proceeds of the transfer ahead of the franchisor.

One of the ostensible reasons given for this approach is to deal with the transferee's bankruptcy. As Official Comment No. 7 explains, "Bankruptcy Code § 552 invalidates security interests in property acquired after a bankruptcy petition is filed, except to the extent that the post-petition property constitutes proceeds of pre-petition collateral." Royalties are *proceeds* that arise from the information *rights*. Thus, the Drafters of Revised 9 considered it essential to prohibit all restrictions on the creation of a security interest in informational *rights*, as this could mean that they would not have a perfected interest post-petition royalty *proceeds* in case of the transferee-debtor's bankruptcy.

This argument, however, begs the question whether a creditor

291. Weise, *supra* n. 32, at 1096.

should be allowed to take a mandatory prior security interest in the transferee's royalty receivables ahead of the transferor in the first place. If the transferor consents to such a security interest, then it attaches to the transferee's rights and resulting royalties and the issue under Bankruptcy Code § 522 never arises. An issue only arises when the transferor does not consent. There are good reasons why a transferor might withhold consent. If the transferee becomes insolvent, who is entitled to the royalties from exploitation of the information by the bankrupt's estate? Under current law, post-petition royalties would be an obligation of the estate to which the transferor is entitled as an administrative claim.²⁹² For example, if the television station in *MLQ Investors* became insolvent, the station would have more value if it could continue broadcasting and earning add revenue instead of going dark. But program suppliers would have no incentive to allow the station to do so if they knew their license fees would be seized by the station's pre-petition secured lender without their prior consent. Bankruptcy Code § 522 intervenes to allow administration of the estate for the benefit of all creditors by providing that program suppliers who allow their works to be broadcast can be paid for so doing, just like other trade creditors dealing with the estate. Revised 9-408 is trying to award a transferee's pre-petition secured creditor a windfall preference over other post-petition information trade creditors by forcing a transferor to dedicate its information to the estate solely for the secured creditor's benefit regardless of objection by the transferor. This is contrary to rehabilitation policy behind Section 522.

Revised 9-408(d) provides an elaborate list of what a secured creditor allegedly cannot do in enforcing its security interest. As the Official Comments say, with emphasis,²⁹³ "*subsection (d) ensures that these affected persons [e.g., licensors] are not affected adversely thereby [i.e., by the licensee's security transfer]. That provision removes any burden or adverse effects on those persons for which a rational basis could exist to restrict the effectiveness of an assignment or to the exercise of any remedies.*" Oh, really? *What about the money?* A transferor does have a rational basis for objecting to a transferee's security interest if it deprives the transferor of a meaningful chance for payment. A significant part of the benefit conferred by intellectual

292 See *In re DAK Industries, Inc.*, 66 F.3d 1091 (9th Cir. 1995) (post-petition royalties under software license attributable to pre-petition commitment so unsecured). For further discussion of DAK see Federal Financing, *supra* n. 3, § II.B.4.

293. U.C.C. § 9-408, cmt. 6 (Rev. 1998).

property law is the ability to collect royalties.²⁹⁴ As Gilmore argued with regard to allowing security interests in executory assignments of unearned future intangibles:

Considerations of policy and common sense suggest that there must be a limiting point somewhere. Borrowers should not be encouraged or allowed to hypothecate all they own or might own in the indefinite future in favor of a creditor who is willing to make a risky loan now. A borrower's other creditors are entitled to know what his true situation is . . . And ways should be found to penalize a lender who, after allowing his borrower to pile up an intolerable weight of debt, then claims all the assets of the insolvent estate, leaving nothing to satisfy other claims.²⁹⁵

Taken to the extreme, Revised 9-408 could encourage information transferees to engage in Ponzi schemes at the expense of their transferors. Assume a licensee owes a royalty of 50% of "profits" (however defined) to its licensor. In other words, if the licensee makes \$1,000 in "profits," it owes \$500 to the licensor. What happens if the licensee wants to use 100% of the profits as collateral? Under current law, the licensor has several methods to ensure that the licensee can only encumber its 50% share of profits. The licensor can: (i) rely on a contractual provision to restrict the licensee's ability to assign its rights for security; (ii) treat the royalties as a general intangible, not account, and claim that any security interest against the licensee could only attach to the licensee's share of net royalties under the law of assignment; (iii) file a mortgage in the appropriate federal office when the information was licensed for the reserved royalty, claiming that this filing gave priority against any unfilled security interest against the licensee; (iv) claim that it was entitled to treat the reserved royalty as a "purchase money" interest, perfected by an appropriate federal or state filing; or (v) reserve a right to cancel the contract for nonpayment.²⁹⁶

Under Revised 9 each of these alternatives is systematically stripped away. Under Revised 9-408, whether the license or applicable law prohibits it or not, the licensor cannot prevent the licensee from assigning its entire profits – including the 50% royalty share payable to the licensor – to a third party for security. Under Revised 102(a)(2), the right to royalties is now an account for which a filing is now required, and such a filing will evidently be junior to a

294. See e.g. *Waterman*, 138 U.S. at 260 ("The right conferred by letters-patent for an invention is limited to a term of years; and a large part of its value consists in the profits derived from royalties and license fees.") (emphasis added).

295. Gilmore, *supra* n. 4, § 7.12, at 248-249.

296. See Federal Financing, *supra* n. , § II.C.

filing under a pre-existing floating lien against the licensee under Revised 9-322(a)(1)'s "first to file or perfect" rule. Under Revised 9-103, an information licensor, unlike any other creditor, has no recourse to "purchase money" status to gain priority over such a pre-existing floating lien. Under Revised 9-316, failure to file against the licensee where it is located within one year of the transfer will make the licensor's reserved royalty "security interest" unperfected retroactively. By treating an exclusive license as a security agreement, Revised Article 9 makes exercise of any cancellation right problematical at best. Finally, if the license is non-exclusive, the licensor's lender is prohibited from gaining any priority at all over the "licensee in the ordinary course of business" under Revised 9-321(b) in any case.

If there is little or nothing a licensor can do to ensure its right to royalties, then it is rational for a licensee to encumber all of its assets, including the royalties payable to a licensor, with a floating lien. That way, the licensee can have immediate use of the licensor's royalty, less, of course, the lender's vigorish. If the licensee's business is booming, then the licensor's royalties will be paid, and no one will be the wiser. But if the licensee is failing, then the licensee can use the royalty it would have otherwise paid to the licensor to stave-off its own the decline. Indeed, the most rational move for a failing licensee would be to acquire even more information, since now it can force licensors to commit their royalties to its business by using a pre-existing floating lien. In order to obtain new licenses, of course, the licensee must conceal its shaky financial state. It will do this by using part of the loan proceeds from new licenses to pay past-due royalties on prior licenses, giving the appearance of solvency – for a while. This is the classic model for a Ponzi scheme.

Revised Article 9 promotes such schemes in a way unimaginable in the goods world by its systematic treatment of intellectual property as inferior to goods. Under Article 2-210, a seller of goods can include an enforceable contractual restriction on a buyer's assignment of its contractual *rights*, while the contract remains executory, thus limiting the availability of contract *rights* as security. Revised 9 denies this treatment to licensors. A seller of goods to a buyer of questionable solvency can protect its right to receive payment with a purchase money security interest. Revised 9-103 prohibits information transferors from claiming "purchase money" status. A seller of goods can demand cash on the barrel instead of payment over time. Given the uncertainties in valuing intellectual property, such "paid up licenses" are filled with risk for information licensors.

f. Needed Federal Reforms

Official Comment 9 to Revised 9-408 says: “This section does not override federal law to the contrary. However, it does reflect an important policy judgment that should provide a template for future federal law reforms.” The Official Comments are right that federal law reforms are imperative. The Reporters indicate the direction those reforms should take:

Nonetheless, some restrictions on alienability actually may promote efficiency. . . . “[T]he familiar problems of externality control[,] . . . imperfect information, ‘prisoner’s dilemmas,’ free rider problems, and the cost of administering alternative policies” may each justify appropriate restraints on alienation.²⁹⁷

Intellectual property is precisely such a case. Eliminating restrictions on alienability that allows information markets to exist and treating information as inferior to industrial goods are not policies that should be endorsed. To the extent there is doubt about the full scope of preemption, federal action is needed to correct what Revised 9 has wrought.

I. R 9-321(b): The “Licensee in the Ordinary Course”

1. *Original Article 9*

Under UCC Article 1-201(9) a “buyer in the ordinary course” means someone who buys in the ordinary course from “a person in the business of selling goods.” Article 9 does not contain a “license in the ordinary course.” Such an entity would be nonsensical, given the basic differences between the “private goods” world of industrial commodities and the “public goods” world of intellectual property.

2. *Revised Article 9*

Over strong objection by intellectual property practitioners the Drafters of Revised 9 adopted the following provision:²⁹⁸

297. See Harris & Mooney, *supra* n. 23, at 2049.

298. One of the Drafters describes the origin of Revised 9-321(b) thus: “Some form of this provision [Revised 9-321(b)] has been in every draft of revised Article 9 since 1996 and also in UCITA since the first draft of UCITA in January 1966 (it has been dropped from UCITA as part of the removal of all secured financing provisions from UCITA). It does not appear that anyone raised objection to it during the discussions of UCITA’s financing provisions during the meetings of the UCITA Drafting Committee.” Weise, *supra* n. 32, n. 90. Other participants had a different view of the process. The drafts UCITA did not contained a “licensee in the ordinary course of business provision.” There were provisions in UCITA dealing with priority of transfers, some of which applied to nonexclusive licenses. When early drafts of those sections were discussed there was consistent objection from intellectual property practitioners that some provisions did not

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(a) In this section, "licensee in ordinary course of business" means a person that becomes a licensee of a general intangible in good faith, without knowledge that the license violates the rights of another person in the general intangible, and in the ordinary course from a person in the business of licensing general intangibles of that kind. A person becomes a licensee in the ordinary course if the person comports with the usual or customary practices in the kind of business in which the licensor is engaged or with the licensor's own usual or customary practices.

(b) A licensee in ordinary course of business takes its rights under a nonexclusive license free of a security interest in the general intangible created by the licensor, even if the security interest is perfected and the licensee knows of its existence.

This radical concept runs afoul of basic principles of federal information law.

3. Detailed Analysis

a. Questionable Justifications

The Drafters of Revised 9 give two ostensible justifications for this concept. The first, according to the Official Comments, is that "[l]ike the analogous rules in Section 9-320(a) with respect to buyers in ordinary course and subsection (c) with respect to lessees in ordinary course, the new rule in subsection (b) reflects the expectations of the parties and the marketplace."²⁹⁹ As one of the Drafters adds, "[section 9-321] protects the reasonable expectations of nonexclusive licensees (generally nonnegotiated transactions) that their rights are not subject to termination as a consequence of the

fully conform to the priority rules under intellectual property law, and a resulting commitment from the Reporter to correct them. Not every section was discussed in every Drafting Committee Meeting, of course, so some provisions continued unchanged in various drafts until it was their turn for discussion, but this never meant there was no objection. During the drafting process for UCITA, NCCUSL had initially indicated that the priority rules for information transfers would be established in UCITA. However, just before the 1998 NCCUSL Annual Meeting where Revised 9 was slated for approval, members of the Revised 9 Drafting Committee descended *en mass* on the UCITA Drafting Committee and demanded that the priority rules for information transfers be removed from UCITA and left solely to in Revised 9. This led to a flurry of objections, including to Revised 9-321(b), especially since the prior NCCUSL policy had induced little participation by intellectual property practitioners in the Revised 9 drafting process. The initial draft of Revised 9-321(b) applied both to exclusive and nonexclusive licensees, and to their credit, the Reporters of Revised 9, after hearing the criticisms, at least eliminated the reference to exclusive licensees. They claimed it is was too late to make other changes, however, and for various reasons the matter could not be discussed publicly.

299. U.C.C. § 9-321, cmt. (Rev. 1998).

licensor's default."³⁰⁰

The second is a purported need for a "balancing test." The Drafters say:

Section 9-321 seeks to balance two legitimate interests: (i) the ability of a secured party to have recourse to its collateral, and (ii) the ability of an ordinary course of business licensee of the collateral to retain the licensee's rights without interference from the secured party of the licensor. [Revised] Article 9 balances these interests by protecting the customer when the customer is a direct customer of the borrower. . . . [I]t is fair to protect the direct customer of the secured party's borrower because the secured party is in a position to oversee the activities of its borrower. Thus, Article 9 imposes on the secured party the risk of its own borrower's activities but not the risk of the activities of remote persons. . . . This reflects a balancing of the interests, expectations and burdens of the various participants.³⁰¹

b. Conflict with Copyright Law

Copyright law rejects Revised 9's "reasonable expectations" justification. If a license is cancelled for breach, continued exercise of rights by a sublicensee is an infringement, regardless of whether the sublicensee had a "reasonable expectation" that its sublicense could continue or not.³⁰² *Fitzgerald Publishing Co., Inc. v. Baylor Publishing Co., Inc.*,³⁰³ for example, held that a sublicensee's "reasonable reliance" on the belief that it had a valid sublicense was no defense to an infringement claim where its licensor's rights were terminated for material breach. Copyright infringement is a strict liability tort; lack of knowledge or innocent intent is simply not a defense.³⁰⁴ As Nimmer explains:

Innocent intent should no more constitute a defense to an infringement action than in the case of conversion of tangible personalty. In each case, the injury to property is worthy of redress, regardless of the innocence of the defendant. Moreover, a plea of innocence in a copyright action may often be easy to claim and

300. Weise, *supra* n. 32, at 1101.

301. Weise, *supra* n. 32, at 1100-1101.

302. *U.S. v. King Features Ent.*, 843 F.2d 394 (9th Cir. 1988) (where original license invalid nonexclusive sublicensee an infringer as well); *Fitzgerald Publ. Co., Inc. v. Baylor Publ. Co., Inc.*, 807 F.2d 1110, 1113 (2d Cir. 1986) (sublicensee's reliance on the terms of its license ineffective where its licensor in material breach; intent or knowledge not an element of infringement); *Costello Publ. Co. v. Rotelle*, 670 F.2d 1035, 1045 (D.C. Cir. 1981) (if main license terminated, sublicensee also liable for infringement; ignorance no defense); *Gilliam v. Am. Broad. Co.*, 538 F.2d 14 (2d Cir. 1976) (sublicensee's reliance on terms of its license no defense where editing program was material breach of original license); Nimmer & Nimmer, *supra* n. 47, at § 11.02[B][1][b] & § 13.08 [and cases cited].

303. 807 F.2d at 1113.

304. Nimmer & Nimmer, *supra* n. 47, at § 13.08 [and cases cited].

difficult to disprove. Copyright would lose much of its value if third parties, such as publishers and producers, were insulated from liability because of their innocence as to the culpability of the persons who supplied them with the infringing material. Furthermore, as between two innocent parties (*i.e.* the copyright owner and the innocent infringer) it is the latter who should suffer because he, unlike the copyright owner, either has an opportunity to guard against the infringement by diligent inquiry, or at least the ability to guard against liability for infringement by an indemnity agreement from his supplier or by an "errors and omissions" insurance policy.³⁰⁵

A more serious problem with Revised 9-321(b) is its conflict with the criminal penalties in the Copyright Act. Under Copyright Act Section 506(a), a person who willfully infringes a copyright for commercial advantage or private financial advantage commits an act of criminal copyright infringement.³⁰⁶ Reliance on advice of counsel is not a defense where the defendant willfully violates federal law.³⁰⁷ Revised 9-321(b) provides, nonetheless, that a non-exclusive "licensee in the ordinary course of business" can knowingly ignore the foreclosure of a prior security interest against its licensor and continue exercising its licensed rights with impunity. One of the Drafters maintains that "[t]he holders of 'off-the-shelf' non-exclusive licenses likely have reasonable expectations that (as long as they perform their obligations) they will continue to have the right to use the license even if their licensor loses *its* rights as a result of a foreclosure by the licensor's secured party."³⁰⁸ Under the Copyright

305. *Id.* at § 13.08, 13-280 - 13-281.

306. See *U.S. v. Larracuente*, 952 F.2d 672 (2nd Cir. 1992) (bootleg movie videotapes; defendant has burden of proving valid sublicense). Under the Copyright Act, "willfulness" means a "voluntary, intentional violation of a known legal duty." *Nimmer & Nimmer*, *supra* n. 47, at § 15.01[A][2] [and cases cited].

307. See *U.S. v. Heilman*, 614 F.2d 1133 (7th Cir. 1980), *cert. denied*, 447 U.S. 922. In *Heilman*, the defendant made unauthorized copies of pre-1972 sound recordings. Attorneys advised defendant that he would not be liable for infringement if he continued paying compulsory license fees. The Justice Department, and several Circuit Courts, repudiated this position, but defendant continued to sell "bootleg" copies in reliance on the advice nonetheless. Reliance on wrong advice was not a defense to acts of willful copyright infringement. See also *U.S. v. Drebin*, 557 F.2d 1316 (9th Cir. 1977), *cert. denied*, 436 U.S. 904 (holding held knowing sale of unauthorized copies of copyrighted motion pictures for private gain without obtaining title to the copies was criminal). The Court held Article 2-403, which allows a merchant entrusted with possession of goods to pass good title to a buyer in the ordinary course, was inapplicable did not invoke a "first sale" defense under federal law. Indeed, the defendant was not even entitled on an instruction on the point to argue mitigation.

308. Weise, *supra* n. 32, at 1097 (emphasis in original). The author does not define an "off-the-shelf" nonexclusive license. The author also claims, at n. 93: "[U]nder the 'shelter' doctrine, if a nonexclusive licensee did qualify for protection under § 9-321 from a foreclosure conducted by a secured party of the nonexclusive licensee's licensor, any

Act, however, a sublicensee who knowingly continues to exercise rights under a nonexclusive copyright license for private financial gain after its licensor is foreclosed out has only one reasonable expectation: a long stay in a federal penitentiary.³⁰⁹

The Copyright Act also includes its own preemptive “balancing test” for nonexclusive licenses contrary to that in Revised 9. Section 205(e) says that a nonexclusive license prevails over a later copyright mortgage if the license is in writing and either taken before execution of the mortgage or taken in good faith and without notice before its is recorded.³¹⁰ Otherwise, the duly recorded – perfected – prior security interest against the licensor prevails. If the secured creditor forecloses, its interest relates back to the recording date, prevails over later nonexclusive sublicenses outside the statutory grace period, and all further exploitation by the sublicensee, whether or not “in the ordinary course” is a copyright infringement. Under Revised 9-321, the Drafters aver that “[a] prudent secured party should ‘police’ its own borrower against the borrower entering into nonexclusive sublicenses. . . . If the secured party to the licensor does not want to encourage nonexclusive licenses, it can, in its security agreement (or elsewhere), require the borrower (the licensor) to place in all of the nonexclusive licenses the borrower grants a provision that the nonexclusive license will terminate if the licensor’s secured party forecloses.”³¹¹ What this really does is impose on information the

person that had a sublicense from the nonexclusive licensee would be protected to the same extent.” Regretfully, the “shelter” doctrine applies to hard goods, not intellectual property. A nonexclusive sublicensee who relies on this reasoning may wind up looking down the barrel of an infringement claim, and from behind bars to boot.

309. In *U.S. v. Drebin*, 557 F.2d 1316 (9th Cir. 1977), *cert. denied*, 436 U.S. 904 the defendant engaged in knowing sale of unauthorized copies of copyrighted motion pictures for private gain without obtaining title. The Court held Article 2-403, which allows a merchant entrusted with possession to pass good title to a “buyer in the ordinary course” was simply inapplicable under federal law. Lawyers who advise such licensees to do so knowingly should be aware that individuals who have the ability to supervise the infringing activity and have a financial interest in it, or who participate in infringing activity are personally liable for infringement even if ignorant that the activity was infringing. See *Southern Bell Tel. and Telegraph Co. v. Assoc. Tel. Directory Publishers*, 756 F.2d 801, 811 (11th Cir. 1985); *Nimmer & Nimmer*, *supra* n. 47, § 15.01[A][2], at 15-10 (“Persons who knowingly and willfully aid or abet copyright infringement are subject to the same criminal penalties as apply to the principal.”).

310. What about a conflict between a security interest in a nonexclusive license and an authorized nonexclusive sublicense? In that case, both are “transfers” subject to Section 205(d), and the one first duly recorded within the statutory grace prevails. Some assume Section 205(d) only applies to “transfers of ownership.” This is incorrect. It applies to “transfers,” and thus covers conflicts between two nonexclusive licenses. Section 205(e) only deals with conflicts between nonexclusive licenses and transfers of ownership.

311. Weise, *supra* n. 32, at 1101.

same excessive policing that was once required for pre-Code account financing under the *Benedict* regime.³¹² It would require a lender to make excessive intrusions into its debtor's business, significantly raising the costs for all parties, which is why federal law says this is what a copyright financier need not do. As Nimmer makes clear, it is *licensees* who have the burden of "looking up" and searching chain of title. They get the benefit when they in turn become sublicensors.

c. Conflict with Patent Law

Patent law also rejects the reasoning in Revised 9. Patent infringement is again a strict liability tort; intent to infringe, or knowledge of the existence of the patent, is immaterial.³¹³ Rather, intentional or knowing infringement of a patented invention allows a court to assess treble damages.³¹⁴ As a result, sale or use of a patented article outside the scope of the license, or after the license is terminated, is an infringement.³¹⁵ The Supreme Court rejected an "ordinary course" defense to a claim of patent infringement in *General Talking Pictures Corp. v. Western Electric Co.*³¹⁶ It held that a party who obtained patented articles knowing that the use exceeded the scope of the licensee's grant, could not be a "purchaser in the ordinary course of trade," but was instead a patent infringer.³¹⁷ Patent law also contains its own "balancing test" where non-exclusive licenses are concerned. A patent assignee takes subject to all existing

312. See Federal Financing, *supra* n. 3, § III.B(2).

313. 17 U.S.C. § 271(a); *Thurber v. Fairchild Motor Corp.*, 269 F.2d 841 (5th Cir. 1959); *Guiberson Corp. v. Equip. Engr., Inc.*, 252 F.2d 431 (5th Cir. 1958) (intent to infringe irrelevant); *Freeman v. Friedman*, 242 F.2d 364, 366 (4th Cir. 1957) (knowledge not necessary).

314. 17 U.S.C. § 284 (1994); *Rite-Hite Corp. v. Kelley Co., Inc.*, 819 F.2d 1120, 1126 (Fed. Cir. 1987); *State Ind. Inc. v. A.O. Smith Corp.*, 751 F.2d 1226, 1236 (Fed. Cir. 1985); *Chaparral Ind. v. Boman Ind., Inc.*, 697 F. Supp. 1113, 1124 (C.D.Cal. 1988); see Chisum, *supra* n. 173, at § 20.03[4][b].

315. See *Gen. Talking Pictures Corp. v. W. Electr. Co.*, 304 U.S. 175 (1938) (sale of patented article outside of scope of license an infringement); *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992) (same); *Intel Corp. v. U.S. Intl. Trade Commn.*, 946 F.2d 821 (Fed. Cir. 1991) (sublicensee who manufactured articles not authorized by license patent infringer); *Straight Side Basket Corp. v. Kull*, 24 F. Supp. 771 (D. Idaho 1938) (buyer of patented devices from licensee after license terminated an infringer); Chisum, *supra* n. 173, at § 21.03[3]. Compare *Intel Corp. v. ULSI System Tech.*, 995 F.2d 1566 (Fed. Cir. 1993) (an *authorized* sale of patented article under license exhausts patent rights).

316. *Gen. Talking Pictures Corp.*, 304 U.S. 175.

317. *Id.* at 180-181. ("The sales made by the Transformer Company to petitioner were outside the scope of its license and not under the patent. Both parties knew that fact at the time of the transactions. There is no ground for the assumption that petitioner was a 'purchaser in the ordinary course of trade.'").

licenses.³¹⁸ This means a prior license would not be foreclosed by a later perfected patent security transfer, but a subsequent license would be.

A “nonexclusive licensee in the ordinary course” who continues to represent that a patented item is licensed with consent of the patent owner after its license is foreclosed may also risk a charge of criminal patent counterfeiting. Section 292 of the Patent Act provides that anyone who, without the consent of the patentee, use the patentee’s name, the patent number, or the word “patent” with the intent of counterfeiting the mark of the patentee, or deceiving the public into believing that the thing was made or sold with the consent of the patentee, is liable for a fine for each offense.³¹⁹ Knowingly continuing to use a patent under a nonexclusive sublicense where the licensor’s authority has been terminated can constitute a violation.³²⁰

d. Conflict with Trademark Law

Revised 9-321 also puts state secured financing law on a collision course with federal trademark law. As Prof. McCarthy explains:

Once a [trademark] license contract is terminated, there is no doubt that the ex-licensee has no authorization or consent to continue use of the mark. After the license has ended, the ex-licensee must stop use of the mark. Continued use by an ex-licensee of the licensor’s mark constitutes a fraud on the public, since they are led to think that the ex-licensee is still connected with the licensor. As the Eleventh Circuit observed: “Common sense compels the conclusion that a stronger risk of consumer confusion arises when a terminated franchisee continues use of the former franchisor’s trademarks.”³²¹

If a trademark license is cancelled for breach, continued use of the mark on goods or services by a sublicensee is an infringement.³²²

318. See *Why Corp. v. Super Ironer Corp.*, 128 F.2d 539, 541 (6th Cir. 1942); *Keystone Type Foundry v. Fastpress Co.*, 263 F. 99 (2nd Cir. 1920).

319. 35 U.S.C. § 292 (1994).

320. See *Petersen v. Fee Intl., Ltd.*, 381 F. Supp. 1071 (W.D. Okla. 1974); also *Chisum*, *supra* n. 173, at § 20.03[7][c][vii].

321. McCarthy Trademarks, *supra* n. 12, § 25:31, at 25-61 (quoting *Burger King Corp. v. Mason*, 710 F.2d 1480 (11th Cir. 1983), *cert. denied*, 465 U.S. 1102 (1984)).

322. See *Green River Bottling Co. v. Green River Corp.*, 997 F.2d 359 (7th Cir. 1993) (breach of license by sublicensor ended sublicensee’s rights); *El Greco Leather Prod. Co., Inc. v. Shoe World*, 806 F.2d 392, 396 (2nd Cir. 1986) (retailer liable for trademark infringement where its supplier had breached its license with manufacturer); *Stabilisierungsfonds Fur Wein v. Kaiser, Inc.*, 647 F.2d 200, 207 (D.C. Cir. 1981) (“Courts have long recognized 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) (“A licensee who has materially breached its license has no rights to give to a sublicensee.”); *Leventhal v. Ollie Morris Equip. Corp.*, 184 Cal. App. 2d 553 (1960)

Knowledge is not a factor, since a trademark owner is entitled to protection against both innocent as well as malicious infringers.³²³ Indeed, since the purpose of a trademark is to identify the source of goods or services to the public, allowing a sublicensee to continue using a mark after termination of its licensor's interest defrauds the public and risks invalidating the mark.³²⁴ Use of a mark by a licensee builds up no rights in the mark as against the licensor.³²⁵ Thus, the remedy for an alleged wrongful termination of a trademark license is an action for money damages, not for the continued use of the mark.³²⁶ Indeed, once a license has been terminated, the licensor has a duty to prevent further use of the mark by the licensee in order to prevent customer confusion, or else the trademark will be forfeited.³²⁷ A licensor's case for an injunction to stop use by a terminated licensee is therefore stronger than in an ordinary trademark

(trademark on patented article); see generally 87 C.J.S., *Trade-Marks, Trade Names & Unfair Competition* § 212 (on termination of a license all rights to use the mark end); 2 McCarthy Trademark, *supra* n. 12, at § 18.15 (company must be able to prove a chain of title extending back to the original user of the mark).

323. *El Greco Leather Prod. Co., Inc.*, 806 F.2d at 396 (retailer's claimed lack of knowledge of its supplier's trademark infringement, even if true, provides no defense); *Major League Baseball Promotion*, 729 F. Supp. at 1035; *Grocers Baking Co. v. Sigler*, 132 F.2d 498, 502 (6th Cir. 1942) (common law trademark); McCarthy Trademark, *supra* n. 12, at § 25:30 (and cases cited).

324. See e.g. *Yamamoto & Co. (Am.) Inc. v. Victor United, Inc.*, 219 U.S.P.Q. 968, 980 (C.D. Cal. 1982) (continued exploitation of mark by sublicensee after termination a fraud on public, invalidating mark); McCarthy Trademark, *supra* n. 12, at § 18:48; Borchard and Richard M. Osman, *Trademark Sublicensing and Quality Control*, 70 Trademark Rep. 99 (1980); Ann. *Granting of "Naked" or Unsupervised License to a Third Party as Abandonment of Mark*, 118 A.L.R. F. 211.

325. See *U.S. Jaycees v. Philadelphia Jaycees*, 639 F.2d 134 (3rd Cir. 1981) ("Once a license has expired, use of the formerly licensed trademark constitutes infringement. To say that the licensee has acquired rights that survive legal termination of the license destroys the entire concept of a license. . . . No rights are established by such use."); McCarthy Trademark, *supra* n. 12, at § 25:31 [and cases cited].

326. See *Green River Bottling Co.*, 997 F.2d at 362 ("Unauthorized use of a trademark is an infringement, and we have held that the infringement of a trademark is not a proper self-help remedy for a breach of contract"); *Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, 970 F.2d 273, 282 (7th Cir. 1992); *S&R Corp. v. Jiffy Lube Intl., Inc.*, 968 F.2d 371, 376 (3rd Cir. 1992); *Burger King Corp. v. Hall*, 770 F. Supp. 633, 638 (S.D. Fla. 1991); McCarthy Trademark, *supra* n. 12, at § 25:31 [and cases cited].

327. See *Gorenstein Enter. v. Quality Case-USA*, 874 F.2d 431, 435 (7th Cir. 1989) ("The owner of a trademark has a duty to ensure the consistency of the trademarked good or service. If he does not fulfill this duty, he forfeits the trademark. . . . If the owner of a trademark has broken off business relations with a licensee he cannot ensure the continued quality of his (e)-licensee's operations, whose continued use of the trademark is therefore a violation of trademark law."); *Oberlin v. Marlin Am. Corp.*, 596 F.2d 1322, 1327 (7th Cir. 1979) (trademark owner must supervise licensees at the expense of abandonment of the mark); *Denison Mattress Factory v. Spring-Air Co.*, 308 F.2d 403, (5th Cir. 1962).

infringement case, since irreparable harm always flows from unlawful use and confusion.³²⁸

There are also potential criminal penalties. In 1984, Congress enacted the Trademark Counterfeiting Act, making trafficking in counterfeit trademarks a federal crime.³²⁹ Continued and knowing use of a trademark after termination of a license is a violation of the act.³³⁰ Ignorance that trafficking in counterfeit goods is a crime is no defense.³³¹

Revised 9-321 is grim news for trademark owners. It endorses continued knowing use of a trademark by a non-exclusive sublicensee even after its licensor has been terminated by foreclosure. Such continued use misleads the public into believing that the trademarked goods or services are being made available with the continued authorization of the new foreclosure sale purchaser and, unless enjoined, invalidates the mark. Any trademark owner who grants a security interest in a trademark, and then makes a non-exclusive license, is at risk. Any trademark owner who grants a license authorizing non-exclusive sublicensing is also at risk because under Revised 9-408, the trademark owner cannot prevent the licensee from granting a security interest. Since a licensor's right to royalties is now conceptualized as an "account" within the ambit of Revised Article 9, apparently, attempting to secure a right to royalties in a non-exclusive trademark license can also trigger Revised 9-321. The "licensee in the ordinary course of business" could conceivably invalidate a wide swath of state trademarks.

With regard to federal trademarks, as discussed in the companion article,³³² several cases, led by *In re Roman Cleanser Co.*,³³³ have held that a security interest in federal trademarks are governed by state law. If these cases remain standing, then Revised 9-321 risks nullifying the Lanham Act as well. The owner of a federal mark has a few courses to protect the mark. First, try a head-on assault on

328. See *Church of Scientology Intl. v. Elmira Mission Church of Scientology*, 794 F.2d 38, 43 (2nd Cir. 1986); accord *S&R Corp. v. Jiffy Lube Intl., Inc.*, 968 F.2d 371, 376 (3rd Cir. 1992).

329. Pub. L. 98-473, 98 Stat. 1837, enacted Oct. 12, 1984, 18 USCA § 2320 codified 18 USCA § 2320. The maximum penalties under the law were substantially increased in the Violent Crime Control and Law Enforcement Act of 1994, Pub. L. 103-322, 108 Stat. 1796. See 4 McCarthy Trademark, *supra* n. 12, at § 30:114 *et seq.*

330. *U.S. v. Bohai Trading Co.*, 45 F.3d 577 (1st Cir. 1995) (also upholding constitutionality of act).

331. *U.S. v. Baker*, 807 F.2d 427 (5th Cir. 1986).

332. See Federal Financing, *supra* n. 3, at § III.G(3).

333. *In re Roman Cleanser Co.*, 43 B.R. at 940.

Roman Cleanser by arguing that the Lanham Act does in fact preempt state law, including Revised 9-321, for perfecting security interests in federal trademarks. Second, argue that Revised 9-321 is incompatible with U.S. obligations under various international trademark treaties, that such treaties are self-executing, and their requirements preempt Revised 9-321.³³⁴ Third, proceed under the Trademark Counterfeiting Act for criminal misconduct. Neither *Roman Cleanser* nor its ilk have considered either of these last two contentions, so they are not foreclosed by precedent. Failure to act, however, risks not merely continuation of the foreclosed out non-exclusive license, but invalidation of the entire mark.

Official Comment 2 to Revised 9-321 says that the “licensee in the ordinary course of business” rule is analogous to that for buyers of goods. However, an invention is not analogous to a used car; a copyright is not like a toaster; a trademark is not a tin can. The market expectations for intellectual property are not those for tangible goods. “Licensees in the ordinary course of business,” who rely on Revised 9-321 to knowingly exercise non-exclusive rights in intellectual property after their licensors are foreclosed out, should be aware of the consequences under federal law of so doing.

J. R 9-102(a)(44): “Embedded Software”

1. Original Article 9

Original Article 9 does not contain a separate definition of “computer program.” At the time Article 9 was drafted of course, computer programs were in their infancy. Under original Article 9-106 a computer program, as a copyrighted work, is a general intangible.

2. Revised 9

Revised Article 9 has now included a new definition of an “embedded” computer program:

Revised 9-102(a)

(44) “Goods” means all things that are movable when a security interest attaches. . . . The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it

334. A full analysis of this argument is beyond the scope of this article. For further discussion of possible self-executing trademark treaties, see McCarthy Trademark, *supra* n. 12, at § 29:33.

customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods. The term does not include a computer program embedded in goods that consist solely of the medium with which the program is embedded.

One the Drafters describes the motivation for this eye-popping definition:

Much equipment, e.g. motor vehicles, printing presses, and medical equipment, usually utilizes software. Is the software subject to a license agreement that, under other law, effectively limits the secured party's enforcement rights? Revised Article 9 assists that determination by distinguishing between "software" which is a "type of general intangible" and, therefore, is subject to the potential restrictions on enforcement and so-called "embedded software" which, instead, is treated as "goods." . . . A secured party repossessing sophisticated equipment collateral will have to expeditiously determine whether it can treat the equipment as "goods" and exercise its enforcement remedy of foreclosure without delay, or whether it has to be concerned with prohibitions or restrictions in a license agreement that necessitate communication with and gaining the consent of a licensor. *These problems, of course, exist under present law, but there has been little focus on the issues and no guidance towards a resolution. Revised Article 9 not only focuses attention upon the problem and potential risks but also provides guidelines for dealing with them.*³³⁵

While the question of "embedded software" is real enough, the claim that before Revised 9 there was "little focus on the issues and no guidance towards a resolution" is a fairy tale. The Copyright Act has long addressed "embedded software" in express statutory provisions.

3. Detailed Analysis

a. Copyright Act Provisions

Computer programs are copyrightable works.³³⁶ It is a fundamental principle of copyright law that an intangible copyright is separate and apart from its physical embodiment. Section 202 of Copyright Act codifies this distinction:

Ownership of a copyright, or any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied. Transfer of ownership of any material object, including the copy or phonorecord in which the work is first fixed, does not of itself convey any rights in the copyrighted work embodied in the object; nor, in the absence of an agreement, does transfer of ownership of a copyright, or any of the exclusive rights

335. Rapson, *supra* n. 252, at 936-937 (emphasis added).

336. 17 U.S.C. § 101 (1994).

under a copyright, convey property rights in any material object.³³⁷

Congress put it succinctly: "The principle restated in section 202 is a fundamental and important one: that copyright ownership and ownership of a material object in which the copyrighted work is embodied are entirely separate things."³³⁸ A *copy* is not a *copyright*.

Under prior law, in some states transfer of a physical object was presumed to transfer the common law copyright.³³⁹ Section 202 obliterates this presumption.³⁴⁰ As a matter of preemptive federal law, the transfer of a material object in itself transfers no right to use the copyright.³⁴¹ This applies regardless of whether the license is exclusive or non-exclusive.³⁴² As a result, when dealing with a security transfer of a computer program one must distinguish the *copyright* from the *copy*.

Begin with the copyright. An exclusive copyright license is assignable absent contractual restrictions.³⁴³ A non-exclusive license, however, being personal to the licensee, is not assignable without

337. 17 U.S.C. § 202 (1994). For detailed discussion of the application of Section 202 to state contracting rules, *see* Article 2 and Software, *supra* n. 60.

338. H.R. Rpt. 94-1476, at 124 (1976).

339. A chief exponent of this view was *Pushman v. N.Y. Graphic Socy., Inc.*, 287 N.Y. 302 (1942), which held that an artist who sold a print master was presumed to convey the common law copyright as well. For further discussion, *see* Nimmer & Nimmer, *supra* n. 47, at § 10.09[B]. Note that this rule only applied to state *common law* copyright; it never applied to federal *statutory* copyright. Many states did not follow this rule. For example, in California mere possession of a print negative raised no presumption that the possessor owned the common law copyright. *Metter v. Los Angeles Examiner*, 35 Cal. App. 2d 304, 313 (1939).

340. H.R. Rpt. No. 94-1476, at 124. (1976): "[T]he bill would change a common law doctrine . . . authors or artists are generally presumed to transfer common law literary property rights when they sell their manuscript or work of art, unless those rights are specifically reserved. This presumption would be reversed under the bill."

341. *E.g. Quintanilla v. Tex. Television, Inc.*, 139 F.3d 494 (5th Cir. 1998) (paying for video tape did not transfer copyright in recording); *Saxon v. Blann*, 968 F.2d 676, 680 (8th Cir. 1992) (sale of manuscript did not transfer copyright in literary work); *Harris*, 734 F.2d at 1334 (purchase of master tapes from bankruptcy trustee did not transfer non-exclusive license to manufacture and distributor recordings); *Marobie-FL, Inc. v. Natl. Assoc. of Fire Equip. Distrib.*, 983 F. Supp. 1167 (N.D. Ill. 1997) (purchase of diskette containing copyrighted clip art did not allow downloading clip art onto Web page); *Applied Info. Mgt., Inc. v. Icart*, 976 F. Supp. 149, 153 (E.D.N.Y. 1977) (no software license from transfer of diskette); *Design Options, Inc. v. Bellepointe, Inc.*, 940 F. Supp. 86, 91 (SDNY 1992) (sale of sweater did not transfer rights in copyrighted fabric designs).

342. *Saxon*, 968 F.2d at 680 (exclusive license); *Harris*, 734 F.2d at 1334; *Applied Info. Mgt.*, 976 F. Supp. at 153 (nonexclusive software license); *Marobie-FL, Inc.*, 983 F. Supp. at 1167; Goldstein § 4.5.1(c).

343. *See In re Patient Educ. Media*, 210 B.R. 237, 240 (Bankr. S.D. N.Y. 1997) (citing *I.A.E., Inc. v. Shaver*, 74 F.3d 768, 774-775 (7th Cir. 1996)); *see generally* Nimmer & Nimmer, *supra* n. 47, at § 10.02[B][4].

consent of the licensor.³⁴⁴ This is a matter of federal intellectual property law, preempting state law transferability rules.³⁴⁵ This means a security transfer of a licensee's interest under a nonexclusive software license is ineffective without the consent of the licensor. Moreover, no security interest even attaches to the *copyright* in a computer program from mere ownership or possession of a *copy*, regardless whether the computer program is "embedded" or not.

Now, look at the copy. Section 106(3) of the Copyright Act grants the copyright owner the exclusive right "to distribute copies . . . of the copyrighted work to the public by sale or otherwise." This means that, in the first instance, the copyright owner has the right to determine *if* copies of the work are sold at all. However, the "first sale" doctrine in section 109 says that once the copyright owner duly authorizes sale of a copy this exhausts this distribution right for that copy, so its further transfer is not an infringement.³⁴⁶ Section 117 allows the authorized owner of a copy of a computer program to make a new copy or adaptation if it is essential for the use of the program.³⁴⁷ The copy may then be leased, sold or otherwise transferred, but only with the original copy and all of the original owner's rights in the computer program.³⁴⁸ However, both of these privileges only apply if the copyright owner authorized the initial sale of a copy.³⁴⁹ Nothing in the Copyright Act requires a copyright owner

344. See *Harris*, 734 F.2d at 1334 (non-exclusive master use license not assignable); *In re Patient Educ. Media*, 210 B.R. at 242-43 (non-exclusive patent license not transferable); *In re CFLC, Inc.*, 89 F.3d at 679 (nonexclusive patent license not transferable); *Neva, Inc. v. Christian Duplications Intl, Inc.*, 743 F. Supp. 1533, 1546 (M.D. Fla. 1990) (nonexclusive license not assignable under the 1909 Copyright Act); see generally Nimmer & Nimmer, *supra* n. 47, at §§ 10.01[C][4], 10.02[B][4].

345. *Harris*, 734 F.2d at 1334.

346. 17 U.S.C. § 109 (1994); see generally 3 Nimmer & Nimmer, *supra* n. 47, at § 8.12. The first sale doctrine only applies to the distribution right. *Design Options, Inc.*, 940 F. Supp. at 91 (§ 109 does not authorize reproduction); *Midway Mfg. Co. v. Strohon*, 564 F. Supp. 741 (N. D. Ill. 1983) (or adaptation); *Red-Baron-Franklin Park, Inc. v. Taito Corp.*, 883 F.2d 275 (4th Cir. 1989) (or public performance).

347. 17 U.S.C. § 117(a)(1) (1994).

348. 17 U.S.C. § 117(b) (1994).

349. *Id.* at § 109(d) ("The privileges prescribed by subsections (a) and (c) do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy or phonorecord from the copyright owner by rental, lease, loan or otherwise without acquiring ownership of it."); *Id.* at § 117(a)(1) (privilege applies to "owner of a copy"); *DSC Comm. Corp. v. Pulse Comm.*, 170 F.3d 1354 (Fed. Cir. 1999), *cert. denied*, 120 S. Ct. 286 (1999), (section 117 applies only to the owner of a copy of a computer program, not to one with mere possession); *Allen-Myland v. Intl Bus. Mach. Corp.*, 746 F. Supp. 520 (E.D. Pa. 1990) (section 117 does not authorize the use of microcode where the copy was not lawfully acquired); see generally Nimmer & Nimmer, *supra* n. 47, at § 8.08.

to sell copies. To the contrary, as the *DSC Communications Corp. v. Pulse Communications* court held, a copyright owner can place restrictions on the initial disposition of copies in ways that vitiate the first sale or computer use privileges.³⁵⁰ Nothing in state law requires copyright owners to sell copies either. They could lease them under UCC Article 2A, just as credit card companies rent their pieces of plastic, public libraries lend copies of books, and video stores rent copies of movies and games.³⁵¹ This means that if a licensee has not become the authorized owner of a copy, a transfer of copies on foreclosure of a security interest would be infringing if not separately authorized by the copyright owner.³⁵²

350. *DSC Comm. Corp. v. Pulse Comm.*, 170 F.3d 1354, 1361-1362 (Fed. Cir. 1999):

Not only do the agreements characterize the RBOC's as non-owners of copies of the software, but the restrictions imposed on the RBOC's rights with respect to the software are consistent with that characterization. . . . Each of the DSC-RBOC agreements limits the contractory RBOC's right to transfer copies or to disclose details of the software to third parties. The agreements also prohibit the RBOC's from using the software on hardware other than that provided by DSC. . . . The fact that the right of possession is perpetual, or that the possessor's rights were obtained through a single payment, is certainly relevant to whether the possessor is an owner, but those factors are not necessarily dispositive if the possessor's right to use the software is heavily encumbered with other restrictions that are inconsistent with the status of owner [of a copy].

Accord Adobe Sys. Inc. v. One Stop Micro, 84 F. Supp. 2d 1086 (N.D. Cal. 2000) (restrictions on transferring software outside educational market in shrinkwrap prevented the transaction from being a "sale" subject to the first sale doctrine); *Stenograph v. Sims*, ___ F. Supp. ___, 2000 WL 964748 (E.D. Pa. July 12, 2000) (where original transfer unauthorized, subsequent "gift" of software not protected by "first sale" doctrine).

351. A state law that purported to prohibit software vendors from renting copies could be preempted in any case. In 1990, Congress amended Section 109 to allow the owner of a computer program to control rental of a copy, even after a sale. Computer Software Rental Amendment of 1990, Pub. Law No. 101-650, Sec. 801, 104 Stat. 5089 *codified* 17 U.S.C. § 109(b) (1994). This "rental right" was enacted due to fear that the ease of copying would lead to wide scale piracy without restrictions on rental. It preempts state law. *Adobe Sys., Inc. v. Brenengen*, 928 F. Supp. 616 (E.D.N.C. 1996); *Central Point Software v. Global Software & Accessories, Inc.*, 880 F. Supp. 957, 965 (E.D.N.Y. 1995).

352. 17 U.S.C. § 109(d) (1994); *CMAX/Cleveland, Inc. v. UCR, Inc.*, 804 F. Supp. 337, 356 (M.D. Ga. 1992) (when copy of software was transferred to creditors, the privilege to continue using the copy under Section 117 ceased); *accord Adobe Systems Inc. v. One Stop Micro*, 84 F. Supp. 2d 1086 (N.D. Cal. 2000); *Stenograph v. Sims*, ___ F. Supp. ___, 2000 WL 964748 (E.D. Pa. 2000); *The Walt Disney Co. v. Video 47, Inc.*, 972 F. Supp. 595 (S.D. Fla. 1996) (rental of counterfeit cassettes an infringement despite purchase of copy); *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208, 213 (E.D. N.Y. 1994) (holding that the first sale defense was inapplicable because "Microsoft only licenses and does not sell its Products"); *Little Brown & Co. v. Am. Paper Recycling Corp.* 824 F. Supp. 11 (D. Mass. 1993) (providing copies on consignment not a first sale). Similar reasoning applies to patents. *Compare Intel Corp. v. ULSI System Tech.*, 995 F.2d 1566 (Fed. Cir. 1993) (authorized sale of patented article under license exhausts patent rights) *with Intel Corp. v. U.S. Intl. Trade Commn.*, 946 F.2d 821 (Fed. Cir. 1991) (sale of articles not

Apply these rules to a copy of software embedded in a motor vehicle, printing press or medical equipment. If the software proprietor has not authorized “embedding” (copying) the software and reselling the copies, then the “embedded software” is infringing, and there is nothing for the security interest to attach to in the first instance. On the other hand, if the software proprietor has authorized *sale of a copy* of the embedded software, then under the first sale doctrine and computer use privilege the owner of the *copy* can transfer its ownership interest in the *copy* for security without consent of the copyright owner. In case of a default, the copyright owner cannot object to resale of the *copy* on foreclosure.³⁵³ However, the *sale of the copy* transfers no license interest to use the copy beyond the first sale, computer use or related privileges accorded to the owner of a *copy*. Any attempted use of the copy of embedded software beyond those privileges, or any attempted transfer of the license, without express permission of the copyright owner, is infringing.³⁵⁴

There is simply no need for the definition in Revised 9-102(a)(44) to deal with the so-called “problem of embedded software.” Federal law already fully handles the matter consistent with the policies of intellectual property law. Indeed, the definition in Revised 9-102(a)(44) is nonsensical. There can never be a case where an intangible computer program “is associated with the goods in such a manner that it customarily is considered part of the goods” because Section 202 of the Copyright Act specifically negates this result. There can never be a case where “by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods” since this was the old minority rule for common law copyright that Section 202 preempts. The claim that Revised Article 9-102(a)(44) was needed because “there has been little focus on the issues and no guidance towards a resolution” is, well, not accurate.

b. Turning First Sale into Forced Sale

The evident reason for including Revised 9-102(a)(44) was to turn the “first sale” doctrine into a “forced sale” doctrine. Assume a

authorized by license is patent infringement).

353. What about the software rental right in 17 U.S.C. § 107(b), which gives the copyright owner the right to control rental of a copy of a computer program even after a first sale? It does not apply to “a computer program which is embedded in a machine or product and which cannot be copied during the ordinary operation or use of the machine or product.” 17 U.S.C. § 107(b)(1)(B). This is obviously far more limited than Revised 9’s “embedded software.”

354. 17 U.S.C. § 107(b)(1)(B) (1994).

copy of “embedded software” is not sold but only provided on loan, along with a nonexclusive license prohibiting transfer of the license or the copy. For example, when the question of transferability was discussed at the Drafting Committee Meetings for UCITA, the medical imaging equipment industry asserted that their equipment uses extensive software components. Since its use often demands considerable expertise, transferability is restricted.³⁵⁵ What if such a machine, in effect a giant copy of software, is licensed to a medical corporation subject to a floating against all its assets? In case of foreclosure, could a secured creditor ignore the restrictions and dispose of the machinery without regard to the license? Under federal law, the software license could not be transferred absent consent of the owner, and the copies could not be transferred because without a “first sale” the transfer would violate the copyright owner’s exclusive distribution right.

These limitations, however, could prevent a secured creditor from maximizing its collateral. Thus, Revised 9 purports to label “embedded software” as a “good” in the hope of re-characterizing the license as a “sale of goods.” Since “title” to “goods” must pass to a buyer in a “sale,”³⁵⁶ this would force a “first sale” whether the copyright owner authorized one or not. Under state “free transferability of goods” policies, once the embedded software is converted to a “good,” federal restrictions on transfer of a license can also arguably be ignored on the pretense that now one is dealing with “goods.” Revised 9-102(a)(44) is thus attempting to transform the federal “first sale” doctrine into a state mandated “forced sale” for computer software.³⁵⁷

One of the Drafters confirms this intent: “In narrow circumstances, software is included in the definition of goods (when software is appropriately embedded or integrated into related hardware). In those few circumstances, the obligations (and rights) of

355. See e.g. *Mallinckrodt, Inc.*, 976 F.2d at 700 (sale of patented medical imaging machines for use outside scope of patent license a patent infringement).

356. U.C.C. § 2-401(1) (1999).

357. The “embedded software” myth has been discussed repeatedly at NCCUSL drafting sessions for UCITA, Revised Article 2 and Revised Article 9. The claims by intellectual property practitioners that “software” cannot be a “good” under preemptive federal law continues to be unpersuasive to traditional commercial lawyers. For example, Prof. Jean Braucher of the American Law Institute claims that “[t]his attempt to distinguish the disk from the software might not withstand challenge. This rather technical distinction might be viewed as an unfair or deceptive practice under section 5 of the Federal Trade Commission Act.” Jean Braucher *Some Basics of Software Contracting, Without Draft UCC Article 2B*, SD30 ALI-ABA 475, 480 (1998). Old ideas die hard.

a secured party in possession of the hardware would encompass the embedded software.”³⁵⁸ Federal information law, however, is exactly the opposite. Where the secured party becomes the legitimate owner of a *copy* upon foreclosure, then the “first sale” doctrine allows resale of the *copy* of the embedded software.³⁵⁹ But where the secured party did not become owner of a copy, transfer or exploitation of the *copy* or the *copyrighted* software is infringing.³⁶⁰

c. “Embedded Software” - Effective Public Notice?

The “embedded software” myth has been repeatedly debunked. In *CMAX/Cleveland, Inc. v. UCR, Inc.*,³⁶¹ a developer licensed software to a retailer for use in tracking videocassette rentals and sales. The retailer, without permission, embodied a modified version of the software in a circuit board. A secured creditor foreclosed on the retailer and transferred the circuit boards to a third party, who began using them with the “embedded” software. The third party argued this was non-infringing under Section 117 of the Copyright Act since it had acquired a copy. Not so, said the *CMAX* court. Since the copyright owner did not authorize embedding the software in the circuit board, the secured creditor had no authority to authorize a transfer of the copy and Section 117 was inapplicable.³⁶² The use was infringing.

*In re SSE International Corp.*³⁶³ dealt with whether a security interest in accounts attached to royalty proceeds from a know-how license. The creditor argued that the know-how was embodied in heat-resistant steel casings, that these were goods, so the royalties were really accounts generated by a “sale of goods.” Disposing of this argument, the court said:

[B]ecause the subject of the “license” agreement in question was the debtor’s rights to its know-how and not merely a reproduction of debtor’s ideas and thoughts, the debtor furnished . . . intellectual property rather than goods. This determination is made

358. See Weise, *supra* n. 32, at 1095 n. 76.

359. See *Bourne v. Walt Disney Co.*, 68 F.3d 621 (2d Cir. 1995); see *Platt & Munk Co., Inc. v. Republic Graphics, Inc.*, 315 F.2d 847 (2d Cir. 1963) (1909 Act); also *McCoy v. Mitsuboshi Cutlery, Inc.*, 67 F.3d 917 (Fed. Cir. 1995) (patented knives); *Monte Carlo Shirt Co. v. Daewoo Intl. (America) Corp.*, 707 F.2d 1054 (9th Cir. 1983) (trademarked shirts).

360. *DSC Comm. Corp. v. Pulse Comm.*, 170 F.3d 1354, 1361-1362 (Fed. Cir. 1999); *Adobe v. One Stop Micro* 84 F. Supp. 2d 1086 (N.D. Cal. 2000); *Stenograph v. Sims*, ___ F. Supp. 2d ___, 2000 WL 964748, 55 USPQ2d 1436 (E.D. Pa. 2000); *The Walt Disney Co. v. Video 47, Inc.*, 972 F. Supp. 595 (S.D. Fla. 1996); *Microsoft Corp.*, 846 F. Supp. at 213.

361. 804 F. Supp. 337, 356 (M.D. Ga. 1992).

362. *Id.*

363. *In re SSE Intl. Corp.*, 198 B.R. 667, 670 n.3 (Bankr. W.D. Pa. 1996).

*independent of whether the tangible medium by which the debtor furnished such rights . . . constituted a good.”*³⁶⁴

The court also addressed the problem of public confusion that arises from assuming that possession of a physical *copy* grants an ostensible license to use a *copyright*:

This holding prevents a strange, if not nonsensical, result that could occur were this Court to hold that the debtor’s intellectual property rights in its know-how were goods merely because they were embodied in a tangible medium that itself constitutes a good. Because “[a] security interest in . . . goods . . . may be perfected by the secured party’s taking possession of the collateral,” 9-305, an entity could perfect its security interest in the debtor’s intellectual property, if it were a good, by merely taking possession of a tangible medium, such a written manual, embodying such intellectual property. Perfection by such methods could have disastrous results, however, because mere possession of the tangible medium by the secured entity would undoubtedly fail to notify other entities of such security interest, which is the point of perfection in the first place.³⁶⁵

It probably needs no further elaboration than saying that knowing use of “embedded software” for private financial gain where the first sale doctrine does not apply can also be criminal.³⁶⁶

Federal law has given crystal clear guidance with how to deal with a security interest in “embedded software.” Revised 9 did not follow it.

K. R 9-102(a)(11): Software Licenses as “Chattel Paper”

1. Original Article 9:

The word “license” can mean either the legal privilege itself or its documentary evidence. To distinguish these meanings, let us use “license right” for the former and “license record” for the latter. Now, is a license record a form of “chattel paper”? Under prior law it never was. Original Article 9 is explicit on that point:

364. *Id.* at 670 (emphasis added).

365. *Id.* at 670, n. 3. It has been suggested that one purpose of including “embedded software” in “goods” is to simplify collateral descriptions. The purpose of a collateral description, however, is to provide adequate notice so that a subsequent creditor would reasonably make further inquiry. *In re Value-Added Comm., Inc.*, 139 F.3d 543, 545 (5th Cir. 1998). The definition of “embedded software” would seem to conceal the fact that real collateral at least purportedly includes a general intangible (copyright interest) as well as a good (physical copy).

366. See *Drebin*, 557 F.2d at 1316; *U.S. v. Moore*, 604 F.2d 1228 (9th Cir. 1979); Lorin Brennan, *Embedded Software - Fact or Felony?*, West’s UCC Bulletin, vol. 43, rel. 4 (May 2001) and vol. 44 rel. 1 (June 2001).

Current 9-105(1)(b)

“Chattel paper” means a record or records that evidence both a monetary obligation and a security interest in or a lease of specific goods ...”

Under this definition, a license record for information, which does not refer to any interest in tangible goods, is not chattel paper.

2. Revised Article 9:

Revised Article 9 now purports to define a license record for software as chattel paper. It says:

Revised 9-102(a)(11)

“Chattel paper” means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph, “monetary obligation” means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods.

“Embedded software” confuses the *copy* with the *copyright*. This section now confuses the license *record* with the license *right*. Once again, the result is contrary to controlling federal law.

3. Detailed Analysis:**a. Origins of the Error**

To understand the error in Revised 9-102(a)(11) requires a brief review the history of intangible financing.³⁶⁷ At common law, personal property was financed by pledge, which required turning possession over to the creditor. Intangibles could not be so financed since they were incapable of physical possession. Eventually, various types of intangibles evidenced by a writing, such as negotiable instruments, corporate securities, and the like, were allowed financing by “pledge” through the device of turning the writing over to the creditor. This is the origin of “chattel paper.” However, this technique never applied to “pure” intangibles like copyrights, patents or trademarks.

The crucial difference between chattel paper and information intangibles is the existence of a recording act. At common law there was no public office for filing security claims in chattel paper. Thus, possession was deemed the best evidence of a creditor’s claim. This made commercial sense, since the chattel paper often involved

367. See Federal Financing, *supra* n. 3, § II.B(1).

negotiable instruments, and a debtor would not easily part with them without good cause. But information intangibles could not be so treated. This is a primary reason why Congress extended the federal recording acts to cover mortgages of copyrights in patents the Act of 1870 and federal trademarks in the Act of 1905.³⁶⁸ It is by recording in the federal system that a creditor gives public notice of an interest in federal information, not by taking possession of a license record.

When original Article 9 was adopted, it continued to recognize perfection of a chattel paper security interest by taking possession due to the large commercial practice that had developed.³⁶⁹ However, it also allowed creditors to perfect by filing.³⁷⁰ In a nod to entrenched practices, it said that a purchaser of chattel paper for value and in the ordinary course who takes possession prevails over a filed security interest of which the purchaser had no knowledge.³⁷¹ Revised 9 continues this approach. Revised 9-312(a) authorizes perfection of a chattel paper security interest by filing. Alternatively, a creditor can perfect in tangible chattel paper by taking possession, or in electronic chattel paper by taking "control."³⁷² Revised 9-330(b) continues the rule that a purchaser of chattel paper for value, in good faith and in the ordinary course takes free of a prior security interest if without knowledge that the purchase violates the rights of the secured party. Under Revised 9, "knowledge" means actual knowledge, not constructive knowledge.³⁷³

The trick with chattel paper is the claim is that possession of the license *record* gives the holder the authority both to exercise the license *rights* evidenced by the record and to seize the royalties due under the license ahead of the licensor. Both results are contrary to federal law.

b. License Rights: Conflicts With Federal Law

Does possession of a license record of copyrighted computer software, whether or not for "use in goods," convey any license right in a copyright? Federal law has a simple answer: "No."

368. See Federal Financing, *supra* n. 3, § II.B(1) & II.C.

369. Original U.C.C. 9-305; see Clark, *supra* n. 96, at ¶ 2.06[1][a].

370. Original U.C.C. 9-304(1).

371. Original U.C.C. 9-308.

372. Revised 9-313(a) (tangible chattel paper) & Revised 9-314(a) (electronic chattel paper). Jane Winn, *The Electronic Filing Rules in Revised Article 9*, Chi-Kent L.R. (1999).

373. Revised 9-102(c) incorporates the definitions in U.C.C. Article 1, and under Article 1-201(25) "knowledge" means "actual knowledge." See Official Comment No. 6 to Revised 9-330.

The leading case is *Kingsrow Enterprises, Inc. v. Metromedia, Inc.*,³⁷⁴ decided under the 1909 Act. A defendant purchased copyright certificates for 26 episodes of "The Judy Garland Show" at a sheriff's sale. He claimed possession of the certificates gave him a valid license to broadcast the shows. To this the court said:

The certificate is not the copyright; it is at its insufficient best in this setting "prima facie evidence of the facts stated therein." [Citation.] Even the owner may controvert such statements. [Citation.] The dispositive point is that the possessor of a copyright certificate is not *ipso facto* the copyright owner. The valuable federal right is not transferred by mere physical delivery, or other acquisition, of the certificate. The owner may, of course, assign the copyright. But this is to be done "by an instrument in writing signed by the proprietor of the copyright." [Citation.]

The statutory provisions relied on in *Kingsrow* were reenacted and expanded in the current Copyright Act. Section 204(a) continues the requirement that a transfer of copyright ownership must be evidenced by a written instrument of conveyance or memorandum of transfer signed by the owner of the rights conveyed.³⁷⁵ Section 204(b) says that an acknowledgement is prima facie, not conclusive, evidence of a transfer.³⁷⁶ By referring to "transfer," not "transfer of ownership," Section 204(b) covers nonexclusive licenses as well as assignments, mortgages and exclusive licenses. Under Section 205, recording an instrument of transfer in the Copyright Office in accordance with statutory requirements provides constructive notice of the facts stated in the instrument.³⁷⁷ These provisions preempt contrary state law.³⁷⁸

Revised 9-102(a)(11), in purporting to treat a license record as conveying a license right in copyrighted computer software, runs

374. 397 F.Supp. 879 (S.D.N.Y. 1975). In *Luft v. Crown Publishers, Inc.*, 772 F.Supp. 1378 (S.D.N.Y. 1991), the same sheriff's sale purchaser sold master tapes containing recorded performances of Judy Garland to the defendant, which the defendant proceed to copy, distribute and sell. The copyright owner sued for infringement, claiming that the transfer of the *copies* (master recordings) granted no right to do so. The court upheld the infringement claim.

375. 17 U.S.C. § 204(a). The signature requirement applies to a transfer of copyright ownership (assignment or exclusive license), not a non-exclusive one. For the impact of this differentiation on state law, see Article 2 and Software, *supra* note 60, at 481-484. This article does not consider the effect of any legislation authorizing electronic signatures.

376. 17 U.S.C. § 204(a). The evidence of transfer is rebuttable. See, e.g. *Lottie Joplin Thomas Trust v. Crown Publishers*, 456 F.Supp. 531 (S.D.N.Y. 1977) (although defendant possessed written assignment of renewal copyright which assignment was duly recorded in Copyright Office, plaintiff met burden of showing assignment invalid for lack of authority; decided under 1909 Act).

377. 17 U.S.C. § 205.

378. *Konigsberg Intl. v. Rice*, 16 F.3d 355, 357 (9th Cir. 1994); *In re Peregrine Entertainment, Ltd.*, 116 B.R. at 199.

contrary to at least four preemptive provisions of federal law.

The first is the writing requirement in Section 204(a) for a transfer of copyright ownership. Mere possession of a license record conveys nothing in the copyrighted software evidenced by the record, regardless of whether the software is “used in goods.”

The second conflict is with Section 204(b)’s proviso that an acknowledgement is only *prima facie* evidence of a transfer, meaning the presumption of a transfer is rebuttable. Revised 9 purports to make a state UCC-1 filing or taking possession of a license record *conclusive* evidence of a transfer of a security interest in the copyright interest evidenced by the license record. Federal law preempts this result.

The third conflict is with the copyright priority provisions. Section 205 says that recording in the Copyright Office in accordance with statutory formalities establishes priority over later transfers. The recording provisions apply to all transfers, including nonexclusive licenses. Yet Revised 9-330(b) asserts that a purchaser “in the ordinary course” of a license record acquires a right to “use in goods” the copyrighted software evidenced by the license record superior to a prior transfer recorded in the Copyright Office.

The fourth conflict deals with the constructive notice provisions in Section 205 which say that due recording in the Copyright Office imparts constructive notice of the facts stated in the instrument. Revised 9-330(b), however, provides that a purchaser “in the ordinary course” of a license record takes free of a recorded security interest unless the purchaser has actual knowledge - not constructive knowledge - that it violates the rights of a secured party.

These conflicts are not limited to financing transactions. As discussed above, Revised 9 purports to classify assignments and exclusive licenses as “security interests” along with actual copyright mortgages. Revised 9-330(b) is therefore asserting that a person who “purchases” a license *record* “in the ordinary course” to “use software in goods” has an interest in the license *rights* superior to any prior transfer duly recorded in the Copyright Office. Federal law disagrees.

c. License Royalties: Conflicts With Federal Law

Does mere possession of the license *record* give a right superior to the licensor to collect the royalties from the licensee? The Official Comments indicate this is what is intended³⁷⁹:

379. Official Comment No. 4.b to Revised 9-102. The Permanent Editorial Board added the quoted text to the Official Comments by the in 1999.

The expanded definition of [chattel paper] covers transactions in which the debtor's or lessee's monetary obligations include amounts owed with respect to software used in goods. The monetary obligations with respect to the software need not be owed under a license form the secured party or lessor, and the secured party or lessor need not be a party to the transaction itself. Among the types of monetary obligation that are included in "chattel paper" are amounts that have been obtained or advanced by the secured party or lessor to enable the debtor or lessee to acquire or obtain financing for a license of the software used in the goods.

The chattel paper rules are thus evidently another device to strip a licensor of royalties. The Drafters say a licensor could try to perfect its right to royalties over a subsequent lien against a licensee by filing a "protective" financing statement.³⁸⁰ (This would not work against a prior lien due to the priority rules.) The chattel paper rules, however, now allow a licensee to defeat even this narrow protection by "selling" the license *record* to a "buyer in the ordinary course." The only way the licensor can protect itself is to take possession of the original record, something few rational licensees would allow since the licensee needs the signed record to prove a defense to an infringement claim.

The assertion that a right to royalties is necessarily severable from the copyright was examined in *Valente-Kritzer Video v. Pickney*.³⁸¹ The case involved an oral agreement to grant an exclusive license, which the court found invalid for failure to comply with the writing requirements in Section 204(a). The Defendant then argued that contract actually contained severable obligations to grant an exclusive license and to pay a "finder's fee" equal to its earnings, and that only the first was barred by Section 204(a). While "doubting that a state law's definition of severability can undercut the policy of § 204(a),"³⁸² the court found that the obligation to pay was not severable from the grant and hence the entire contract as barred under Section 204(a). Such a ruling is consistent with the Copyright Act. Indeed, Section 501(b) indicates that a copyright owner retains a beneficial ownership interest in the rights transferred, giving a right a

380. Weise, *supra* n. 32, at 1085, fn.29: "Revised section 9-505(a) provides that a person in a transaction that might be classified as a transaction subject to Article 9 may file a protective security financing statement. It should be noted that this section specifically provides that a *licensor* may file a protective financing statement indicating its interest in a license. See R § 9-505(a)." [Emphasis in original.]

381. 881 F.2d 772 (9th Cir. 1989)

382. *Id.* at 776. Compare *Papa-John's Music, Inc. v. McLean*, 921 F.Supp. 1154 (S.D.N.Y. 1996) (oral agreement by joint authors to unequal sharing of copyright in joint work barred by § 204, but defendant granted leave to assert a good faith claim that the oral agreement was really one to administer royalties.).

right to sue for infringement as this may effect royalties due.³⁸³

In providing that possession of a license record constitutes a mandatory right to collect license royalties ahead of the licensor, Revised 9 is in effect asserting that a software owner cannot grant a license conditioned on payment of royalties. Instead, Revised 9 would use the chattel paper rules as a way to sever the royalty obligation from the grant of rights, regardless of the deal with the licensor. Such mandatory separation is contrary to federal information policy.

L. R 9-103: Purchase Money Security Interests

1. Original Article 9

Original Article 9 defines a purchase money security interest in the following section:

Current 9-107

A security interest is a “purchase money security interest” to the extent that it is:

- (b) taken by a person who by making advances or incurring an obligation gives value to enable to the debtor to acquire rights in or use of the collateral if such value is in fact so used.

Although this provision has its primary application for goods, in principle there is no reason why it could not apply to intangibles.³⁸⁴

2. Revised Article 9

Revised Article 9 redefines and constricts “purchase money” status where intellectual property is concerned. It provides:

Revised 9-103

(a) In this section:

- (1) “Purchase money collateral” means goods or software that secures a purchase money obligation incurred with respect to that collateral.
- (2) “Purchase money obligation” means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

(c) A security interest in software is a purchase money security interest to the extent that the security interest also secures a purchase money obligation incurred with respect to goods in which the secured party holds or held a purchase money security interest if both of the following conditions are satisfied:

- (1) The debtor acquired its interest in the software in an integrated transaction in which it acquired an interest in the

383. 17 U.S.C. § 501(b) (1994); see 3 Nimmer & Nimmer, *supra* n. 47, § 12.02[C].

384. Gilmore, *supra* n. 4, § 29.2, at 780.

goods.

(2) The debtor acquired its interest in the software for the principal purpose of using the software in the goods.

Official Comment 5 to Revised 9-103 says: “Subsections (b) and (c) limit purchase money security interests to goods, including fixtures, and software. . . . [However,] [t]he software must be acquired by the debtor in a transaction integrated with the transaction in which the debtor acquired the goods, and the debtor must acquire the software for the principal purpose of using the software in goods.” All types of intellectual property other than “software” – copyrights, patents, trademarks, domain names, rights of publicity, *etc.* – can never qualify for purchase money treatment under Revised 9. As to software, the purported attempt in Revised 9-103(c) to treat an intangible copyrightable computer program as “embedded” in goods is legal nonsense.

3. Detailed Analysis

a. Purchase Money In Intangibles

As Prof. Gilmore opines, current Article 9 certainly accommodates purchase money status for intangibles:

[T]he species of property which the Code calls “general intangibles” could easily become the subject of a purchase-money transaction: for example, an inventor transfers his patent (or his rights under it) for a sum to be paid in installments, reserving a security interest until paid; or a bank lends money to the X Corporation for the purpose of enabling it to acquire the inventor’s patent, with a security interest in the patent reserved to secure the loan. . . . There seems to be no reason, however, why the term “collateral” should have other than its normal meaning: the purchase money concept may thus, in an occasional case, apply to intangible property.³⁸⁵

There are several examples of patent owners doing precisely this. In *Transducer Patents Company v. Renegotiation Board*,³⁸⁶ a patent owner assigned a patent, reserving the right to a royalty. In order to secure its interest, the patent owner also took back a “lien,” which the court duly identified as a security interest, in the patent in order to secure the payment of royalties. *Transducer Patents* relied on the pre-Code Supreme Court decision in *Littlefield v. Perry*,³⁸⁷ in which the

385. Gilmore, *supra* n. 4, § 29.2, at 780. See also Clark, *supra* n. 96, at ¶ 3.09[2][b] (“[T]here is no logical reason to exclude intangible collateral from purchase money treatment if the right case comes along.”).

386. 492 F.2d 247 (9th Cir. 1974).

387. 88 U.S. 205, 220 (1874).

patent owner also reserved a lien on the patent to secure the payment of royalties. Similar patterns exist in other information industries.

Revised 9, however, looks to impose the “horizontal” financing model adopted in original Article 9 on intellectual property, since this would allow information royalties to be subject to pre-existing floating liens against licensees. As described in the companion article, the “horizontal” model requires a super-priority both on the going-in side when goods are bought, and on the going-out side when goods are sold to a buyer in the ordinary course. Imagine what would happen in the goods world if purchase money status were unavailable.³⁸⁸ What lender would finance a factory’s acquisition of a new piece of heavy equipment if it knew its loan would become immediately subject to a prior floating lien of the buyer with no way to gain priority? If Revised 9 were consistent, it would subject information to both sides of the horizontal financing imagery. It certainly subjects intellectual property to the half that hurts creators by saying a security interest does not extend to “licensees in the ordinary course.”³⁸⁹ Purchase money status, however, would give information transferors a chance to secure their royalties by filing within the limited purchase money period, just like any seller of a user car. But this would prevent lenders to transferees from using floating liens to ensure priority in the transferor’s royalty income.

b. Conflicts with Federal Law

The approach in Revised 9-103 is arguably inconsistent with the federal information statutes. Section 205 of the Copyright Act contains a detailed recording scheme for determining the priority between all conflicting copyright transfers, whether exclusive or nonexclusive. For a document to obtain constructive notice under this system, it must specifically identify the registered work to which it applies.³⁹⁰ A floating lien which merely identifies “all general intangibles, including copyright interests, now owned or later acquired,” even if recorded federally, would not impart constructive notice since it does not identify the affected works. Thus, such a floating lien would not have priority over a later recorded security interest on a specifically registered and identified work licensed to a debtor, subject to a floating lien.³⁹¹

388. See discussion in Federal Financing, *supra* n. 3, § III.D(1).

389. See *infra* n. 302 and accompanying text.

390. 17 U.S.C. § 205(c) & (d) (1994).

391. Unfortunately, the decision in *Aerocon Engr., Inc. v. Silicon Valley Bank (In re World Auxiliary Power Co.)*, 244 B.R. 149 (1999), inexplicably held that a security interest

The Patent Act raises similar problems. The PTO regulations require that all assignments specifically identify the patent in order to be recorded.³⁹² Like copyrights, an earlier floating lien against “all patents now owned or later acquired” would also be insufficient to gain priority over a later mortgage specific to the patent. The problems for patents arise in licensing, since the Patent Act only covers assignments, not licenses. This means that a patent owner or exclusive licensee grants a license to someone subject to a pre-existing floating lien, all royalties payable to the transferor become junior to the floating lien. There is no way for the patent transferor to gain priority against the floating lien except to beg the floating creditor to subordinate. In the goods world, no one could tolerate this state of affairs even for outmoded equipment, but the patent owner must now accept it for the latest invention. As *Everex*³⁹³ observed, in a world of free assignability, paid-up non-exclusive patent licenses can be extraordinarily risky for a licensor. Revised 9-103 now makes licensing on a royalty basis just as risky.

The more serious problem, however, is with the Lanham Act. The courts have held that security interests in federal trademarks are perfected solely under state law.³⁹⁴ This means that if a trademark owner grants a license to a licensee subject to a pre-existing floating lien, under Revised 9 the floating lien automatically attaches to and has priority over any royalty right of the licensor, regardless of restrictions in the license. Such a “naked” security transfer was addressed in the *Haymaker Sports, Inc. v. Turian*.³⁹⁵ It held that granting a security interest in a mark independent of good will constituted an invalid assignment in gross, voiding the mark. A mere recital that “good will” was included in the collateral was insufficient where the secured creditor obtained none of the facilities necessary to ensure quality control nor ever exercised any supervision over quality.³⁹⁶ Under Revised 9, a trademark owner cannot prevent an assignment by the licensee for security, nor “carve-out” its mark by use of a purchase money security filing. If the licensee is subject to a

in an *unregistered* work was perfected by a filing in the state UCC registers. This would mean that a licensee’s pre-existing floating lien would take priority over a later security interest in an unregistered work under Revised 9. This questionable decision is reviewed in Federal Financing, *supra* n. 3, § III.G.(1).

392. See *Manual of Patent Examining Procedures*, Patent and Trademark Office, U.S. Department of Commerce, Rule 316 (February 1, 2000).

393. *In re CFL, Inc.*, 89 F.3d 673, 679 (9th Cir. 1996).

394. See Federal Financing, *supra* n. 3, § III.G.3.

395. *Haymaker Sports, Inc. v. Turian*, 581 F.2d 257 (C.C.P.A. 1978).

396. *Id.* at 259.

prior floating lien with an after-acquired property clause that sweeps in the trademark, then merely making the license risks invalidating the mark. It is true that Revised 9-408(d) prevents the secured creditor from using the mark in several ways. In *Haymaker*, however, the security agreement was an escrow that also prevented various uses. Whether the limitations in Revised 9-408(d) are sufficient to overcome the objections in *Haymaker* remains to be seen.

M. R 9-702: Unperfection Day

Revised Article 9 proposes many changes in the law applicable to information financing. The impact of these changes will be felt both retroactively, due to the transaction rules, and prospectively, due to the choice of law rules. In the changes wrought by Revised 9, one date stands out: July 1, 2001. It could become known as Unperfection Day.

1. Retroactive Effect: Transition Rules

Under Revised 9-701, the statute's official effective date is July 1, 2001. However, in those states that have adopted Revised 9, the statute is in effect today due to the Revised 9's transition rules. All information security interests existing as of the date Revised 9 goes into effect must comply with the filing rules under Revised 9, not under former law. Since the rules under Revised 9 differ from those under former law, lenders with existing information loans can look forward to extensive refiling to maintain their perfected status. There are two grandfather provisions, but neither one appears to cover information. Let's see how this works.

The basic transition rule as contained in Revised 9-702 as follows:

Revised 9-702(a)

(a) Except as otherwise provided in this part, this [Act] applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this [Act] takes effect.

As a result, all information security interests existing as of the date Revised 9 goes into effect in an applicable state are governed by Revised 9, not former law, unless an exception applies.

Under Revised 9-301, a security interest in information must be perfected by filing a financing statement in the jurisdiction where the "debtor is located," unless an applicable federal statute or treaty requires a different place. As discussed above, under Revised 9-307(c), for information many a debtor may well be deemed "located" in the District of Columbia. For federal information, at least as far as

Revised 9 goes, the federal statutes do not provide an exception. For information outside the United States, the debtors, including the licensees paying royalties, will often be deemed located in their home countries. This makes July 1, 2001, a potential Unperfection Day: absent federal preemption, a lender with information collateral may need to refile its security interest under the law of the District of Columbia or another State, and in applicable national registers in other countries or it will be unperfected – unless one of the grandfather provisions apply.

The first grandfather provision could apply both to federal information and to royalty financing. It says:

Revised 9-702(b)

(b) Except as otherwise provided in subsection (c) and in Sections 9-703 through 9-708:

(1) Transactions and liens that were not governed by [former Article 9], were validly entered into or created before this [Act] takes effect, and would be subject to this act if they had been entered into or created after this [Act] takes effect, and the rights, duties, and interests flowing from those transactions and liens remain valid after this [Act] takes effect; and

(2) the transactions and liens may be terminated, completed, consummated, and enforced as required or permitted by this [Act] or by the law that would otherwise apply if this [Act] had not taken effect.

With regard at least to copyrights and patents, and arguably federal trademarks, they were “not governed” by former Article 9 at least as to the priority and perfection rules under original Article 9-302(3)(a). It is not clear whether this meets the “not governed” requirement in Revised 9-702(b)(1), although the issue may be moot due to federal preemption in any case. As to royalties, as discussed previously, royalties under intellectual property licenses were not accounts under original Article 9-103. Thus, a “sale” (executed assignment) of royalties was outside Article 9, although a security transfer of royalties would be within Article 9.³⁹⁷ In practice, there seemed to be little differentiation, some cases analyzing royalty financing under the law of assignment, others under Article 9, without differentiating the nature of the transaction. Nonetheless, it may be possible to argue that at least some royalty “financing” transactions effective pre-Revised 9 should remain effective under former law due to the savings clause. Note that this would apply only to financing the royalties, not the information.

The next grandfather provision is in Revised 9-705:

397. See Federal Financing, *supra* n. 3, at § II.B.3.

Revised 9-705

(b) The filing of a financing statement before July 1, 2001, is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under this division.

(c) This division does not render ineffective an effective financing statement that is filed before July 1, 2001, and that has satisfied the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in former Section 9103. However, . . . the financing statement ceases to be effective at the earlier of either of the following:

- (1) The time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed.
- (2) June 30, 2006.

Under Revised 9-705(b), a pre-Revised 9 financing statement is effective to perfect to the extent that it would satisfy the requirements for perfection under Revised 9. Before Revised 9, perfecting an information security interest did not require a filing under the laws of the District of Columbia, at least for “covered debtors” outside the District, and one cannot necessarily expect pre-Revised 9 information security interests to be filed under its law for such debtors. If a secured creditor did file in the District, then that presumably would be the “jurisdiction governing perfection” for purposes of Revised 9-307(c). Unfortunately, unless and until the District adopts Revised 9, the District may refer to the law of yet another state as the place to file under the circular *renvoir* problem discussed above. Undoubtedly, most information security interests filed against “covered debtors” located outside the District will need careful review to determine if, when, where and how they should be refiled.

There is another grandfather provision in Revised 9-703. It says:

Revised 9-703

(a) A security interest that is enforceable immediately before July 1, 2001, and would have priority over the rights of a person that becomes a lien creditor at that time is a perfected security interest under this division if, on July 1, 2001, the applicable requirements for enforceability and perfection under this division are satisfied without further action.

(b) Except as otherwise provided in Section 9705, if, immediately before July 1, 2001, a security interest is enforceable and would have priority over the rights of a person that becomes a lien creditor at that time, but the applicable requirements for enforceability or perfection under this division are not satisfied on July 1, 2001, when all of the following rules apply with respect to the security interest:

- (1) It is a perfected security interest until July 1, 2002.
- (2) It remains enforceable thereafter only if the security interest becomes enforceable under Section 9203 before July 1,

2002.

(3) It remains perfected thereafter only if the applicable requirements for perfection under this division are satisfied before July 1, 2002.

Under Revised 9-703(a), a pre-Revised 9 security interest perfected against a *lien creditor* before July 1, 2001, remains perfected if the applicable requirements for enforceability and perfection under Revised 9 are satisfied without further action. This provision again uses the “lien creditor test” as the intellectual solvent for determining where to file. As discussed above, such a test could often be inapplicable to information security interests since they look to perfect against bona fide purchasers, not lien creditors.³⁹⁸ Revised 9-703(b) gives a one-year period following July 1, 2001 in which to reperfect under Revised 9. Unfortunately, this one-year period also only applies to security interests that take effect against lien creditors. This could also exclude information security interests, so arguably the one-year grandfather period does not exist for information. Undoubtedly, a bankruptcy trustee would so argue.

Prudent secured creditors with information collateral subject to Revised 9 should carefully evaluate whether any existing security interest will become unperfected on July 1, 2001, and act accordingly.

2. *Prospective Effect: Choice of Law Rule*

If a lender decides that financing information under Revised 9 leads to less than optimal results, can the lender elect to have law other than Revised 9 govern its security interest? The answer is “no.” The adoption of Revised 9 required the following conforming amendment to Article 1-105 of the UCC:

UCC 1-105

(2) Where one of the following provisions of this code specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified: . . . Law governing perfection, the effect of perfection or nonperfection, and the priority of security interests and agricultural liens. Sections 9-301 to 9-307, inclusive.

Under this provision, the choice of law rules in Revised 9 are mandatory and cannot be changed by agreement. If the borrower is located in a jurisdiction that has adopted Revised 9, perfection and priority must be determined under Revised 9. There is no escape by clever drafting.

The only way to ensure that Revised 9 does not apply is locate

398. See Federal Financing, *supra* n. 3, § III.E.3.

the debtor in a jurisdiction that has not enacted it. Since the goal is to have Revised Article 9 adopted in every state in the country, this means locating the debtor outside the United States. Organize a borrowing entity in another country, transfer all of the information collateral to that entity, and then make the loan under the laws of that country. Make sure that all international license royalties are not repatriated to the United States, but stay in the overseas entity. In other words, ensure that the number one export industry in America ceases to exist.

III Revised 9 Redux

Revised 9 is a subtle and complex statute. Most of its real effects are buried beneath a bewildering statutory text and opaque Official Comments. Some examples may therefore help demonstrate how it could work in practice.

A. A Copyright Financing Example

Motion picture financing is a fitting illustration since the architects of Revised 9 claimed they discussed motion picture financing extensively in crafting the statute.³⁹⁹ It also illustrates prototypical intellectual property financing, with tiers of exclusive and non-exclusive licenses, and extensive use of export financing mechanisms.⁴⁰⁰ Consider this hypothetical:

Producer contacts Bank to finance production of the motion picture *Big Pix*. The Bank will secure the loan by the copyright and all other rights worldwide in the screenplay and completed motion picture, along with royalty payments due under exploitation licenses in all media worldwide. Both Producer and Bank are headquartered in California. Producer duly registers the screenplay in the U.S. Copyright Office, and Bank files a copyright mortgage in the Copyright Office and a UCC-1 financing statement in California to cover the physical materials (props, sets, film elements, *etc.*) and any other state intellectual property interests.

The Producer then engages in what the industry calls “pre-sales.” This means Producer enters into exclusive distribution licenses for various rights and territories before starting production. These include crucial licenses in the U.S. as well as export licenses to distributors in other countries, for example a grant of exclusive

399. Weise, *supra* n. 32, at 1077, n.3 (“Substantially all of the discussions on these issues [the methods of financing for intellectual property] involved software and motion picture financing”).

400. For further discussion see Schuyler M. Moore, *Entertainment Bankruptcies: The Copyright Act Meets the Bankruptcy Code*, 48 Business Lawyer 567 (1993).

theatrical, video and television rights in Japan. Each licensee agrees to pay Producer a contingent share of exploitation income (a "royalty") against a fixed "Minimum Guarantee" (guaranteed payment) due on delivery of the film elements. Bank expects the total of the Minimum Guarantees to retire the production loan. Bank requires Producer to give each licensee written Notice of Bank's security interest and to obtain a signed Acknowledgement of the Bank's superior lien and agreement to pay all moneys due Producer directly to the Bank. Producer also makes a number of nonexclusive licenses for a variety of ancillary rights, such as for a soundtrack album and merchandising rights, on similar terms.

Based on this collateral, Bank advances funds to produce *Big Pix*. Upon its completion, Producer registers *Big Pix* with the U.S. Copyright Office and the Bank records its mortgage against the motion picture as well.

Unfortunately, *Big Pix* is a flop. Some licensees refuse to pay. Meanwhile, scores of unpaid general creditors harass Producer. After *Big Pix* is completed and before the loan is repaid, Producer files for bankruptcy.

This example illustrates many basic components of intellectual property financing. The purpose of the financing is to allow the Producer to create a new work, in this case *Big Pix*. The Producer does so by encumbering the intellectual property rights and the royalty income from licenses of those rights. There are two types of licenses involved, exclusive and nonexclusive, and they arise both from licenses within the U.S. and from export licenses to other countries.

Both rights and royalties are critical to the financing scheme. The reason that royalties are important is obvious. The rights are important because the Producer often retains the right to terminate a license for nonpayment (a "Termination Right").⁴⁰¹ Typically, a license provides that no rights vest until the Minimum Guarantee is paid. If it is not paid when due, then Producer will exercise the Termination Right and try to license the rights elsewhere. Whether Producer can exercise a Termination Right for failure to pay royalties over and above the Minimum Guarantee ("Overages") is negotiable. However, a Termination Right is often less valuable than payment; once a picture is released, it cannot be re-released for the same return.

In order to secure the loan, the Bank needs to establish priority in two classes of assets - rights and royalties - against two classes of competing creditors - those of the Producer, and those of the

401. For further discussion of the termination right, see Moore, *supra* n. 400 at 589-594.

licensees. For the Producer, we can assume that before making the loan the Bank conducted an appropriate search of the chain of title for *Big Pix* and determined that there are no pre-existing mortgages or clouds on title. Therefore, the Bank needs to perfect against Producer's subsequent creditors for the rights in *Big Pix* and for the royalty payments due to Producer from the licensees. To protect against the licensees, the situation is more complicated. Licensees may be subject to prior liens that could attach to their rights or royalties. They may also declare bankruptcy. Therefore, the Bank needs to establish priority in both the rights and royalties against each licensee's pre-existing creditors and against any subsequent creditors. In so doing, the U.S. and the international licenses must be treated separately.

Let us look at how Revised 9 will effect the Bank's ability to secure its production loan:

U.S. Nonexclusive Copyright Licenses:

Situation: Assume Producer has licensed *Big Pix* for theatrical exhibition in the U.S. under customary nonexclusive exhibition licenses. Esquire Theaters has an existing floating lien over all "accounts and general intangibles" evidenced by a UCC-1 financing statement filed at the state level. *Big Pix* generates \$100,000 in box office receipts, of which Producer's share is 50%. Esquire's Lender claims it is entitled to the entire \$100,000 in case Esquire defaults on its loan. Who wins?

Revised 9 Result: Under Revised 9, Esquire's Lender prevails. Esquire Theaters is a "licensee in the ordinary course of business" who takes free of the Bank's security interest in Producer's share of box office. Neither the Bank nor Producer can claim priority against Esquire's Lender under a "purchase money security interest" because Revised Article 9 eliminates purchase money status for intellectual property. Bank cannot use the technique under current law of sending notice to Esquire Theaters of its assignment, because Revised 9 has now reclassified royalties as "accounts" for which a financing statement must be filed. Such a filing would not gain priority because Lender's "floating lien" was recorded first. Under Revised 9, the only thing Producer or Bank can do to secure their share of the box office is to beg Esquire's Lender to subordinate, a result Esquire's Lender finds quite satisfactory.

Federal Result: Under the Copyright Act, this result is certainly preempted as to the rights, and should be for royalties, although one

must deal with *Broadcast Music, Inc. v. Hirsch*.⁴⁰² Establishing this point, however, may require litigation. Original Article 9 deferred to federal law, did not recognize a “licensee in the ordinary course,” allowed “purchase money” status for intangibles, and did not treat royalties as “accounts,” so no litigation was needed.

U.S. Exclusive Licenses:

Situation: Assume Producer granted exclusive U.S. video distribution rights in *Big Pix* to a Video Wholesaler. The Wholesaler defaults, but continues distributing cassettes. Producer sends a notice of cancellation for nonpayment and attempts to license the rights elsewhere. The Wholesaler sues for an injunction to stop the re-licensing and for damages. Who wins?

Revised 9 Result: Under Revised 9, the Wholesaler does. Since Revised 9 claims exclusive copyright licenses are “really” financing arrangements, an exclusive licensee’s interest cannot be cancelled for breach; it must be foreclosed under the procedures in Revised 9. The Wholesaler can therefore enjoin the termination as an “improper foreclosure” and sue the Producer for damages to boot. Moreover, even if Producer follows the foreclosure procedures, the Producer may not be able to reacquire the video rights but must license them to a third party in a public auction. As to Bank, its interest in the royalties due from the Wholesaler to Producer is junior to any pre-existing “floating lien” against the Wholesaler, and now the ability to exercise a Termination Right for nonpayment is significantly impaired.

Federal Result: Under the Copyright Act, there is again a preemption argument. Original Article 9 does not treat exclusive copyright licenses as *ipso facto* security transfers, and so would not penalize exercise of a Termination Right.

U.S. Ancillary Licenses:

Situation: Assume Producer has made several licenses of ancillary rights under state law, including a right of publicity to use the name and likeness of major stars on merchandising, and the domain name for a Web page about *Big Pix*. Producer’s bankruptcy Trustee claims that the Bank’s filing was insufficient to perfect an interest in these rights or royalties. Correct?

Revised 9 Result: Under Revised 9, yes. Since the Producer is a partnership, it now requires security transfers of state intellectual property to be perfected under the law of the District of Columbia, at least for “covered debtors.” If the District has not adopted Revised 9,

402. *Broad. Music*, 104 F.3d at 1163; see Federal Financing, *supra* n. 3 at § III.G(1).

the Trustee will argue that the circular *renvoi* in Revised 9-307(c) nonetheless requires a filing in the District.

Federal Result: Since these are state law information rights, federal law does not apply. Under original Article 9, the California filing would have been sufficient.

International Exclusive Licenses – Minimum Guarantees

Situation: Assume Producer exclusively licensed all rights in *Big Pix* for France to a French Distributor headquartered in Paris for a minimum guarantee of \$1,000,000 payable, 25% on signature and 75% on delivery of the film elements. The initial \$250,000 has been paid into a collection account at the Bank. The second \$750,000 is now due but unpaid. Producer's bankruptcy Trustee claims all the money. Who wins?

Revised 9 Result: Under Revised Article 9, the Trustee wins. Start with the unpaid \$750,000. Under Revised 9, the Notice and Acknowledgement is no longer effective to perfect the Bank's interest against U.S. creditors. Instead, the French Distributor is a "debtor" and arguably the Bank must look to French law to determine how to perfect its right in the royalty payments. France, like many countries, maintains a copyright registration system that requires a filing in France for a creditor to obtain priority against insolvency representatives. Since the \$750,000 is proceeds from the rights in France owed by a French "debtor," under Revised 9 the Bank apparently must file in France to perfect its right to collect the French royalty payments ahead of Producer's bankruptcy Trustee. As to the \$250,000 already paid, since they are proceeds from the license in France, the Bank is unperfected unless it has separately perfected a security interest in the deposit account into which the amounts are paid. Of course, this separate deposit account perfection may be challenged if it constitutes a preference.

Federal Result: Federal statutory preemption does not apply here since the copyright interest is in France. Although French law will control the priority of *rights* in France, U.S. law, including as applicable Revised 9, will control when the *royalties* are remitted to the U.S. The Bank's only hope is to claim that France has adhered the Berne Convention, that Article 5(2) establishes the territoriality principle as the conflicts rule, that it would reference U.S. law once royalties are remitted to the U.S., so that recording in the Copyright Office was thus sufficient to perfect. The argument is a slender reed at best. Under Original Article 9, the Notice and Acknowledgement would have been sufficient to perfect against the Trustee.

International Exclusive Licenses – Additional Royalties

Situation: Assume that for a similar Japanese license, the Bank collected the entire minimum guarantee of \$1,000,000 before the Producer declared bankruptcy. In Japan, the theatrical release of *Big Pix* was disappointing, but the television release was successful. Eighteen months after the license was made, the Japanese distributor is prepared to pay substantial “overages” (royalty payments in excess of the Minimum Guarantee) to the Producer. The Trustee claims entitlement to all overages and, in addition, asserts that the Bank is required to disgorge the initial \$1,000,000 it has already received. Who wins, Trustee or the Bank?

Revised 9 Result: The Trustee wins. Under Revised 9-316, the Bank’s security interest becomes unperfected against an exclusive licensee unless, within one year of the license, it perfects in the jurisdiction where the licensee is located. Once the security interest becomes unperfected, it is deemed unperfected *ab initio*. Japan also has a register that requires a filing for a copyright mortgagee to gain priority. Since the Bank never recorded there, it is unperfected in both the overages and the original Minimum Guarantee, at least against the Trustee as a garnishing creditor against the Japanese licensee.

Federal Result: Again, there is no federal statutory preemption, and Bank is forced to rely on some conflicts argument based on a *renvoi* from the licensee’s country to U.S. federal law or a treaty preemption in the United States. Under original Article 9, the Notice and Acknowledgement was sufficient to perfect against the Trustee.

Conclusion

Knowing all this, what will the Bank do when the Producer asks for a production loan for *Big Pix II*? Require the Producer to set up a production entity overseas and ensure that all license income stays outside the United States. The alternative – staying in the U.S. – is bleak. Under Revised Article 9, Bank will not be able to perfect in royalty payments due under nonexclusive licenses without a massive campaign of seeking subordination agreements from potential lenders to hundreds of licensees. For exclusive licenses, its priority in royalties will also be in doubt, and any Termination Right for nonpayment could be significantly impaired. To perfect in license income outside the U.S. will require another massive and expensive campaign of registering in scores of national registers. The Bank may be able to change some of these results if it is willing to endure the risks of extensive litigation, but that is not the Bank’s business. Under Revised 9, for both the Bank and the Producer, the commercially reasonable choice may well be to leave the country.

B. A Trademark Financing Example

The situation with regard to trademarks will be somewhat different. The following is an example:

Fred's Flyer is the sportsman's choice for clear water fly-fishing. Light, durable, reasonably priced, it has quickly become the market leader throughout Georgia, where Fred lives, and several neighboring states. Fred has obtained a federal trademark for Fred's Flyer.

A Sporting Goods Chain, Sportland, a California joint venture between two corporations, wants to expand its product line. It approaches Fred about obtaining an exclusive assignment to manufacture and sell fly rods under the Fred's Flyer mark in several Western States, promising Fred a handsome royalty on each sale. Fred agrees. Encouraged by this success, Fred makes several other non-exclusive trademark licenses in the South, and an exclusive license with an British Company for the E.U. Each license promises up front payments and royalties based on sales of poles under the mark; they also contain detailed manufacturing instructions and quality controls.

Since all the contracts promise royalties over time, Fred contacts Bank to finance them. The Bank agrees, and files a UCC-1 financing statement against Fred where he lives in Georgia which covers "all accounts and general intangibles now known or later acquired." Just for good measure, it also filed in the Patent and Trademark Office. It sends a notice to the British company and receives a written acknowledgement of its interest.

Things work out, for a while. Then they go wrong.

U.S. Exclusive Trademark Licenses:

Situation: Unbeknownst to Fred, Sportland was in deep financial trouble, and was looking to new product lines, including the popular Fred's Flyers, to revitalize its sagging sales. All of its assets were encumbered with a "floating lien" to a Finance Company that covered after-acquired property and included "all accounts and general intangibles." Sportland was a California joint venture, so the Finance Company filed a UCC-1 financing statement against Sportland in California, but only after Fred's license was executed. Sportland stores were operated as franchise operations, so Sportland made several non-exclusive licenses to local stores authorizing them to manufacture and sell fly rods under the Fred's Flyers mark. Although payments were good, for a while, Sportland eventually began experiencing cash flow problems, resulting in fifteen considerable unpaid royalties owed on Fred's license. Fred sends a notice canceling the license and demanding past-due royalties. The Finance Company now forecloses on its security interest. Who gets the past-due royalties and the trademark license, Fred or Fred's Bank Finance Company? Assume all relevant jurisdictions have adopted

Revised 9.

Revised 9 Result: Under Revised 9, the Finance Company. Let's start with the trademark rights. The Finance Company prevails for at least three different reasons. First, in Georgia does not allow attachment or levy on a "chose in action," so under Revised 9-307(c) Fred will most likely be deemed located in the District of Columbia with regard to the trademark collateral. As to Sportland, it is unclear whether a joint venture (unregistered) of corporations (registered) would qualify as a "covered debtor," but it is arguable that Sportland would be a "covered debtor" and thus also located in the District of Columbia under California's approach to liens on intangibles. Since neither Fred, with regard to his royalty "account," Fred's Bank nor Finance Company have filed in the District, they could all be unperfected under District law, and so the first security interest to "attached or become effective" will prevail under Revised 9-322(a)(3). Since Finance Company's "floating lien" "became effective" before Fred's right to royalties or the Bank's security interest, it should prevail. Second, even if Fred or Bank had filed in the District, since Sportland's transfer was an executory partial assignment, under Revised 9-3179(d) Finance Company could argue it was perfected without necessity of a filing in any case, even though Fred had no way of discovering the "secret" lien. Third, since more than 12 months have elapsed since the partial assignment was made, and neither Fred nor Bank filed in the District (or California?) they are unperfected *ad initio* under Revised 9-316(b). Similar reasoning will apply to the past-due royalty accounts. This means that Finance Company prevails in both the trademark rights and the past-due royalty payments. Moreover, since Revised 9 now purports to classify information assignments as "security interests," Fred's cancellation would constitute a wrongful foreclosure under Revised 9 and Finance Company can sue to enjoin the cancellation and for damages to boot. In addition, since the interest of Fred and Bank is now "really" a security interest, their "junior" interest, in the form of a Termination Right, has arguably been wiped-out by Finance Company's foreclosure, so maybe Finance Company can keep the trademark license until the end of its term as well.

Federal Law Result: Although Fred's Flyers is a federal trademark, the courts have inexplicably held that state law governs perfection of a security interest in a federal trademark.⁴⁰³ To overcome this result, Fred or Fred's Bank must be prepared to

403. See Federal Financing, *supra* n. 3, § III.G.(3).

initiate a lawsuit challenging these holdings or alleging some other ground for prevailing, such as treaty preemption.

Non-Exclusive Sublicensees:

Situation: After its foreclosure, Finance Company tries to cancel the non-exclusive licenses to the Sportsland franchisees. It wants to transfer the trademark, good will and manufacturing equipment to a large discount chain, which will not agree to the transfer if other stores can compete with it. Two of Sportsland's franchise stores resist, claim they are "licensees in the ordinary course of business" who took free of Finance Company's interest. Who is right?

Revised 9 Result: Under Revised 9, the stores. Revised 9 says that, as "licensees in the ordinary course of business," they take free of Finance Company's security interest and can continue under their license. (This presumes that Finance Company's security interest against Sportsland did not include the assets of its independent franchisees).

Federal Law Result: Under federal law, termination of Sportsland's license by foreclosure should have terminated non-exclusive sublicenses. But, once again, one must deal with the case law saying that state law governs security interests in federal trademarks.

Other Licensees:

Situation: One of the Sportsland franchisees, Salvage Co., begins selling its own Salvage Co. brand of the Fred's Flyer in its amateur sportsman section for a reduced price. The Fred's Flyer is a quality pole not meant for amateurs. Without proper instruction, amateurs tend to break it. The word begins to spread that the Fred's Flyer is not that good after all. Adventure Land, one of Fred's licensees across the border in a neighboring state, complains to Fred about what Salvage Co. is doing to the reputation of the Fred's Flyer. People are confused about the difference between the "genuine" Fred's Flyer sold by Adventure Land, and what they believe is the inferior model sold by Salvage Co. Fred complains to Salvage Co., but it claims it still has a valid license from Sportsland. Finally, Adventure Land refuses to pay on its license at all, claiming that Fred as abandoned the mark. Who is right?

Federal Law Result: Under federal law, upon termination of Sportsland's license, Fred had a duty to prevent any use of the Fred's Flyer mark by any sublicensee of Sportsland for precisely this reason. It looks like Fred has forfeited the trademark by a failure to act, even though Revised 9-321 place a major road block in Fred's way.

Bank's Security Interest:

Situation: Once Adventure Land refuses to pay, other licensee's join in. Eventually, Fred is forced to file for bankruptcy. Fred's Bank claims that it has a perfected security interest in the trademark and any remaining licenses ahead of Fred's Bankruptcy Trustee. It is correct?

Revised 9 Result: Under Revised 9, no. The Bankruptcy Trustee prevails. Recall that Fred was "located" in the District of Columbia under Revised 9-307(c); since the Bank did not file there, it is unperfected against the Trustee. As the license to the British Company, since the U.K. requires trademarks to be filed in the Company's Register for perfection against insolvency representatives, and the Bank did not file there, is unperfected in the royalty payments from the British licensee.

Conclusion

Grandpa Peevyhouse sits on the elbow bend of the Little Clyde, teaching his grandson the traditional ways of the angler. The grandson reaches for Grandpa's special pole, but Grandpa gently demurs. The boy is not ready to try that pole just yet. You see, it's a genuine Fred's Flyer, and they don't make them any more.

C. Revising Revised 9?

Can Revised 9 be revised to harmonize with intellectual property law? The prognosis is not good. The Official Comments tells us that, where information is concerned, the purpose of Revised Article 9 is to make available "previously unavailable property as collateral" in order to "enable debtors to obtain additional credit."⁴⁰⁴ But this begs the question: unavailable to *whom*? Intellectual property law grants creators the exclusive right to make information unavailable precisely to encourage the creation of viable markets in the first place.⁴⁰⁵ "[T]he law gives [creators] the right to exclude that functions in much the same way as do fences, or real property's rights against trespass: These rights gives owners an ability to bar certain uses of their creative work and thus gives them the ability to extract a price from those who wish to use the work."⁴⁰⁶ By attempting to free up these "otherwise unavailable assets" - information unavailable to licensees and their lenders precisely to enable creators to bargain for royalties from their use - Revised 9 runs contrary to the economic

404. Official Comment 8 to Revised 9-408.

405. Gordon, *supra* n. 9, at 854. ("[C]reators and their potential customers would face a market failure in the absence of a legal rule that requires copyists to seek permission and pay license fees.").

406. *Id.* at 855 (emphasis in original).

fundamentals necessary for viable markets in information.

Think of information markets as a vast cycle. Rights flow “downstream” from creators through licensees to end users, and royalties flow back “upstream” from end users through licensees to creators. In this image, waves of cash -royalties - flow through licensees on their way from their sublicensees back up to their licensors. It is tempting to think that a licensee owns the entire royalty wave passing through its coffers at any point in time, but in fact the licensee only surfs on top of the wave to the extent of its royalty share. The remaining royalty share must be passed on to its licensor for the cycle to continue. Revised 9 now says that, no matter what a licensor may say or do, a licensee must have the absolute right to dam the flow and redirect the entire royalty wave to its secured creditor. It is surely a windfall for the licensee and its lender, at least in the beginning. But the inevitable result will be to deprive creators of the financial nourishment then need to create new information flows in the first place, and soon the entire river will run dry.

One can fuss with the details, argue over the meaning of this phrase or that, but none this will change the fact that at the end of the day the avowed purpose of Revised Article 9 is in direct conflict with the core purpose of federal intellectual property law.

Congress has so far been reluctant to preempt all secured financing rules for federal information, preferring to let federal law establish the priority rules, and state law to fill the gap with rules for creating and enforcing a security interest. Original Article 9 respected this partnership. Revised Article 9 has sundered it. Congress must establish a preemptive federal scheme for financing intellectual property. The companion article discusses how this could and should be done.

IV Conclusion

The information industries are now at the center of America’s economic future. They employ more people than the manufacturing sector, are growing at a rate double that of the economy as a whole, and have become the leading national export industry. As the world continues its irrevocable transition to an international information economy, a vigorous information sector will be critical to America’s global competitiveness and future prosperity.

Revised Article 9, absent effective federal preemption, could decimate the information industries. Under Revised 9, licensees will find that by going deeper into debt they can freely speculate with

some else's money – the royalties they would have paid to licensors. Those who gamble with other people's money do not incline to a prudent restraint. The result will be intense fights in the bankruptcy courts over the carcasses of failed speculators and further fights in the federal courts over the conflicts between Revised 9 and federal intellectual property law.

Twenty years after drafting original Article 9, Grant Gilmore, as a “repentant draftsman,” had this to say:

If we [the drafters of the UCC] had listened to what the courts were trying to tell us, we might have come closer to the mark. . . . [W]hy on earth should the fruits of a known insolvent's labors feed the assignee while all the other creditors starve? . . . [D]oes it make any sense to award everything to a secured party who stands idly by while a doomed enterprise goes down the slippery slope into bankruptcy?⁴⁰⁷

Revised Article 9 has bet the future on the conceit that the information sector will prosper if free riders are given free reign. It is not a wise bet. It could be a national disaster.

407. Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 Ga.L.Rev. 605, 627 (1981).

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