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Security Interests in Intellectual Property in Australia

Abstract
This paper will explain the law and consider the legal issues relating to security interests in intellectual property in Australia. The focus of the paper is directed to five intellectual property rights, namely, patents, registered designs, copyrights, registered trade marks and domain names. The overall question that this paper attempts to answer is whether a lender would be wise to lend money where intellectual property is the main form of security.

Keywords
securities, intellectual property, patents, registered designs, copyrights, registered trade marks, domain names

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Security Interests in Intellectual Property in Australia

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SECURITY INTERESTS IN INTELLECTUAL PROPERTY IN AUSTRALIA

by John V. Swinson[1]

PART ONE: INTRODUCTION

This paper will explain the law and consider the legal issues relating to security interests in intellectual property in Australia. The focus of the paper is directed to five intellectual property rights, namely, patents, registered designs, copyrights, registered trade marks and domain names. The overall question that this paper attempts to answer is whether a lender would be wise to lend money where intellectual property is the main form of security.

PART TWO: BACKGROUND

For many businesses, and not just those in high-tech industries, intellectual property is their most valuable asset. Copyright is at the heart of the entertainment and publishing industries. For consumer product companies, trade marks and brands are often the single most valuable asset of the business.

A security holder faces a number of challenges when taking a security interest in an intellectual property right. Being an intangible right, the security holder cannot take physical possession of the secured asset. It is often difficult to determine the identity of the true

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[1] This paper is based on an earlier work by the author, published as a chapter in C. Wappett and D. Allan (eds) *Securities Over Personal Property*, Butterworths, Sydney, 1999, and later revised and updated for the Law Commission of Canada and presented at its conference *Leveraging Knowledge Assets: Security Interests in Intellectual Property*, November 16-17, 2001, London, Ontario. See http://www.ivey.uwo.ca/leverip/ The author

owner or owners of the right. Many intellectual property rights prosper in the hands of their owners and are either unprofitable or unattractive to others.[2] It takes special skill to value intellectual property correctly.[3] One of the challenges is that the law in this area is not entirely "lender friendly". This paper will consider the legal issues facing a security holder in Australia.

Intellectual property rights are personal property in Australia.

Intellectual property is a term that covers a number of different rights. Patents, copyrights, trade marks, industrial designs and trade secrets are common forms of intellectual property. Other intellectual property rights exist in Australia, such as rights in integrated circuits[4] and plant breeder's rights.[5] These forms of intellectual property are not common, and are not discussed in this paper. Internet domain names, although not strictly intellectual property, will be considered briefly. This paper does not deal with specialized forms of security interests relating to intellectual property, such as security for the financing of a motion picture[6] or a theatrical production.

A product, process or service can be protected by more than one form of intellectual property. In fact, most forms of intellectual property are complementary.[7] For example, a new beverage can be protected by trade mark (the brand name, advertising slogans, shape of bottle); patent (the process to make the beverage); and copyright (the packaging, advertising materials). As another example, different aspects of a computer software

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wishes to thank those who provided assistance in relation to this paper, including Gaye Middleton, Philip Argy, Janet Werner, Jo Lim, Stephen Skehill and Anna Pino.

[2] Jeremy Phillips, *Intellectual Property as Security for Debt Finance - A Time to Advance?*, (1997) 6 EIPR 276.

[3] See, for example, Smith and Parr, *Valuation Of Intellectual Property & Intangible Assets,* John Wiley & Sons, 3rd ed, New York, 2000; R Parr, *Investment Risk and Royalty Rates* (1995) *Licensing Economics Review* 14; Smith and Parr, *Intellectual Property: Licensing and Joint Venture Profit Strategies,* 2nd ed, John Wiley & Sons, New York, 1998.

[4] Circuit Layouts Act 1989 (Cth).

[5] Plant Breeder's Rights Act 1994 (Cth).

[6] J A Gilbert and W P Streeter, *Film Industry Bankruptcy: Securing the Right to Payment Before It Happens*, (1992) 26 Bev Hills B Ass'n J 175

[7] However, some forms of intellectual property are mutually exclusive, for example, patent and trade secret rights.

product can be protected by patent, copyright, trade secret, trade mark and US design patent. When obtaining a security interest in intellectual property relating to a product or service, a security holder should consider obtaining security over all forms of intellectual property protecting that product or service.

For the most part, the protection provided by intellectual property is territorial. For example, an Australian patent is not enforceable in Fiji, and one will not usually infringe an Australian trade mark by selling goods under that trade mark in Ireland. A number of publications consider the law relating to security interests in intellectual property in other jurisdictions.[8]

Australia, like the United States and Canada, has two tiers of government. The federal government's powers are specified and limited by the Australian Constitution. There are six States, and each can pass laws on virtually all areas, subject to conflicting federal law taking precedence. For example, the federal government has power to make law in relation to intellectual property, corporations and bankruptcy, and has done so. The States make law in relation to contracts, personal property and real property.

The Australian federal government's corporations power was recently expanded, and because the corporate law regime relates to some of the issues discussed below, is summarized here. Until recently, the federal government had limited power in relation to corporations. The main source of that limited power is contained in section 51(xx) of the Constitution which provides that the federal parliament has power to make laws with respect to foreign corporations and trading or financial corporations formed within the limits of the

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[8]For example, see the collection of 21 papers delivered at the Law Commission of Canada's conference *Leveraging Knowledge Assets: Security Interests in Intellectual Property*, November 16-17, 2001, London, Ontario, especially, Howard P. Knoff, *Security Interests in Intellectual Property: An International Comparative Approach*; see also I J Kautman, M Simensky and L Bryer, *International Laws of Security Interests in Intellectual Property*, (1991) 6 JIBL 120; L Bryer, *Security Interests in Intellectual Property - International Law and Practice*, Trademark World, June-July 1996; P Sumpter and R Johnston, *Creation and Enforcement of Security Interests in Intellectual Property: A New Zealand Perspective*, (1991) 2 IPJ 77; T Guthrie and A Orr, *Fixed Security Rights over Intellectual Property in Scotland*, (1996) 11 EIPR 597.

Commonwealth. (Other miscellaneous heads of legislative power in section 51 of the Constitution also could support limited aspects of corporate law.)

For much of Australia's history, each State had its own corporations law. The States agreed on a uniform scheme to ensure that each State's corporations law was similar. The federal government (perceiving defects in the then co-operative scheme relating to uniform corporations legislation in place amongst the States) and relying on its powers under the Constitution, legislated independently of the States to introduce a national scheme of regulation (the *Corporations Act* 1989 (Cth)). However, there was uncertainty as to whether section 51(xx) of the Constitution allowed the federal government to legislate for the *formation* of trading and financial corporations. In 1990, the High Court decided section 51(xx) did not allow the federal government to make laws for the incorporation of trading or financial corporations, as distinct from regulating the activities of such corporations once they were created.[9]

The federal government and the States then each enacted new co-operative legislation known as the Corporations Law. The Corporations Law was contained in an Act of the Commonwealth Parliament enacted for the Australian Capital Territory. Each State adopted this law by State legislation. Thus, for the most part, the Corporations Law was State law.

However, there were constitutional problems with this new law. For example, the High Court decided that it was unconstitutional for a State to confer jurisdiction under State law on Federal Courts.[10] The High Court then decided that the federal government could not authorize its authorities or officers to undertake a function under State law involving the performance of a duty (particularly a function having the potential to effect adversely the rights of individuals) unless the function had a sufficient nexus with one of the heads of

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[9] *NSW v Commonwealth* (1990) 169 CLR 482.
[10] *Re Wakim; Ex parte McNally* [1999] HCA 27.

Commonwealth legislative power conferred by the Constitution.[11] This made the role of the federal securities commission unworkable.

On 15 July 2001, the Corporations Law scheme was replaced by the Corporations Act 2001 (Cth). This is federal law, and applies to the whole of Australia. In substance, the Corporations Act is virtually identical to the old Corporations Law.

The Corporation Act 2001 is constitutional because each State referred (i.e., delegated) its corporations powers to the federal government. Therefore, instead of separate but uniform corporations legislation in the various States, there is now one law for Australia which generally transcribes the former Corporations Law.

Patents, copyrights, trade marks and industrial designs are rights created by statute. In Australia, as stated above, they are federally created rights. Until 15 July 2001, there was possible conflict between federal intellectual property laws that had provisions regarding security interests and each State's Corporations Law that also had provisions regarding security interests. Although this conflict still may exist, it is now a conflict between two federal laws, and the constitutional problems that existed now disappear.[12]

PART THREE: PATENTS

I. THE UNDERLYING LAW IN AUSTRALIA[13]

The exclusive rights granted to the patentee are personal property: Patents Act s13(2). Patent rights can be assigned, devised and licensed. Patent rights can also be mortgaged:

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[11] *R v Hughes* [2000] HCA 22.

[12] Compare the situation in Canada and the United States. See Statement of Marybeth Peters, Register of Copyrights, Before the Subcommittee on Courts and Intellectual Property, On Recordation of Security Interests in Intellectual Property, June 24, 1999; Thomas Ward, *A Summary of the Structural Problems Associated With Perfecting the Securty Interest in Intellectual Property under United States Law* (presented at the Law Commission of Canada conference in November 2001 - see fn 1); Colleen Spring Zimmerman, *Intellectual Property in Secured Transactions* (presented at the Law Commission of Canada conference in November 2001 - see fn 1).

[13] This section considers the position under the current Australian legislation, the Patents Act 1990 (Cth). For a discussion of security interests under the previous legislation, the Patents Act 1952 (Cth), see C Sexton, *Security*

s103(1); Patents Regulations reg 19.1(1)(a). An assignment of a patent must be in writing signed by both the assignor and the assignee: s14(1). Thus, a legal mortgage by way of assignment must be in writing signed by both the patent owner and the security holder: s14(1). If the patent is owned by two or more patentees, none of them can assign an interest in the patent without the consent of the others: s16(1)(c). The Patents Act does not require licenses or equitable mortgages to be in writing.

A Register of Patents (hereafter "the Register") is kept at the Patent Office: s186(1). The Register records particulars of patents in force (s187), including the patentee; that is, the person who is the grantee or proprietor of the patent.

An assignment, license or security interest in a patent arises and is effective regardless of whether it is registered.[14] The Patents Act 1990 is not, however, totally clear on this point. Section 187 states that particulars of patents in force "and other prescribed particulars relating to patents (if any) must be registered". Prescribed particulars include "a transfer of an entitlement to a patent or licence" (reg 19.1(1)(b)) and "an entitlement as a mortgagee, licensee or otherwise to an interest in a patent" (reg 19.1(1)(a)). Section 187 does not state who has the obligation to register the prescribed particulars.[15] Is the obligation to register on the Registrar of Patents, the grantor, or the grantee?[16] Does s187 require that an entitlement must be registered by the security holder to be effective? The Explanatory Memorandum of the Senate for the Patents Bill 1990, which, typical of explanatory memoranda, provides no explanation, merely states that "This clause requires particulars of patents in force and other prescribed particulars to be registered".

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over Intellectual Property in Australia, (1991) 2 EIPR 65. A recent summary is also found in G Middleton, *Security interests in intellectual property in Australia,* (1999) Australian Banking & Finance Law News 81.

[14] *Vitamins Australia Ltd v Beta-Carotene Industries Pty Ltd* (1987) 9 IPR 41 (decided under the Patents Act 1952 (Cth)).

[15] Also, no time limit is specified in which the particulars must be registered, and there is no monetary penalty or offense for failing to register.

[16] The Law Council of Australia Recommendations on the Trade Mark Bill 1994 (Exposure Draft) 31 August 1994, notes that the Patents Act 1990 (Cth) provides for a mandatory system of entering security interests in the Register. The recommendations assume that the obligation to register the security interest is on the parties to the transaction.

In the context of Chapter 19 of the Patents Act and reg 19.1 of the Patents Regulations, the most probable interpretation of s187 is that the obligation is on *the Registrar* to register the prescribed particulars when a request for registration is made in the approved form. It is the Registrar's obligation to register prescribed particulars submitted for registration, but there is no obligation on the parties to a transaction to submit prescribed particulars to the Registrar.

In addition, reg 19.1(1)(c) implies that the entitlement that is registered is in existence at the time of making the request for registration and does not arise by virtue of being entered in the Register.[17]

Thus, a security interest arises even if it has not been registered. However, to enforce the security interest against the security provider, the security interest should first be registered in the Patent Office. (See discussion of s196 in Examples 3 and 4 below.)

Although registration of a security interest in a patent is permissive, not compulsory, a security holder will obtain a number of benefits from registration of the security interest with the Patent Office:

- Any dealings with the patent by the patentees are subject to the interests of the security holder: s189(1).
- The Register is prima facie evidence of any particulars registered in it: s195(1).
- The security interest will be admissible as evidence as to title. Subject to three exceptions, a document that has not been registered is inadmissible "in any proceedings in proof of title to a patent or to an interest in a patent": s196.
- The patent specification cannot be amended without written consent of the security holder: s103(1).

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[17] M Pattison, *Using Intellectual Property as a Security*, (1996) 7 AIPJ 135, p 138.

As mentioned in the first bullet point above, a registered security holder is protected by s189, which provides:

> "(1) A patentee may, subject only to any rights appearing in the Register to be vested in another person, deal with the patent as the absolute owner of it and give good discharges for any consideration for any such dealing.
>
> (2) This section does not protect a person who deals with a patentee otherwise than as a purchaser in good faith for value and without notice of any fraud on the part of the patentee.
>
> (3) Equities in relation to a patent may be enforced against the patentee except to the prejudice of a purchaser in good faith for value."

A security holder can rely upon the Register to determine who is the true owner of the patent and whether there are any relevant licenses or security interests over the patent. Pursuant to s189(1), the security holder can treat the patentee[18] as the "absolute owner" of the patent, subject only to other rights appearing on the Register. Section 189 is not as straight forward as it appears, and the following five examples will assist in understanding its effect.

A. Applying s189 in a priority dispute - five examples

Example 1 Patent assigned by X to A who does not register assignment. Subsequently, security interest granted by X to B who registers. B has no knowledge of the earlier assignment. B's interest prevails: see s189(1).

Example 2 Patent assigned by X to A who does not register assignment. Patent then assigned by X to B who also does not register. B has no knowledge of the earlier assignment. B's interest prevails. X, not A, is the patentee.[19] X can deal with the patent as the absolute owner of it and give good discharges for any such dealings.

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[18] The Patents Act defines 'patentee' to be the person 'for the time being entered in the Register' as the grantee or proprietor of the patent.

[19] If an assignment is not registered, the assignee would not be a 'Patentee' under the Patents Act and would not receive the benefits that the Patents Act provides to patentees.

Example 3 Patent assigned by X to A who does not register assignment. Patent then assigned by X to B who also does not register. After the assignment to B, A registers assignment. B has no knowledge of the earlier assignment. A would prevail. B could rely upon the Register (s189(1)) and obtain title from X. X was the patentee as in the previous example. But the moment A registers, A becomes the patentee. If B attempted to register its assignment, presumably registration of the assignment would be refused. Unless the Register is corrected (s192), A could deal with the patent as "absolute owner".

Moreover, the assignment to B may not, unless the court directs, be admissible to prove B's title.[20] A document that has not been registered is "not admissible in any proceedings in proof of title to a patent or to an interest in a patent": s196. There are, however, three exceptions to this rule:

- if the court directs: s196(a);
- in proceedings to rectify the Register: s196(b)(i); and
- to enforce equities in relation to a patent or license: s196(b)(ii).

For the first exception, the court should not exercise its discretion if any interest has in fact suffered by the failure to register or any person has taken any steps to incur liability that they would not have taken if the interest had been registered.[21] Thus, the court may decide that B's assignment is admissible in evidence, because B's failure to register has not adversely affected A's decision to enter into the assignment (as A's transaction was before B's transaction) or, at this stage, any third party. But that only overcomes the issue of admissibility, and does not mean that B's interest would be registered.

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[20] See also the Patents Regulations reg 22.19, which requires a copy of a document that affects ownership of a patent to be filed if the commissioner is to consider the document for the purposes of the Patents Act or Regulations.

[21] *Martin Engineering Co v Matflo Engineering Pty Ltd* (1987) 17 FCR 132 at 134.

Example 4 Patent assigned by X to A who does not register assignment. Patent is then assigned by X to B who also does not register. After the assignment to B, A registers assignment. A assigns to C and C registers. B has no knowledge of the assignment to A. C has no knowledge of the assignment to B. C would prevail. Because the assignment to A was registered, A is the patentee and may deal with the patent as the absolute owner of it.

Moreover, B would have an additional hurdle because the assignment to B is inadmissible to prove B's title (s196), and it is unlikely that a court would direct that it be admitted.

In *Martin Engineering Co v Matflo Engineering Pty Ltd* (1987) 17 FCR 132 the court, in exercising its discretion to admit into evidence an unregistered document, stated (at 134):

> "The failure to register has not left the respondents, as parties interested, in ignorance of the existence or identity of the licensee of the patent, so as to prejudice them in taking any steps which could have avoided their incurring liability."

B's failure to register did affect C's decision to enter the transaction with A, and so it is likely the court would not exercise its discretion under s196(a) to admit B's assignment into evidence. Further, B would either have a legal interest or no interest in the patent, but not an equitable interest, and so the court would not exercise its discretion under s196(b)(ii).

Example 5 X grants security interest in patent to A by way of an equitable mortgage. A does not register the security interest. X then assigns the patent to B who also does not register. B has no knowledge of the security interest of A. After the assignment to B, A registers the security interest. B later registers the assignment. B would prevail over A. A is not a patentee, as A is not the proprietor of the patent. A cannot deal with the patent as absolute owner or give good discharges. When B dealt with X, X was the patentee and could deal with the patent as absolute owner: s189(1). At the time B dealt with X. A's interest did not appear on the Register, so B's ownership of the patent would not be subject to A's security interest. If A assigned its security interest to C, B would still prevail as A is not a patentee and s189(1) would not assist C.

B. Summary of examples

The only way to ensure that an interest in a patent is protected is to register it. As the above examples show, failure to register may be fatal. A subsequent registered or unregistered interest will prevail over a prior unregistered interest: Examples 1 and 2. In some instances, a prior unregistered interest that later becomes registered may prevail over a subsequent unregistered interest: Examples 3 and 4. But as Example 5 shows, the first interest registered does not always prevail over a subsequent interest registered second. Merely because an interest is recorded in the Register does not necessarily ensure that the interest cannot be trumped by another. Section 189(1) only provides protection when dealing with the registered proprietor of the patent and not when dealing with the holder of a lesser interest, such as an exclusive licensee or mortgagee.

C. Good faith for value and without notice of any fraud

A security holder can only rely on the Register if the security holder is "a purchaser in good faith for value and without notice of any fraud on the part of the patentee": s189(2).[22] A security holder is usually a purchaser for value.[23] What is meant by "in good faith" and "without notice of any fraud on the part of the patentee"?[24]

Generally, a good faith purchaser is one who buys without notice of circumstances which would put a person of ordinary prudence on inquiry as to the title, or as to an impediment on the title, of a seller. Usually, one would not be a purchaser in good faith if one had actual notice of a prior inconsistent dealing. A bona fide purchaser buys believing he or she is entitled to buy and that the seller is entitled to sell. If "good faith" in s189(2) has this meaning, what is the ambit of the additional requirement of "without notice of any fraud on the part of the patentee"?

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[22] For no apparent reason, s189(3) does not include the requirement that the purchaser have no notice of any fraud on the part of the patentee.
[23] *Household Financial Services Ltd v Island & River Trading Pty Ltd* (1993) 6 BPR 13,312.
[24] The intent and drafting of s189(2) is not clear. Containing a triple negative, it is difficult to follow.

A patent or part of a patent may be revoked on the ground that "the patent was obtained by fraud, false suggestion or misrepresentation": s138(3)(d). Is s189(2) directed at this type of fraud, preventing a purchaser relying on the section if the purchaser had knowledge of the patentee's fraud in obtaining the patent? This is a strange interpretation, although s189(2) does use the words "any fraud" suggesting a broad reading of this requirement. However, if there was fraud in obtaining the patent, the patent could be revoked and it would not matter who owned an interest in the now valueless patent.[25] For s189(2) to have any real meaning, "any fraud on the part of the patentee" must include fraudulent acts other than, or in addition to, fraudulent acts in obtaining the patent.

The "fraud on the part of the patentee" may relate to acts where the patentee is trying to defraud the holder of an unregistered interest in the patent. However, if the purchaser for value knew of this fraud, surely this must amount to lack of good faith on the part of the purchaser because the purchaser (having knowledge of the fraud) would have knowledge of a prior inconsistent interest. Applying this interpretation, there is no need for the "any fraud" requirement in s189(2). In short, the meaning of the "any fraud" requirement in s189(2) is unclear.

If the purpose of s189 is to provide a Register that most people can rely upon, then s189(2) should be read narrowly. The primary intent of s189 is to provide a Register that can be relied upon by the public. The Register is to *"protect"* purchasers (s 189(2)), not those who failed to register their interest in a patent.[26] The Explanatory Memorandum of the Senate for the Patents Bill 1990 (Cth) states:

> The *main effect* of clause 189(1) *is to protect* a person who deals with a patentee on the basis of the rights appearing in the Register of Patents, so

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[25] In *Davies Shephard Pty Ltd v Stack* [2001] FCA 501, the Federal Court rejected the novel argument that s189 protected an assignee in any proceedings to revoke the patent. The court stated: "Section 189(1) cannot have been intended to allow an original patentee to give title to the patent free from liability to revocation if he or she holds subject to such liability. The possibility of revocation does not deprive the patentee of his or her capacity to deal with the patent as 'absolute owner'."

[26] *Davies Shephard Pty Ltd v Stack* [2001] FCA 501. (Section 189 is "concerned with protection of title".)

> long as that person is a purchaser in good faith for value without notice of any fraud on the part of the patentee (emphasis added).

For this reason, the following interpretation is preferred:

a "otherwise than ... in good faith" requires no bad conduct or dishonesty on the part of the purchaser. The focus here is on the purchaser's actions and actual knowledge.[27] A purchaser does not have good faith if the purchaser has actual knowledge of another's inconsistent interest in the patent or actual knowledge of circumstances which would put a reasonably prudent purchaser on inquiry as to title;

b "without notice of any fraud on the part of the patentee" requires that the purchaser have no actual knowledge of the patentee's intent to defraud another of his or her interest in the patent, and possibly, no actual knowledge of any other fraud by the patentee relating to the patent, such as fraud in obtaining the patent (s138(3)(d)) or granting and fraudulently threatening to enforce a license with a void condition (s144). To some extent, this overlaps with the above point.

Applying this interpretation, "good faith" relates to actual knowledge.

Constructive notice[28] of another's inconsistent interest not appearing in the Register is not sufficient to deny a purchaser the protection of s189(1).[29] To read "good faith" to include constructive notice of interests not recorded in the Register would greatly diminish the protection of s189(1).[30] Of course, under s189(1), the purchaser takes subject to "any rights appearing in the Register" whether or not the purchaser had knowledge of such rights.

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[27] Compare M Pattison, *Using Intellectual Property as a Security*, (1996) 7 AIPJ 135, pp 139 and 146.
[28] Constructive notice is notice implied or imputed by law, usually on the basis that the information is part of a public record or file.
[29] Other interpretations of s189(2) are possible. The 'otherwise than ... in good faith' requirement could be read more broadly to cover actual and constructive notice. Alternatively, 'otherwise than ... in good faith' could be read even more narrowly to cover only dishonest actions of the purchaser and not the patentee's actions or knowledge of them.
[30] For example, interests recorded in the United States Patent Office and all other Patent Offices in the world may possibly defeat the protection of s189(1).

In short, what is the purpose of the Register? Is the Register's purpose:

1. to provide notice of interests in patents; or

2. to provide a central register which is the one and only place to look to determine ownership of, and whether security interests exist in, patents; or

3. to allow one to transfer and obtain rights through registration, for example, so that the assignment or security interest is only effective upon registration; or

4. to allow one to obtain priority rights?

Item 3 above is clearly not the purpose of the Register. Items 1, 2 and 4 could all be regarded as valid statements.

D. Interaction with Corporations Act

In Australia, security interests over certain assets of corporations must be registered in the Australian Register of Company Charges in accordance with Chapter 2K of the Corporations Act 2001 (Cth). This is a debtor-based registration system.

Suppose a security interest in a patent is registered under the Corporations Act but not in the Patent Office in accordance with the Patents Act. Is the security interest enforceable against a subsequent purchaser of the patent who searches the Patent Office Register but does not search the Register of Company Charges? Both the Patents Act and the Corporations Act are federal laws.[31]

Section 262(1)(e) of the Corporations Act provides that the provisions of Chapter 2K:

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[31] As stated above, the Corporations Act replaced the Corporations Law on 15 July 2001. The Corporations Law was State law. This gave rise to difficult constitutional issues. A registration under State law should not provide constructive notice or defeat a registration under federal law unless the federal law clearly so allows. See J Swinson, *Security Interests in Intellectual Property*, published in *Securities Over Personal Property*, Butterworths, Sydney, 1999 at [6.20] to [6.22].

> ... relating to the giving of notice in relation to, the registration of, and the priorities of, charges apply in relation to ... a charge on ... a patent or licence under a patent ...

The intent is that Chapter 2K of the Corporations Act relating to charges applies to charges over patents. When a charge over a patent is created by a company, the company must ensure that the charge is lodged within 45 days (s 263) and particulars of the charge will be included in the Register of Company Charges: s 265. The company must also maintain a register containing the security interest: s 271.

As both the Patents Act and the Corporations Act deal with registration of security interests in patents, the issue arises whether or not these two registration regimes are inconsistent, and if so, which of the two regimes overrides the other.

The Corporations Act requires security interests granted by corporations to be registered in the Register of Company Charges. The Patents Act allows security interests in relation to patents to be recorded in the Patent Office register. These provisions are not inconsistent, because a corporation could comply with both, and register in both registers.

Priority disputes in relation to charges registered on the Register of Company Charges are determined in accordance with ss 280-282 of the Corporations Act.[32] However, these sections do not affect the operation of the Patents Act because pursuant to s279(5)(d) of the Corporations Act, the priority dispute sections of the Corporations Act do not apply "so as to affect the operation of ... the Patents Act 1952".[33]

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[32] The priority provisions of ss 280-282 of the Corporations Act do not apply to all priority disputes. The Corporations Act only regulates priority disputes as between security interests and not as between security holders and purchasers.

[33] Section 279(5)(d) refers to the Patents Act 1952. This Act has been repealed and replaced with the Patents Act 1990. Possibly, Acts Interpretation Act s 10(b) may cure this error.

If there was a priority dispute between an assignment of a patent and a security interest over the patent, then the Patents Act would clearly apply because the priority dispute sections of the Corporations Act only apply to disputes between security interests.

If there was a priority dispute between two charges over a patent, would operation of the Patents Act be affected by the Corporations Act? As stated above, s189 of the Patents Act only relates to dealings with the patentee. If the priority dispute was between two security holders, one or both of whom obtained rights from the patentee, then s189 would apply rather than the Corporations Act. If the priority dispute was between two security holders who both obtained rights from someone other than the patentee, then there is an argument that the Patents Act is silent on this point (as s189 only relates to dealings with the patentee), so the priority provisions of the Corporations Act should apply.

Accordingly, s189 of the Patents Act should be the primary means used to resolve priority disputes concerning patents, even if a charge is registered in the Register of Company Charges. If the Patents Act is silent (for example, in relation to priority disputes not involving a patentee or between two interests that have not been registered anywhere), the priority rules of the Corporations Act will apply.

Consider the following example. X grants a charge over a patent to A, and the charge is registered under the Corporations Act but not under the Patents Act. Later, X assigns the patent to B. Would A's security interest take priority over the subsequent assignment of the patent to B, who did not search the Register of Company Charges? Applying s189(1) of the Patents Act, X is the patentee and can deal with the patent as absolute owner of it and give good discharge to B. To succeed, B must be "a purchaser in good faith for value and without notice of any fraud on the part of the patentee": Patents Act s189(2). B would be able to do so, as B has no actual notice of another's prior interest and constructive notice is not enough to deprive B of "good faith". Further, subject to three exceptions, the security interest granted to A is not admissible in any proceedings to prove an interest in a patent:

Patents Act, s196. If B had actual notice of A's interest because B searched the Register of Company Charges and found A's interest, then B would not be “in good faith” and A would prevail.

Thus, the Register of Company Charges may be effective to provide actual notice, but not constructive notice, to those dealing with interests in patents.[34]

To hold that the Register of Company Charges provides constructive notice sufficient to deprive a purchaser of the protection of s189(1) of the Patents Act would nullify the purpose of the Register of Patents and be contrary to the intent of s279(5) of the Corporations Act. Otherwise, a purchaser could not rely on the Register of Patents if a registration under the Corporations Act affected whether a purchaser obtained good title to a patent. The Register of Patents is intended by Federal Parliament to be the one and only place to look to determine ownership of, and whether security interests exist in, patents. It is the central clearing house for recordation of titles in relation to patents.

Chapter 2K of the Corporations Act does have some effect relating to patents. For example, certain charges, including charges over patents, are void against a liquidator or administrator: s266.

Regardless of the effect of Chapter 2K as it relates to patents, the prudent course is for a security holder to search both the Patent Office and the Register of Company Charges prior to taking a security interest in a patent, and to register the security interest in both Registers.

To paraphrase Professor Wood:[35]

> It seems likely, therefore, that in Australia the federal statutes governing intellectual property and corporations operate concurrently in relation to security interests granted by corporations. Registration of a security interest in the Register of Company Charges is required by the Corporations Act. With a single registration, a secured party will be able to record its security interests over a large inventory of

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[34] J Lipton, *Security over ‘Information Products’*, (2000) 11 AIPJ 23 at 34.
[35] R J Wood, *The Nature and Definition of Federal Security Interests*, (2000) 34 C.B.L.J 65 at 106.

intellectual property rights, including after-acquired rights and intellectual property licenses. Registration under the Corporations Act alone with carry a somewhat greater level of risk. The security interest will be defeated by a competing transferee or secured party who obtains rights from the patentee and who registers in the federal patents Register. To be able to take advantage of the Patents Act's priority rule, the competing party must be without notice. However, a registration under the Corporations Act does not constitute constructive notice. Therefore, registration in both the Register of Company Charges and the federal patents Register will be necessary if a secured party wants to obtain the maximum level of protection.

II. SECURITY INTERESTS IN PATENT APPLICATIONS

Patent applications can be assigned. The Patents Act does not state whether assignments of patent applications must be in writing. Legal title passes to the assignee on grant of the patent: Patents Act s15(1)(b).

The Patents Act is not clear as to whether security interests in pending patent applications can be registered. Section 187 contemplates that only particulars of patents, not applications, are registered. The practice of the Patent Office is to receive the application to record the security interest, and put it into a pending category until the patent issues.

A security interest in a pending patent may be structured as an interest in after-acquired property. As soon as the patent issues, the security interest attaches to the patent. If the security interest is a legal mortgage, the patent will be granted to the mortgagee: Patents Act s15(1)(b).[36]

III. SPECIAL RISKS WHEN TAKING A SECURITY INTEREST IN A PATENT

Patents are considered to be the intellectual property of choice in which to take a security interest, because they are carefully documented and are subject to a system of

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[36] See also J Lipton, *Security over 'Information Products'*, (2000) 11 AIPJ 23 at 33.

registration.[37] However, there are a number of risks that a security holder takes when obtaining a security interest in a patent. Some of those risks will be outlined in this section.

A. The patent may be invalid

Just because a patent has been granted does not mean that the patent is valid: Patents Act s20(1). There are a number of grounds to invalidate a patent, the most common being that the invention claimed is not in fact new and non-obvious. If prior art is found that anticipates the claimed invention, then the patent is invalid. In court proceedings to enforce a patent, it is common for the defendant to assert that the patent is invalid.

A careful security holder taking a security interest in a patent that was perceived to be valuable should commission a detailed prior art search and validity opinion from a patent lawyer, prior to taking an interest in the patent. No prior art search can give an absolute answer that the patent is valid, but can provide a greater level of comfort as to the validity and strength of the patent.

B. The scope of the patent is often difficult to determine

Most patentees will assert that their patent is wide in scope, covering all technology in a particular area. A patentee, through fraud, pride or simple misunderstanding, may overestimate the coverage of the patent.

It is often difficult to determine the exact scope of a patent.[38] Some patents that on first reading appear broad, in fact cover only a minor improvement in a crowded area of technology. The patent is of little value if it is easy to "design around" or if it is easy to develop a non-infringing alternative technology to the patented invention.

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[37] J Lipton, *Security over 'Information Products'*, (2000) 11 AIPJ 23 at 35.
[38] See, for example, *Nyyssonen v Bendix Corp 342* F.2d 531 at 533-4 (1965): "[W]e cannot read [the patents] intelligently ... Moreover, we have great difficulty in understanding, even in a general way, the technical testimony of the experts and the discussion of that testimony by counsel."

To determine the scope of a patent, one should understand the technology. Without an understanding of the technology and the "state of the art" when the patent was filed, it is difficult to ascertain whether the patented technology was a significant breakthrough or a minor improvement.

The scope of the patent is determined by its claims, not the detailed description appearing in the specification of the patent. Claims are often complex and difficult to understand. There are many patent drafting conventions that limit or expand the apparent scope of a claim. The claims of a patent define a technological invention in legal language. Those who are not skilled in patent law would have difficulty understanding many patent claims.

C. The patent may only be valuable to one business

There are many reasons for obtaining patents. The most common is to protect the new technology of a business and prevent competitors using or otherwise exploiting that technology. However, competitors may not ever be interested in using that technology. There are other reasons for obtaining patents. A patent may be obtained to:

- enhance the ego or reputation of a senior employee;
- build up a library of patents as a defensive measure in case a competitor asserts a patent claim against the business;
- provide a portfolio of technology to license; or
- assist in raising venture capital finance.

For various reasons, a business may obtain a patent on technology not used by the business. Others file patents to protect their technology from exploitation by a single competitor. A large percentage of patents are never successfully commercialized.

In short, the technology patented, no matter how clever, may be useful to only a few, or one, and sometimes not any, businesses. A security holder in possession may have difficulties selling such a patent.

D. The patent does not ensure that the patentee has the right to practice the invention

A patent is a right to exclude or prevent, not a monopoly. A patentee has no absolute right to practice what is patented. There may be a blocking patent preventing the patentee from carrying out the patented method or selling the patented product. If a security provider defaults and the security holder obtains ownership of a patent, the security holder or subsequent purchaser does not necessarily have the right to commercialize what is patented.

Further, if the security is over all the assets of a business, including a patent, and the security provider defaults due to a competitor enforcing its patents against the security holder,[39] the business may not necessarily be a going concern.

IV. PRACTICAL STEPS[40]

Security over a patent can be taken by way of legal mortgage,[41] where the security provider assigns the patent to the security holder subject to the right of the security provider to have the patent assigned back on discharge of the secured obligation. Alternatively, security over a patent can be taken by way of equitable mortgage, where the security provider retains

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[39] Knowledge is not an element of patent infringement. A patent may be infringed without knowledge of the patent, the invention covered by the patent or the existence of the patentee.

[40] See Dykhouse, Lewis and Napoletano, *When Biotechnology Lending Is Worth Risking*, New York Law Journal, 9 March 1998.

[41] Legal mortgages of Australian patents are considered in detail in J Lipton, *Security over 'Information Products'*, (2000) 11 AIPJ 23.

legal title but is under the obligation to assign the legal title to the security holder upon default.[42]

In a legal mortgage, the security holder becomes the "patentee" under the Patents Act. An equitable security holder is not a "patentee". A security holder may prefer to be the patentee, as this apparently provides better protection against a subsequent inconsistent dealing by the security provider.[43]

A legal mortgage may not be beneficial in all circumstances. Where the security provider is exploiting the patented technology, the security holder should grant an exclusive license back to the security provider to allow the security provider to continue to use the patented technology and to enforce the patent against infringers.[44] However, if the security provider has granted licenses under the patent that have not been terminated prior to granting the security interest, the security holder cannot grant an exclusive license back to the security provider. In such a case, only a non-exclusive license can be granted by the security holder to the security provider, which could be detrimental. For example, if a third party infringed the patent, the infringement suit will be brought in the name of the security holder.

Where a legal mortgage is granted, the security holder can sue infringers in its own name. The security provider may want some degree of control over the lawsuit, especially where a major competitor is the one infringing the patent and adversely affecting the security provider's business.

Generally, an equitable mortgage is preferred where the security provider is commercializing the patent.

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[42] An equitable mortgage can also arise where the patentee agrees to enter into a legal mortgage in the future, or where a legal mortgage is entered that does not comply with the requirements of the Patents Act, for example, not in writing signed by both the patentee and the security holder.
[43] See Examples 3 and 5 above.
[44] *City Bank & Trust Co v Otto Fabric Inc* 83 B.R. 780; 7 U.S.P.Q.2d. 1719 at 1722 (Bankr. D. Kan. 1988).

In Australia, a legal mortgage over a patent must be in writing, signed by both the security provider and the security holder: Patents Act s14(1).[45]

The certificate of registration for a patent is not a document of legal title. Possession of the certificate of registration gives the possessor no rights in, or to, the patent.

When obtaining a security interest in a patent, the following issues should be considered:

- Is the security provider required to maintain the patent? Who has the obligation to pay the maintenance fees?
- Is the security provider entitled to grant licenses, including an exclusive license, under the patent?
- Is the security provider required to enforce the patent against infringers, and if so, who has control of the lawsuit and settlement negotiations?[46] Should the security holder be appointed as the security provider's agent to enforce the patent (and to pay maintenance fees)?
- Should the security cover proceeds generated from the patent received by the security provider, such as licensing fees, royalties and infringement damages?
- Should the security cover corresponding foreign patents and patent applications?
- Should the security cover patents and patent applications on improvements to the patented technology?
- Should the security cover after-acquired patents?

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[45] Compare the United States position in 35 U.S.C. § 261 which states that "Applications for patent, patents, or any interest therein, shall be assignable in law by an instrument in writing". There is no requirement in the United States that the assignee sign the assignment.

[46] See *Wang Laboratories Inc v Mitsubishi Electronics America Inc 29 U.S.P.Q. 2d.* 1481 (D.C. Cal. 1993), where an agreement between a security provider and a bank provided that the security provider had an exclusive right

- To what extent should the security provider be required to report on the status of pending patent applications and the development of new patentable technology? Does the security holder require the right to inspect Patent Office files relating to the security provider, and if so, at what stage (for example, prior to lending money or at regular intervals or only upon default)?

- If the security provider defaults and the security holder obtains ownership of the patent, what are the obligations on the security provider (and the inventors) to assist in any future legal or Patent Office proceedings?

- Should the security provider be prevented from “dedicating the patent to the public”?

- Should the security provider be required to obtain legal expenses patent insurance to cover litigation expenses if the patent is infringed?

- Is a legal opinion needed from the security provider's lawyer as to ownership or validity of the patents?

- Does the security holder require a power of attorney to prosecute any pending patent applications in the event of default?

Immediately after the closing, the security interest should be registered with IP Australia and any other applicable Patent Offices around the world. As discussed above, if the security provider is a company, the security interest must also be registered with the Australian Securities and Investments Commission (ASIC) on the Register of Company Charges.

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to enforce the patent except in the case of default. The bank was not a necessary party in the patent infringement suit.

PART FOUR: INDUSTRIAL DESIGNS

I. THE UNDERLYING LAW IN AUSTRALIA

Industrial designs are protected by the Designs Act 1906 (Cth) (hereafter, "1906 Act"). Industrial designs can be registered under the 1906 Act. A registered design (called a design patent in the United States) protects the appearance of articles, including the distinctive shape, appearance, ornamentation or pattern. The focus of industrial designs is the visual appearance, not the function, of an object.

To obtain a registered design, an application must be filed with IP Australia. At the time of filing, the visual appearance of the article must be new or original in Australia. Under the 1906 Act, and unlike patents, novelty is assessed by looking at materials available in Australia only. Accordingly, an application for an industrial design registration must be filed before the design is used or published in Australia.

Once registered, the design is protected throughout Australia for 16 years.

Designs constitute personal property: s25C(1). The owner of the registered design can assign the design. The assignment must be in writing, signed by, or on behalf of, the owner: s25C(3). A mortgage can be granted over a design. The interest of the mortgagee must be registered, but arises independently of registration. Section 38A states:

> "Where a person becomes entitled as mortgagee, licensee or otherwise to an interest in a registered design, he shall apply to the Registrar to register his title, and the Registrar shall, on receipt of the application, and on proof to the satisfaction of the Registrar of the title of the applicant, cause notice of the interest to be entered in the register, together with particulars of the instrument creating the interest."

Section 38B does not state the consequences of non-registration of an interest in a design, other than that the document or interest:

> "... in respect of which no entry has been made in the register ... is not, unless the court otherwise directs, admissible in evidence in a court in proof of title to a design or to an interest in a design."

The 1906 Act does not include any provisions to determine priority disputes between competing interests. Section 25C(2) merely provides that:

> ... the laws applicable to ownership and devolution of personal property apply in relation to the monopoly in a registered design as they apply in relation to other choses in action.

Accordingly, normal priority rules apply. The Register will provide notice, but there is no assurance that the registered owner is the true owner of the design. If the owner of the design is a corporation, priorities between competing security interests in the design could be resolved in accordance with the priority principles in the Corporations Act s279(5).[47] Presumably, priority disputes between a security holder and a purchaser are resolved by common law and equitable principles.

PART FIVE: COPYRIGHTS

I. THE UNDERLYING LAW IN AUSTRALIA

In Australia, there are no formalities required to obtain copyright protection in a work. As soon as the work is represented in a material form, the work is protected by copyright. There is no requirement for a copyright notice. There is no copyright registration process.

The Copyright Act 1968 (Cth) governs copyright law in Australia. It is a federal law.

Copyright is personal property, and is transmissible by assignment, by will and by devolution by operation of law: Copyright Act s196(1). An assignment of copyright does not have any effect unless it is in writing signed by, or on behalf of, the assignor: s196(3).

The copyright in works to be created in the future can be assigned prior to the creation of the work: s197. A security provider can grant a security interest in future works, the security becoming effective when the work is created.

As stated above, there is no register of copyrights in Australia. There is no specific register to record ownership of, or assignments or security interests involving, copyrights.

Thus, it is difficult to determine whether any prior inconsistent interest has been created.[48] Failure to determine the true owner can be fatal. If X transfers a copyright to A, and then X grants a security interest in the same copyright to B, B will obtain nothing. In a priority dispute between a prior legal interest and a subsequent legal or equitable interest, the prior legal interest will prevail.

Any license granted for the copyright will bind every successor in title to an interest in the copyright to the same extent as the license was binding on the grantor: s196(4). Again, there is no register to determine if licenses have been granted. If X grants a license to A, and then a security interest to B, B takes subject to A's license. If the license to A is a perpetual, royalty-free exclusive license, B in effect would receive a security interest over nothing of any value. An exclusive license, for most purposes, is equivalent to an assignment.

Thus, a lender is well advised to conduct a due diligence investigation prior to lending money where copyright is a main form of security. This should also include searching the Register of Company Charges if the security provider (or a contractor of the security provider) is a corporation.

For software, the security holder should consider obtaining a copy of the work at the time of obtaining the security interest,[49] and/or require the security provider to place commented

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[47] This section states that the priority rules in the Corporations Act "do not apply so as to affect the operation of the Designs Act 1906". Since the Designs Act has no priority rules, the Corporations Act presumably would not affect the operation of the Designs Act.

[48] It is also somewhat difficult to determine who is the true owner or owners of a copyright. For complex works created over a period of time by a number of employees and contractors (such as computer programs), there are often many legal relationships and contracts to be considered to determine the copyright owner or owners. Often, over time, the contributors to a complex work cannot identify what parts they created or modified.

[49] For security issues relating to software, see S Pollard, *Aspects of Lenders' Security Over Computer Software Copyright,* (1995) 6 AIPJ 80.

source code in escrow and update the source code on a regular basis and obtain the names and addresses of key programmers.

A security interest in copyright can be by way of a legal or equitable mortgage. A legal mortgagee can sue copyright infringers in its own name. The security provider will most likely require a license back from the legal mortgagee to use the copyright, and may require the right to grant sublicenses. For example, if the copyright is in a computer program, the security provider may need to grant licenses to its customers to allow use of the program. If there is a legal mortgage over the copyright in a work, any copyright notice in respect of that work should name the security holder.

II. DOES THE U.S. COPYRIGHT REGISTER PROVIDE CONSTRUCTIVE NOTICE?

If an Australian work is registered in the United States Copyright Office, are the details on the U.S. Copyright Register notice to Australian lenders?

The U.S. Copyright Register records ownership details of registered copyrights, including assignments and security interests. [50]

A work protected by copyright in Australia is, by virtue of the Berne Convention, protected by United States copyright law in relation to acts of copyright infringement occurring in the United States. A work created in Australia can be registered in the U.S. Copyright Register. Accordingly, for a work created in Australia that is registered in the United States, license and security interests can be recorded in relation to this work in the United States.

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[50] For a discussion of issues relevant to taking security over copyright in the United States, see G McLaughlin and B Hull, *Lack of Security: Problems for Lenders in Taking Copyrights as Collateral,* (1998) 9 JBFLP 238; J R Capwell, *Secured Financing in Intellectual Property: Perfection of Security Interests in Copyrights to Computer Programs*, (1988) 39 Syracuse L Rev 1041; W W Chip, *Transfers of Copyrights for Security Under the New Copyright Act*, (1978) 88 Yale LJ 125; P Heald, *Resolving Priority Disputes in Intellectual Property Collateral,* (1993) 1 J Intell Prop L 135; G Concoff, *Motion Picture Secured Transactions Under the Uniform Commercial Code: Problems in Perfection,* (1966) 13 *UCLA L Rev 1214;* S E Fayne, *Copyright as Collateral*, *(1984) LA County B Ass'n J*; G Gilmore, *Security Interests in Personal Property* §17.3 at 545 (1965).

Consider the following example. An Australian corporation, DownUnderGames, creates a computer game. It registers this work in the U.S. Copyright Register. DownUnderGames obtains a loan from NYBank, secured against all copyrights owned by DownUnderGames. NYBank registers its security interest in the U.S. Copyright Register, but not in the Australian Register of Company Charges.[51] Later, DownUnderGames grants a similar security interest to AussieBank. AussieBank searches the Australian Register of Company Charges, and finds nothing. AussieBank registers its security interest in the Australian Register of Company Charges. Is AussieBank's security interest subject to NYBank's security interest?

Section 280(1)(b) of the Corporations Act states that a charge registered on the Australian Register of Company Charges has priority

> "over an unregistered charge on the property created before the creation of the registered charge, unless the chargee in relation to the unregistered charge proves that the chargee in relation to the registered charge had notice of the unregistered charge at the time when the registered charge was created."

Additionally, section 278(2) states:

> "A reference in this Part to a person having notice of a charge includes reference to a person having constructive notice of the charge."

There are three possible approaches, and the answer may depend upon whether a U.S. or Australian court is the tribunal:

1. AussieBank is taken to have constructive notice of the security interest recorded in the U.S. Copyright Office, and so NYBank's charge takes priority. This is consistent with the constructive notice provisions in the Corporations Act s278(2) and U.S. Copyright Act 17 U.S.C. § 205(c).

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[51] Corporations Act, s263(1) requires that the corporation must ensure that the charge is lodged on the Register of Company Charges. If NYBank takes priority, would AussieBank have a good legal claim against DownUnderGames in tort for breach of statutory duty for failing to comply with s263(1)?

2. AussieBank is taken to have constructive notice only of security interests recorded in Australia. Applying the Australian Corporations Act, NYBank's charge is unregistered, and so AussieBank's registered charge takes priority.

3. Because copyright rights are territorial, different rules will apply depending on the jurisdiction. In relation to the U.S. copyright, NYBank will have priority. In relation to non-U.S. copyright, AussieBank will have priority. The U.S. Copyright Act only applies to U.S. copyright rights, and the decisions in *In re Avalon Software Inc*[52] and *In re Peregrine Entertainment*[53] should be limited to U.S. copyright rights.[54] Ownership of the non-U.S. copyright rights should be determined pursuant to the Australian Corporations Act.

Thus, due to this uncertainity the cautious Australian lender obtaining a security interest in any copyright work should conduct a search of the United States Copyright Office to determine if the work has been registered, and if so, whether any assignment, security interest or exclusive license has been recorded in the United States relation to the work.

A work created in Australia is automatically protected under United States copyright law. If the United States copyright is valuable, which may be the case, for example, for software, film or musical recordings, the security provider should perfect its security interest in the copyright in the United States. At present, the only way to do this is for the work to be registered in the United States Copyright Office and the security interest recorded there.

Thus, a wise Australian lender acquiring a security interest over valuable copyrights of an Australian business should require the security provider to register any significant works with the U.S. Copyright Office, and then record (within one month) the security agreement with the U.S. Copyright Office against each work.

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[52] 209 B.R. 517 (Bankr. D. Ariz. 1997).

If future copyrights are covered by the security interest, the security holder should also:

- require the security provider to report regularly with respect to newly created copyrightable works;
- require the security provider to register regularly all newly created works; and
- record the secure interest over the newly created works in the Copyright Office.[55]

PART SIX: REGISTERED TRADE MARKS

I. THE UNDERLYING LAW IN AUSTRALIA[56]

Australia has a system of trade mark registration. When an application is made to register a trade mark, the Trade Marks Office (in Australia, part of IP Australia) will examine the mark to ensure that the trade mark is distinctive and its use would not be likely to cause confusion in the marketplace. If accepted, and the application is not successfully opposed, the Trade Marks Office issues a trade mark registration. There are no State trade mark registers.

A registered trade mark is personal property: Trade Marks Act s21(1).

Both an application for a trade mark and a registered trade mark can be assigned: s106(1).[57] The assignment may be with *or without* the goodwill[58] of the business using the trade mark: s106(3).

If a trade mark registration is assigned, s109(1) of the Trade Marks Act requires that either the person registered as the owner of the trade mark or the person to whom the trade mark

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[53] 116 B.R. 194; 16 U.S.P.Q.2d 1017 (C.D. Cal. 1990).
[54] But *see In re AEG Acquisition Corp.*, 161 B.R. 50 (Bankr. 9th Cir. 1993).
[55] If software is involved, it is common for the security provider to enter a source code escrow agreement that will ensure that the security holder has access to the source code if the security provider defaults. The source code in escrow should be regularly updated and include any written specifications relating to the code.
[56] For the position under the Trade Marks Act 1955, see C Sexton, *Security over Intellectual Property in Australia,* (1991) 2 EIPR 65 at 67. The current law is discussed in detail in J Lipton, *Security Interests in Trade Marks and Associated Business Goodwill* (1999) 10 AIPJ 157.

has been assigned must apply to the Registrar for the assignment to be entered in the Register. Although the Act appears to obligate registration of assignments,[59] the assignment is effective whether or not it is filed for registration. The Act does not deal with the effect of failing to record an assignment.

Where an assignment is lodged, the particulars of the assignment are deemed to be entered in the Register on, and the assignee becomes the registered owner of the trade mark from, the day the assignment is filed (s110(2)), even if the Trade Marks Office does not actually record the assignment until a later date.

Similarly, if a trade mark application is assigned, s107(1) requires that either the original applicant or the person to whom the application is assigned must apply to the Registrar for the assignment to be recorded. An assignment of an application is recorded, but not on the Register, since there is not, as yet, a registration.

Part 11 of the Trade Marks Act enables the voluntary recording of security interests in trade marks. Part 11 allows voluntary recording of claims to interests and rights in respect of registered trade marks and trade mark applications other than assignments. Interests such as security interests and licenses may be recorded on a voluntary basis. Recordation of a security interest or license (or other interest recorded under Pt 11) "is not proof or evidence that the person has that right or interest" (s116). Part 11 does not provide any guidance as to the effect of having an interest in a trade mark recorded on the Register.

The application to have a security interest recorded must be made both by the security holder and the registered owner of the trade mark together: Trade Marks Act s113(1).

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[57] I Zeitler, *Assignments and Voluntary Recordal of Trade Marks under the Trade Marks Act 1995*, (1996) 7 AIPJ 103.
[58] J Lipton, *Security Interests In Business Goodwill*, (1998) 26 Australian Business Law Review 25.
[59] Although on its face s109(1) appears to mandate registration of an assignment, it is not clear who is responsible (the previous recorded owner or the assignee) if the assignment is not lodged for registration. If an assignee does not apply to record the assignment, could a subsequent bona fide purchaser from the assignor

Thus, a legal mortgage by way of assignment is registered under Pt 10 where *either* the security provider or security holder may apply to register the assignment. An equitable mortgage is registered under Pt 11 where *both* the security provider and the security holder must apply to register the interest.

When a trade mark assignment is recorded under Pt 10, the Registrar must notify any person with an interest recorded under Pt 11 of the assignment: Trade Marks Act s111.

The Trade Marks Act does not provide protection for a person dealing with the person recorded as the owner of the trade mark registration. Section 22, entitled "Power of registered owner to deal with trade mark", makes any dealing with the registered owner subject to any rights vested in another person. It is irrelevant that these other rights are not recorded in the Register. Section 22, which has been described as "fundamentally defective",[60] states:

> (1) The registered owner of a trade mark may, subject only to any rights vested in another person, deal with the trade mark as its absolute owner and give good faith discharges for any consideration for that dealing.
>
> (2) This section does not protect a person who deals with the registered owner otherwise than:
>
> (a) as a purchaser in good faith for value; and
>
> (b) without notice of any fraud on the part of the owner.

Although s22(2) uses the word "protection", none is given, at least not to those relying on the Register. Subsequent dealings are subject to prior registered and unregistered interests.

The Law Council of Australia has stated, in relation to cl 21 of the Bill which became s22 of the Act, that:

> the clause seems unsatisfactory ... The proviso in sub-clause (1) is "subject only to any rights vested in another person". This directs attention to the fact

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who fails to obtain good title claim that the assignee is in breach of a statutory duty and sue the assignee in tort for damages?

[60] M Pattison, *Using Intellectual Property as a Security*, (1996) 7 AIPJ 135, p 142.

> of the existence of the rights and appears to reduce the significance of registering or recording interests on the Register.[61]

Elsewhere in the same recommendations, the Law Council states:

> The intent and effect of this clause ... is far from clear. Members of the Law Council have variously interpreted this rule as stating that a registered title is indefeasible or as intended to repeal the rule that a bona fide purchaser for value without notice acquires a valid title. This needs to be clarified.[62]

If read literally, s22 has strange consequences, particularly if the "protection" mentioned in s22(2) is protection for the holder of a prior unregistered interest.[63]

As an example, as a gift, X grants an exclusive license over its trade mark to G. Under Pt 11, recordation of the exclusive license by G is voluntary, so G does not register. Later, X grants a security interest in the trade mark to B. Is B's interest subject to G's exclusive license? Section 22(2)(a) states that s22 does not protect a person who deals with the registered owner otherwise than as a purchaser for value. G is not a purchaser for value. and so is not protected by s22. Thus, B may assert that it should not be subject to G's license since, under s22(1), X can give good faith discharges "subject only to any rights vested in another person". As that "another person" is G, who is not protected by s22, B should prevail. If the exclusive license to G was not a gift but granted for a $100 license fee, then B would take subject to G's license.[64]

A recent Full Court of the Federal Court also highlighted that the register should not be relied upon.

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[61] Law Council of Australia, *Recommendations on the Trade Mark Bill 1994 (Exposure Draft),* 31 August 1994.
[62] Ibid.
[63] A decision of the Deputy Registrar of Trade Mark supports this weird view. The Deputy Registrar suggests that the Registrar should give priority to and register an assignment executed earlier in time but lodged with the Registrar after a later assignment was executed and lodged. *Re Applications of Tashounidis*, (1996) 35 IPR 305 ("If it emerges that documentation is deficient and fails to prove transmission of title, the registrar cannot record the assignment. Where a registered owner files two sequential applications on a single trade mark, and claims that the second filed application pre-dates the other, the registrar should give precedence to investigating this claim. This is because a valid assignment of the mark precludes the assignor from any further assignment actions.")
[64] If G registers the exclusive license, the question then arises as to whether B has notice of any fraud on the part of X. See discussion in part two section I(A).

> "Neither the registrar, nor anybody searching the register, would reasonably conclude that the bare fact of assignment indicated that no person other than the owner held any rights in respect of the trade marks."[65]

A subsequent purchaser relying on the Register also takes the risk that the Register is not up-to-date. Registration of an assignment takes effect from the date of filing, not the actual date the assignment is recorded in the Register.

Special care should be taken by security holders when dealing with a subsequent owner of a trade mark who has not recorded the assignment giving the subsequent owner title. Section 113(1) requires the registered owner to file an application to record a security interest jointly with the security holder. The subsequent owner of a trade mark registration, who has not recorded the assignment giving the owner title, is not the registered owner and thus cannot join the application to record the security interest.

II. INTERACTION WITH CORPORATIONS ACT

Again, issues arise in relation to the Corporations Act.

Section 279(5)(e) of the Corporations Act states that the priority provisions in ss 280 - 282 of the Corporations Act do not apply so as to affect the operation of the Trade Marks Act.[66]

One may argue that s22 of the Trade Marks Act has no operation in relation to resolving priority disputes, and so only the Corporations Act would apply to disputes between two security holders.

However, if the Trade Marks Act trumps the priority provisions of the Corporations Act, then applying the s22 rule, a prior unregistered security interest would prevail over a later security interest. This would be the case even if the later party searches the Register of Company

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[65] *Transport Tyre Sales v Montana* (1999) 93 FCR 421.
[66] Note that s279(5)(e) refers to the Trade Marks Act 1955 which has been repealed. The current Act is the Trade Marks Act 1995.

Charges and (finding nothing) registers its security there. Applying s22, the later party takes subject "... to any rights vested in another person ...", which would include the rights of the holder of the prior unregistered security interest.

In short, with respect to a registered trade mark, searching the Register of Company Charges or registering a security interest there may provide no protection against a person with a prior right in the trade mark.

The wise course is to search both the Trade Marks Register and the Register of Company Charges. Security providers should record their interest in any trade marks on both registers. However, keep in mind that prior unregistered interests may prevail regardless because of the possible uncertain and illogical operation of s22 of the Trade Marks Act.

III. PRACTICAL STEPS

The certificate of registration for a trade mark is not a document of legal title. Possession of the certificate of registration gives the possessor no rights in, or to, the registered trade mark. It is not needed to record an assignment or security interest in an action for trade mark infringement.

Because an application to register an equitable security interest in a registered trade mark must be signed by both parties for it to be recorded, it is recommended that the appropriate form (Form 7) be signed by the security provider as part of any security transaction.

Care should be taken when assessing the value of a trade mark. As a simple example, a trade mark for a word or phrase in the form of a logo may not prevent another person using or, in some instances registering, a trade mark for the same word or phrase in a different logo form. As a general rule, a "word mark" registration (the trade mark in block capital letters) is the most valuable form of registration for a word or slogan, as it generally covers use of the word or slogan in all fonts and stylized forms. Also, the scope of a trade mark is affected by the description of goods or services in the registration. But again, one must be

careful. An overly broad description of goods or services is subject to an application for rectification of the Register, which could result in the description of goods or services in the registration being limited to only the goods or services actually provided under the mark.

One significant risk for a security provider is that a trade mark registration may be removed after three years of continuous non-use in Australia.[67] For example, if the trade mark owner stops using the registered mark in Australia in relation to the goods or services described in the registration, after three years of continuous non-use the registration may be subject to removal from the Register. Similarly, if the trade mark owner has a logo registered as a trade mark and changes the design of the logo, then the trade mark registration for the original logo design may be subject to removal after three years: Trade Marks Act Pt 9.

When preparing a security agreement for a registered trade mark, one should consider the following issues:

- Whether the security provider is required to use the trade mark in Australia as a trade mark in the form covered by the registration. Alternatively, should the security provider be required to notify and obtain the consent of the security holder if the security provider intends to cease use of the trade mark or change the design of the trade mark?

- Should the security interest cover all variations of the trade mark? Should the security provider be required to apply for registrations over such variations and notify the security holder of these additional applications?

- Should the security interest cover after-acquired trade mark registrations?

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[67] J Lipton, *Security Interests in Trade Marks and Associated Business Goodwill*, (1999) 10 AIPJ 157 at 164.

- Should the security interest cover brand names and logos of the security provider adopted at later times, and if so, what is the obligation of the security provider to obtain trade mark registrations for these new brands and logos?

- Should the security interest cover proceeds generated from the trade mark, such as licensing fees, royalties and infringement damages?

- Should the security interest cover foreign trade mark registrations for the same trade mark? (If so, one should consider how to perfect the security interest in relation to those registrations.)

- What unregistered or common law trade mark rights should be included as secured property?

- How the security provider must use the trade mark, for example, that the security provider use the trade mark in accordance with proper trade mark use principles, and, for registered trade marks, use the ® symbol.

- Whether the security provider can grant licenses allowing others to use the trade mark. If licenses are granted, whether the license agreements should be approved by the security holder and have appropriate quality control provisions.

- Who has the obligation to pay Trade Marks Office maintenance fees? If the obligation is that of the security provider, the security agreement should provide that the maintenance fees be paid on time. Generally, the security agreement should require the trade mark owner not do anything that would adversely affect the validity of the trade mark or the registration.

- For a logo trade mark, does the trade mark owner also own copyright rights in the logo, and if so, should the security interest cover such copyright rights as well?

- Is the security provider required to enforce the trade mark registration against infringers, and if so, who has control of the lawsuit and settlement negotiations? Should the security holder be appointed as the security provider's agent to enforce the trade mark registration? Failure to police the trade mark against infringers may result in the trade mark becoming non-distinctive and therefore invalid.

- Is a legal opinion needed from the security provider's lawyer as to ownership or validity of the trade marks?

- Does the security holder require a power of attorney to prosecute any pending trade mark applications in the event of default?

- What are the reporting and inspection obligations of the security provider in relation to pending applications?

As soon as the transaction closes, the security interest should be registered with IP Australia and any other applicable Trade Mark Offices around the world. If the security provider is a company, the security interest should also be registered with the ASIC on the Register of Company Charges.

PART SEVEN: INTERNET DOMAIN NAMES

This Part will briefly consider security interests in “dot com au” and “dot com” domain names.[68]

I. DOT COM AU

In Australia, the domain name system is currently undergoing fundamental reform. Plans are well underway to introduce competition into the .au domain name registration market.

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[68] See also J Lipton, *What's in a (Domain) Name? Web Addresses as Loan Collateral*, (1999) 2 *The Journal of Information, Law and Technology*. (http://elj.warwick.ac.uk/jilt/99-2/lipton.html); J Lipton, *Secured Finance Law*

This has required a re-write of the domain name registration policy, and the creation of a number of new policies and legal entities.

In 1999, a not-for-profit organization called .au Domain Administration Ltd (auDA) was established by the Australian Internet community with the goal of becoming the industry self-regulatory body for administering the .au country code top level domains (ccTLD) and its associated sub-domains, for the benefit of the Australian community. auDA has been formally endorsed by the Australian Government as the appropriate entity to hold the delegation of authority for administration of the .au domain space.[69]

Under the current rules, successful registration of a ".com.au" domain name results in a license to use the domain name for a given period (at present, two years and biennially or annually renewable). The domain name license is non-transferable.

Earlier this year, auDA issued a report regarding domain name allocation and eligibility.[70] A principle of .au domain name registration and allocation is that only Australian entities that intend to use the domain name be entitled to own a domain name registration, and that the domain name must derive from that entity's name. One reason for these rules is to try to prevent cybersquatters and domain name speculators registering .com.au domain names. Additionally, the registrant is regarded as having a "domain name license" rather than ownership of the domain. An effect of these rules is that it is difficult to use a .com.au domain name as collateral. The relevant allocation and eligibility rules can be summarized as follows:

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and Practice in the Global Information Age, 11 Journal of Banking and Finance Law and Practice 17 at 29 (March 2000).

[69] See auDA Competition Model Advisory Panel, *Final Report - Competition Model for the .au Domain Space*, June 2001 (http://www.auda.org.au/docs/auda-competition-final.html)

[70] *Final Report on Domain Name Eligibility and Allocation Criteria*, 11 May 2001 (http://www.auda.org.au/docs/auda-name-eligibility-final.html) Changes to domain name eligibility and allocation policies do not have retrospective effect for current domain name license holders. The new policy will only apply to existing domain name licenses if the license is re-registered to a different entity, or when the existing license holder's license expires. The current but soon to be replaced Australian system is described in P Hourigan, *Domain Names and Trade Marks* in *Going Digital 2000: Legal Issues for e-commerce, software and the Internet,* Prospect Media, Sydney, 2000, Chapter 9.

- Domain name licenses will be allocated on a “first come, first served” basis.
- The domain name license applicant must be an Australian entity.
- The proposed use of the domain name license for a .com.au domain name must be for commercial purposes, which includes commercial entities, currently registered and trading in Australia, as well as commercial products and services.
- The registrant must sign a declaration of “good faith” intention to use the domain name consistently with the policy.
- It is not good faith to license a domain name for the sole purpose of selling it.
- There must be a substantial and close connection between the domain name and the domain name license holder. A connection between the domain name and the domain name license holder can be demonstrated if the domain name exactly matches the name on which the domain name license application is based (eg. company name, trade mark, etc) or is a name by which the domain name license holder is widely known.

It is a well-accepted notion in Australia that there are no proprietary rights in the domain name system. For example, auDA believes it does not “own” the .au domain space, but that it has been granted the delegation to manage the .au domain space under certain terms and conditions. Similarly, a registrant does not “own” a domain name, but holds a license to use the domain name under certain terms and conditions. This is why the Name Policy Advisory Panel was careful to refer to “domain name licenses” and “domain name license holders” in its reports.

As at 26 October 2001, the auDA draft proposed mandatory Registrant Agreement included the following terms:

> “2.2 The Registrar and the Registrant do not have any proprietary right arising from the Registered Domain Name.”

…

"6.3 The Registrant must not, in any way:

6.3.1 transfer or purport to transfer any proprietary right in any domain name registration;

6.3.2 grant or purport to grant a registered domain name as a security; or

6.3.3 encumber or purport to encumber a registered domain name."

The clause does not prevent the transfer of a domain name license, but it does prevent the transfer of a proprietary right in a domain name registration.

Thus, a .com.au domain name is of little value as security, because:

- it does not give rise to a proprietary right;
- there is an express prohibition on the use of the domain name as security.

Additionally, there must be a substanital and close connection between the domain name and the domain name holder. A security holder or purchaser therefrom may have difficulties showing this. However, if a corresponding trade mark was subject to the same security, the security holder could demonstrate this connection via ownership of the trade mark.

Although there was significant industry and public consultation in relation to the new .au policy, there was no debate or discussion regarding security interests in domain names or whether the above prohibition on security interests is desirable.

If one has a valuable ".com.au" domain name and intends to grant a security interest in it, regardless of the above rules, the following procedure could be adopted:

- create a "holding company" with a corporate name the same as the intended domain name;
- register the domain name with that company as the licensee; and

- grant a charge over the shares of the corporation.

For example, assume Smile Pty Ltd runs an Internet dating agency. Smile Pty Ltd has a subsidiary, Smile Two Pty Ltd. Smile Two registers smile.com.au. Smile Pty Ltd grants a security interest over all its assets, which would include its shares in Smile Two Pty Ltd. This procedure will have the same practical result as granting a security interest in the domain name.

II. DOT COM

This is a short note summarizing the author's view on some issues of the many issues relating to security interests in dot com domain names.

There is a large body of law developing regarding dot com domain names. Books on intellectual property valuation now include a chapter on domain name valuation.[71] Many people regard dot com domain names as intangible property that can be sold. In fact, in at least one arbitration decision under the UDRP, the panelist considered whether a domain name could be security:

> "The Respondent's argument does raise the interesting question whether an unpaid web designer once given control over a domain name by the client can retain it as a security for payment. In my view, this may be so. The law may recognize some sort of lien or charge against a domain name. To assert such a claim is to assert a legitimate interest. On that assumption, this could be a dispute to be decided by traditional means - as it would fall outside the scope of this tribunal.
>
> This case, however, does not quite reach that issue. The Respondent has failed to persuade me that there is any chance that the law would permit it, without the consent of the client, to *take* control of a domain name, and then retain control as a security against payment for web-design work. And that is what happened here."[72]

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[71] Smith and Parr, *Valuation Of Intellectual Property & Intangible Assets,* John Wiley & Sons, 3rd ed, New York, 2000.
[72] *Map Supply Inc. v On-line Colour Graphics*, NAF 12000096332 (February 6, 2001).

However, one must compare this with the decision in Network Solutions, Inc. v. Umbro International, Inc.[73] where it was decided that a domain name was not subject to garnishment. In that case, NSI acknowledged that the right to use a domain name is a form of intangible personal property.

If it is not possible to take a security interest in a domain name, it may be possible for a lender to take a security interest in the contractual right to use the domain name.

Although there is a register to record the owner of a dot com domain name, one cannot record other interests, such as security interests, on the register. A lender can, of course, take legal ownership of the domain name, while allowing the borrower to continue to use it, and promise to return legal ownership of the domain name to the borrower upon repayment of the loan. In doing so, the lender could be named as the owner of the domain name on the register, and could prevent any sale or other transfer of the domain name.

If the borrower will not assign, the lender could obtain an assignment and power of attorney, and hold that in escrow.

Another alternative is to change the administrative contact details in the domain name register to that of the security holder, which in most instances will prevent the domain name owner transferring the domain name.

The security holder also may wish to have the domain name registered with a registrar that is easier to deal with than Network Solutions.

When a security holder is considering a dot com domain name as security, the security holder should not merely rely upon a search of the register to determine ownership.[74] There may be a pending ICANN arbitration proceeding involving the domain name, and so the

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[73] 259 Va. 759, 54 U.S.P.Q.2d 1738 (2000).
[74] The register can be searched at, for example, www.betterwhois.com.

ICANN dispute database should also be searched.[75] It is risky taking a security interest in a domain name that is not being used by a legitimate business. A security holder should search to see if the security provider is a possible cybersquatter, for example, by searching the ICANN database for details of other disputes involving the security provider or involving other people at the same address as the security provider.[76] If the security holder becomes aware of a possible blemish on the title of the domain name, the security provider is best advised not to proceed, because:

> "One cannot pass good title to a domain name where one does not have good title. Similarly, in certain circumstances, illegitimacy and bad faith of a prior domain name owner may 'attach to' the domain name, and pass with the transfer to a subsequent domain name owner." [77]

PART EIGHT: TRENDS

I. ARE LENDERS AWARE?

It is common for a corporation to grant a security interest over all their assets to their bank. Typically, this security interest is registered only in the Register of Company Charges, and is not recorded in the appropriate registers at the Patent Office or the Trade Mark Office. Why is this?

IP Australia provided the author with the following statistics regarding registration of mortgages over patents and patent applications:

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[75] http://www.icann.org/udrp/
[76] *Schott Glas and Nec/Schott Components Corp. v. Necschott*, WIPO Case No. D2001-0127; *John Argento v. Futureconsulting*, WIPO Case No. D2001-1030.
[77] *Mucos Emulsions, GmbH and Marlyn Nutraceuticals, Inc. v. Esex.org and Kim Taeho*, WIPO Case No. D2000-1513; *Miles D., Ltd dba Jazz Alley* v. *Tokaido Shosha,* eResolution Case No. AF-0318.

Table 1

Year	Registered	Pending	Total
2001 (to 31 July)	3	38	41
2000	58	6	64
1999	18	2	20
1998	36	3	39
1997	5	0	5
1996	6	0	6

In Table 1, "Pending" means that IP Australia has received advice of a mortgage but the patent application has not yet been accepted so the mortgage cannot be registered.

Similar statistics in relation to registered trade marks are more difficult to determine, because the Trade Mark Office does not distinguish between the different types of interests recorded, such as licenses and mortgages. Registration of security interests in trade marks is believed to be rare.

It is impossible to determine how many security interests over patents and trade marks are granted but not recorded in the patent and trademark registers. Clearly, not a large number of security interests are being recorded on the patent and trade mark registers in Australia. There may be a number of reasons for this:

1. Lenders and their advisors are not aware that there are special registers to record security interests over patents and registered trade marks. Similarly, because most

security is real property, the lender may have no procedures set up to register the security interest in the Patent Office and the Trade Mark Office.

2. It is more common to grant a security interest over all assets of a business, and intellectual property assets are considered to be of minor value in relation to the other assets.

3. Lenders may be unwilling to lend money where intellectual property is the only or major form of security.

3. Many businesses have few or no patents.

4. Lenders may believe that intellectual property is of little value to the business.

5. Lenders may not ask whether the borrower has intellectual property, and if told, may not understand the significance of the intellectual property to the business.

6. Lenders may believe that registering the security interest in the Register of Company Charges is sufficient protection.

7. Lenders may decide to register the security interest in the Patent Office and the Trade Mark Office only when the lender believes that the borrower is about to run into financial difficulties.

8. The Australian intellectual property of the borrower may be considered insignificant when compared with the patent and trade mark portfolio owned by the borrower in more larger markets, such as the United States and Europe. The lender may be more motivated to perfect the security interest in relation to intellectual property in those countries, rather than in Australia.

9. Companies with significant intellectual property assets, such as biotechnology and Internet businesses, more often raise finance by selling equity rather than by way of a secured loan.

10. Lenders mistakenly believe that it is expensive to record a security interest in the Patent Office and the Trade Mark Office.

The main positive factor from Table 1 is that there has been a remarkable increase in the registration of security interests for intellectual property over the past five years.

II. MORE BANKRUPTCIES

Over the past year, more technology companies are running into financial difficulties. This is causing lenders and others to think more carefully about issues such as security interests. The author has noted an increase in the creative use of security interests in intellectual property related transactions in Australia.

For example, in large outsourcings, customers are considering the issue of bankruptcy of the service provider, and are using security interests to protect their position. The assets of the customer that are transferred to the service provider as part of the outsourcing can be the subject of a security interest, and therefore more easily recovered in the event of default by the service provider.

It is common for Australian businesses to “joint venture” with foreign corporations to bring new technology to Australia. A common transaction is as follows. A U.S. corporation (“USCo”) and an Australian corporation (“AUCo”) form a corporation in Australia (“JVCo”), owned 50% by USCo and 50% by AUCo. USCo’s contribution is an exclusive license in Australia to all intellectual property owned by it now and in the future, plus training and support. AUCo will contribute local knowledge and marketing skills. AUCo is concerned that

USCo may go bankrupt, leaving JVCo stranded.[78] If this happens, JVCo is unlikely to continue to receive any more training or support from USCo. Additionally, the U.S. trustee in bankruptcy could reject trade mark license from USCo to JVCo,[79] and reject any license covering intellectual property created after the date of bankruptcy.[80] One technique to deal with the possibility of bankruptcy of USCo is as follows:

1. JVCo should obtain a security interest in the intellectual property licensed to JVCo from USCo. The secured property is the intellectual property which is the subject of the license (or preferably, if possible, all of the intellectual property of USCo). The secured interest is the performance by USCo of the license and any other transaction documents, i.e., security over damages if USCo breaches. This will not solve all problems, but will give JVCo leverage with the trustee in bankruptcy if USCo becomes bankrupt.

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[78] This example assumes U.S. bankruptcy law will apply if USCo is bankrupt.

[79] In 1988, U.S. Congress responded to a developing line of contrary case law by enacting section 365(n) of the Bankruptcy Code to make clear that the rights of an intellectual property licensee cannot be unilaterally cut off in the event of the licensor's bankruptcy, because licenses were possibly executory contracts that could be rejected by a bankruptcy trustee or debtor in possession, thereby terminating the non-debtor's rights to use the licensed technology. Section 365(n) essentially provides that if the debtor in a bankruptcy case rejects an intellectual property license agreement under which the debtor is the licensor, the licensee may elect to retain its rights to use the intellectual property. After rejection, the debtor must allow the licensee to exercise its rights to the intellectual property, including any grant of a right to exclusive use. The licensee, in turn, must continue to make the royalty payments due under the contract for the duration of the contract. However, the protections of section 365(n) do not extend to trademark licenses. See M Standlee, *Are Licensees of Intellectual Property Really Protected in Bankruptcy Cases?,* http://www.gcwf.com/articles/review/revspring_99_5.html See also papers delivered at the Hawaii Bankruptcy Conference, June 28, 2001, *dot com cases http://www.abiworld.org/abidata/online/conference/01hibc/* and *365 issues http://www.abiworld.org/abidata/online/conference/01hibc/*

Under Australian law, a liquidator cannot disclaim a contract (other than an unprofitable contract or a lease of land) except with leave of the court: Corporations Act s568(1A). *See Old Style Confections v Microbyte Investments* [1995] 2 VR 457; *Transmetro Corp. v Real Investments* (1999) 17 ACLC 1,314.

[80] Section 365(n) of the U.S Bankruptcy Code does not appear to protect the licensor's right to intellectual property created after the bankruptcy filing. By its terms, section 365(n) protects a licensee's rights to intellectual property "as such *rights existed immediately before the case commenced* . . . ." This limitation may create serious problems for the licensee when dealing with intellectual property that is in the process of creation when a bankruptcy proceeding is filed, such as a partially created book, record, or motion picture. The limitation may also be significant in dealing with property, such as copyrighted computer software, that may be upgraded after the date of the filing of the debtor's bankruptcy petition. M Standlee, *Are Licensees of Intellectual Property Really Protected in Bankruptcy Cases?*, http://www.gcwf.com/articles/review/revspring_99_5.html

2. If possible, the Australian trade mark rights should be assigned outright to JVCo, rather than licensed. (An assignment to JVCo with an assignment back in certain circumstances should be avoided, as it may be treated as a license.)

3. In structuring the deal, it should be made clear which payments from JVCo to USCo relate to the copyright, patent and trade secret licenses, and which payments are for other things, such as enhancements, maintenance and training. If JVCo wishes to continue use of the intellectual property, JVCo will have to continue to make royalty payments if USCo goes bankrupt but will not have to make payments for enhancements, maintenance and training not received.

4. Additionally, AUCo should obtain a security interest over USCo's shares in JVCo. The secured interest is the performance by USCo of any shareholders agreement, future funding obligations, the license and any other transaction documents, i.e., security over damages if USCo breaches.

As can be seen from the above, security interests involving intellectual property are useful to users and exploiters of intellectual property, as well as traditional lenders.

PART NINE: CONCLUSION

This paper has discussed the legal issues relating to security interests in intellectual property in Australia. With care, lenders should be able to take advantage of security provided by a borrower's intellectual property assets. Sophisticated lenders can secure the borrower's obligations with such intellectual property assets. Overall, security over patents has the least legal risk in Australia.

It is fair to say that there is significant uncertainty in key legal provisions regarding intellectual property security, and that many of the laws in this area are not well drafted or sophisticated. These issues have not attracted the attention of lenders, and the

documentation used by most lenders in Australia relating to security interests in intellectual property is relatively unsophisticated. Remarkably, there have been few legal disputes involving security interests in intellectual property in Australia. In the past five years, there have been no reported cases in this area in Australia of any consequence. There are a number of issues that have yet to be considered by the courts or lawmakers in any significant way at all, such as:

1. security interests over royalties, after-acquired or after-developed intellectual property, goodwill and unregistered trade marks;

2. whether the various registers provide constructive notice;

3. the effect of delay between the time an interest is granted, lodged for registration and finally recorded on the register; and

4. the interaction between the Corporations Law and the intellectual property statutes.

It appears somewhat wasteful and inefficient to have two systems of registration for security interests over patents and trade marks where the security provider is a corporation. One system of registration is “asset” based and the other is “debtor” based. Unlike the U.S., where there is some pressure from the entertainment industry to retain a broadly preemptive federal works-oriented system governing the recordation and priority of security interests in copyrights,[81] there has been almost no discussion of this overlap in Australia or consideration of whether an asset-based or debtor-based registration system is best for security interests in patents and trade marks. There is a clear need, however, for a register that will identify who owns each patent and trade mark. With the proper use of technology, one computer database could record all appropriate information, and allow easy searching by asset, by owner, by debtor, and even by lender. To do this, there would need to be

significant cooperation between IP Australia and ASIC. It would also require corporations (or lenders) to identify each item of intellectual property covered by the security interest, which is not the current practice for "all asset" security interests. Lenders, who are most affected by this, apparently see little need for a single register. The most efficient way forward may be simply to clarify the operation of the existing rules.

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[81] R H Rotstein, *Paul Heald's 'Resolving Priority Disputes in Intellectual Property Collateral': A Comment*, (1993) 1 J Intell Prop L 167.

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CONTENTS

by John V. Swinson 1

PART ONE: INTRODUCTION 1

PART TWO: BACKGROUND 1

PART THREE: PATENTS 5

I. THE UNDERLYING LAW IN AUSTRALIA 5

A. Applying s189 in a priority dispute - five examples 8

B. Summary of examples 11

C. Good faith for value and without notice of any fraud 11

D. Interaction with Corporations Act 14

II. SECURITY INTERESTS IN PATENT APPLICATIONS 18

III. SPECIAL RISKS WHEN TAKING A SECURITY INTEREST IN A PATENT 18

IV. PRACTICAL STEPS 21

PART FOUR: INDUSTRIAL DESIGNS 25

I. THE UNDERLYING LAW IN AUSTRALIA 25

PART FIVE: COPYRIGHTS 26

I. THE UNDERLYING LAW IN AUSTRALIA 26

II. DOES THE U.S. COPYRIGHT REGISTER PROVIDE CONSTRUCTIVE NOTICE? 28

PART SIX: REGISTERED TRADE MARKS 31

I. THE UNDERLYING LAW IN AUSTRALIA 31

II. INTERACTION WITH CORPORATIONS ACT 35

III. PRACTICAL STEPS 36

PART SEVEN: INTERNET DOMAIN NAMES 39

I. DOT COM AU 39

II. DOT COM 43

PART EIGHT: TRENDS 45

I. ARE LENDERS AWARE? 45

II. MORE BANKRUPTCIES 48