Patent Security Agreements: Perfection Lost?

Overview

Professiona

December 14, 2020

By: Brian T. Moriarty

Bloomberg Law

Click here to view the full article from the publication.

A dual filing strategy for patent collateral seeks to provide “belt and suspenders” protection for lenders by filing an additional security agreement with the PTO. Yet, these ubiquitous patent security agreements provide very little security and can also undermine otherwise perfected patent security interests, leaving lenders with less, not more, protection, says Brian T. Moriarty, intellectual property attorney at Hamilton, Brook, Smith & Reynolds P.C. He lays out what he says is a better approach.

Billions of dollars loaned annually to emerging growth companies are secured by patent security agreements. Nearly 100,000 patent security agreements have been filed in the U.S. Patent and Trademark Office (PTO).

There is only one problem: They provide very little security.

For loans based on patent assets, lenders first enter into a general security agreement granting it a security interest in patents and other assets. The lender then files a financing statement (UCC-1) under state Uniform Commercial Code and its rights are perfected.

But, oddly, perfection for a lender does not seem to be enough. Many lenders are concerned that federal patent laws will preempt state UCC laws and they will lose their rights in patent collateral.

To hedge against this risk, they prepare a patent security agreement which re-grants the same security interests in the patents, but is filed with the PTO, not as a UCC-1. This common “dual filing” strategy is approved by the American Bar Association.

A dual filing strategy seeks to provide “belt and suspenders” protection for patent collateral. But, by regranting the same patent security interests, the second agreement can undermine the initial grant of rights.

The result can be no belt, no suspenders, and an unperfected security interest in patent collateral leaving lenders with less, not more, protection. There is a better approach.

Security Interests

A security interest is not a grant of an ownership interest in personal property, but part of a contract that allows the lender to foreclose on that collateral. A lender then perfects its interests by filing a UCC-1, giving it superior rights over other creditors. A UCC-1 is not a contract. It is public notice of a security interest.

A patent security agreement is a security agreement limited to only patents and filed only with the PTO. A PTO filing does not perfect the interest, but only gives notice to those who happen to see the filing.

Unlike a UCC-1, it is not simply a notice. It is a new contract that re-grants the same security interest in patents that was previously granted. A patent security agreement is supported by new consideration and can contains new obligations (e.g., file at PTO and periodically update patent list).

A lender's perfected interest can be lost in a variety of seemingly picayune ways, including filing the UCC-1 in the wrong location, misidentifying parties, and not describing collateral correctly. Failure to comply with these and many other technical issues can make the UCC-1 "seriously misleading" and result in a loss of perfection.

Courts recognize that creating a second security agreement can nullify (by novation) a prior grant of a security interest on the same collateral. This can occur where the second security agreement is a contract supported by consideration, contains a new grant of the same security interests, and adds new rights or obligations.

If the second security agreement is a patent security agreement and the conditions for novation occur, the first agreement would no longer perfect the patent security interests—those interests having been transferred to the patent security agreement.

To enforce its unperfected interests in the patent security agreement, the lender must prove that the buyer knew about the security interest beforehand, such as by seeing it at the PTO. This is a much higher burden than for a lender with a perfected security interest, who is not required to prove the buyer knew of the security interest to enforce its rights.

Some drafters avoid novation issues by not granting new security interests but stating that the patent security agreement is only notice of the rights in the prior agreement. Others simply file a UCC-1 corresponding to a security agreement with the PTO without preparing a patent security agreement.

Preemption

Federal law may preempt state UCC laws where it provides clear governance on the same issue as the UCC. The use of patent security agreement is based on a fear of preemption of the UCC. This concern, however, is unsupported by recent case law, the text of the PTO recordation statute and is contrary to the 2012 amendments to the statute that show Congress did not intend to preempt state regulation of security interests.

Alternatives

It is best to avoid the ABA's "dual filing" strategy of preparing a general security agreement and then preparing a second security agreement covering the same patents. There is no need, but there is risk, to enter sequential contracts granting the same rights.

Instead, prepare only one security agreement directed to patents and file a UCC-1 to perfect those patent interests. If more than perfection is sought, the patent security agreement and a UCC-1 can be filed with the PTO for extra "insurance" without fear of loss of perfection.

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.

Boston
155 Seaport Boulevard
Boston, MA 02210
p: 617.607.5900

Concord
530 Virginia Road
Concord, MA 01742
p: 978.341.0036