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How to Enforce U.S. Security Interests in Trademarks

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As the economic worth of successful brands keeps soaring, the ability to leverage their trademark assets is becoming more important. This is particularly true for companies seeking financing to support growth and cover cash flow shortfalls for operating expenses. The addition of trademark registrations to a secured loan portfolio can provide additional leveraged capital for a company. Indeed, as part of a huge financial bailout in 2006, Ford Motor Company pledged its famous FORD blue oval mark (pictured below), along with many other assets, which it reclaimed in 2012 after its investment grade was bumped up. As **quoted in the *New York Times***, Ford's Chairman, William C. Ford Jr., said, "Getting the blue oval back was both a relief and a validation of the comeback. … We were pledging our heritage."

The intangible nature of trademarks, however, and the difficulty of valuing them, as measured by the goodwill of the business they represent, may make lenders reluctant to rely solely on these assets for collateral. In addition, in the event of a loan default, the foreclosure and sale of pledged trademarks is more complex and may be less attractive than securing loans with traditional tangible assets.

Nevertheless, valuable trademark rights that reflect the goodwill of a successful company add value to a lender's collateral pool and provide an additional level of insurance and an incentive not to default.

Perfection and UCC Recordation

Obtaining a security interest in any collateral includes two steps. First, a security interest "attaches" to pledged collateral, including intellectual property (IP) assets, upon execution of a secured lending agreement between a creditor and a debtor. In order to grant the creditor priority over competing creditors concerning the same collateral, however, the security interest must also be "perfected."

Perfection is governed by Article 9 of the **Uniform Commercial Code** (UCC), as adopted by the states, unless preempted by U.S. federal law. While security interests in copyrights, for example, can only be perfected by recordation with the U.S. Copyright Office pursuant to Section 205 of the **1976 Copyright Act**, the **Lanham Act** does not prescribe any process for perfecting security interests in trademarks. Therefore, the only way to perfect an Article 9 security interest in a registered or unregistered trademark is through UCC state law procedures.

Trademark assets fall within the category of "intangible assets" under Article 9-102(a)(42) of the UCC. To obtain perfection for any type of collateral, including intangible assets, Article 9 requires that an initial financing statement (UCC-1) be filed with the

applicable UCC filing office, which generally is an institutional debtor's state of organization. Security interests are formally terminated by a lender filing a UCC termination statement (UCC-3) in the same government office where the related UCC-1 was filed.

Perfection is also critical in a bankruptcy case because unsecured security interests are subordinated to a trustee in bankruptcy and other judgment and lien creditors. An excellent example of this priority in action is *Oy v. Supreme Brands L.L.C.*, 2015 WL 8492041 (D. Minn. Dec. 10, 2015), where a plaintiff-assignee of a debtor's trademark registration lost out to the defendant, which previously had acquired the same collateral through two assignments from banks that held senior perfected security interests in the same debtor's general intangible assets, inclusive of the registration.

Courts have confirmed over the years that UCC filings remain the only way to perfect security interests in trademarks.

Ownership Due Diligence

As part of the process of obtaining a valid security interest, a lender must exercise due diligence to ensure that any pledged trademark rights are in fact owned by the debtor entity, and not by an affiliate company or third party that licenses the rights to the debtor. Including trademark collateral in a UCC financing statement that is not in fact owned by the debtor will invalidate the security interest.

For due diligence purposes, owner and mark searches within the U.S. Patent and Trademark Office's (USPTO's) database will reveal active and canceled registered marks, pending and abandoned applications, and any previously recorded instruments affecting the lender's rights. UCC searches must also be done. It is not uncommon, for example, in a new lending or refinancing situation, to find one or more prior recordations of UCC security interests or collateral assignments previously recorded with the USPTO that are still of record. This can occur even where the debt was previously paid in full but the prior lender or its counsel simply forgot to file a UCC termination statement or terminate a USPTO-recorded interest.

USPTO Recordation

Title 37 of the Code of Federal Regulations (C.F.R.), Section 3.11(a), provides for the recordation with the USPTO of both assignments of trademark applications and registrations and "other documents." Recordations must be accompanied by completed cover sheets, "affecting title" to applications or registrations. While this recordation statute applies specifically to assignments and not security interests, the regulations extend to any record "affecting title," and security interests are regularly recorded with the USPTO under this provision. Records of such interests, with reel and frame numbers, can be accessed through each registration and application data record on the USPTO's website.

Courts have confirmed over the years that UCC filings, rather than filings with the USPTO, are the only way to perfect security interests in trademarks. This fact was made clear in ***Trimarchi v. Together Development Corp.*, 255 BR 606, 612 (D. Mass. 2000)** (applying New York law), holding that "the Lanham Act's registration provision does not preempt UCC filing requirements for the perfection of a security interest in a trademark." Nevertheless, it is a best practice for a lender to record a security interest with the USPTO in any registered trademark or pending trademark application. This ensures that any due diligence conducted in the USPTO's online database will provide additional notice to third parties, including purchasers and subsequent lenders. It also provides a due diligence checkpoint that there is no lingering recordation of a prior security interest with the USPTO, even if a UCC termination statement was properly filed releasing the security interest. If a lender is concerned about the public accessibility of the specifics of the security interest that is recorded, an abbreviated abstract or memorandum of the grant of a security interest, or a partially redacted version of the entire agreement, may be filed with the USPTO to ensure confidential information is not made public.

The Importance of Goodwill

Under U.S. law, any transfer or assignment of a registered or unregistered trademark must include underlying goodwill. Section 10(a)(1) of the Lanham Act, 15 U.S.C. Section 1060(a), requires that any assignment of a registered mark or a mark for which an application to register has been filed "shall be assignable with the goodwill of the business in which the mark is used, or with that part of the goodwill of the business connected with the use of and symbolized by the mark."

It is imperative that any security interest include the goodwill of the marks being pledged, because any transfer of interest in a mark without the goodwill of the underlying business can be voided by competing creditors, especially in a bankruptcy context. While goodwill may not be necessary to perfect a security interest, upon a default, the only way a lender can recover and monetize the trademark collateral is by some form of an assignment and sale to a third party. Thus, without a grant of goodwill, a competing creditor or even the debtor could challenge any such assignment by asserting the trademark rights are void.

But merely including the word "goodwill" alone may not suffice to transfer these rights lawfully upon a foreclosure, unless other

assets of the debtor's business were also pledged that support the ability to maintain the business and, the underlying goodwill. Instead, to ensure proper transfer of goodwill as part of a pledge agreement, a creditor should include in the agreement other assets of a debtor that contribute to the continuance of the goodwill in the pledged mark, including any extant license and distribution agreements, debtor-owned manufacturing equipment tied to trademarked properties, and similar assets, if possible. A third party acquiring pledged trademark assets from a creditor must also continue using the mark on products or for services that are substantially similar to the debtor's products or services to support the continuance of "goodwill." While most trademark licenses will prohibit licensees from pledging collateral or assigning their license rights, these restrictions are generally not placed on licensors.

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Restriction on Assignments of ITU Applications

Section 10 of the Lanham Act, 15 U.S.C. Section1060, sets forth a critical limitation on assignments of intent-to-use (ITU) applications before the filing of an amendment to allege use or a verified statement of use, "except for an assignment to a successor to the business of the applicant, or portion thereof, to which the mark pertains, if that business is ongoing and existing." This requires careful drafting to avoid a security interest being characterized in loan documentation as a "collateral assignment," which could trigger this prohibition and result not only in the voiding of the security interest, but the underlying mark itself.

In a highly publicized 1996 decision, *Clorox Company v. Chemical Bank*, 40 U.S.P.Q.2d 1098 (TTAB 1996), the Trademark Trial and Appeal Board (TTAB) held that a designated collateral "assignment" of an ITU application to Chemical Bank, although intended as collateral security in a loan transaction, was nevertheless an improper assignment of an ITU, resulting in invalidation of the underlying trademark itself. This restriction does not prohibit the granting of security interests in ITU applications, but it will affect the ability to foreclose and assign an ITU application unless the application has developed into a registration, or an amendment to allege use or a verified statement of use has been filed and accepted before any UCC foreclosure sale.

One security agreement drafting tip is to exclude a debtor's pending ITU applications unless and until acceptable evidence of use of these marks has been filed with and accepted by the USPTO, to the extent that granting a lien on these ITU applications prior to the filing would negatively affect the enforceability and validity of the underlying rights in those applications.

Recourse to Trademark Collateral upon Default

Upon a debtor's default, a secured lender has a few options to foreclose on that collateral. It may take possession of the pledged collateral or use judicial process, options that are not well suited for intangible trademark assets. A creditor may also dispose of assets in a foreclosure sale, which is subject to numerous UCC notice and procedural requirements. Alternatively, if a debtor and any junior lien creditors consent, a lender may resort to a UCC process known as "strict foreclosure," which is a preferred means of enforcing liens on trademark assets because it allows a lender to retain the trademark assets without the need for a formal foreclosure auction sale. Strict foreclosure works where the total debt equals or exceeds the value of the trademark collateral (together with any other pledged collateral), but also wipes out any remaining debt the lender might still be owed in excess of the fair market value of the collateral.

There is limited case law addressing secured parties foreclosing on trademark interests outside of a bankruptcy context (which is beyond the scope of this article). One interesting case from 2009 involved the IP law firm, Fish & Richardson, which sought to foreclose on 13 registrations of WHO'S YOUR DADDY that were owned by Who's Your Daddy, Inc., a former firm client that owed the firm money. ***Fish & Richardson, P.C. v. Who's Your Daddy, Inc.,*** Case No. 09-cv-01993 (S.D. Cal. filed September 10, 2009). The firm had recorded a UCC financing statement covering these marks after the client fell behind on payments and the parties entered into a settlement agreement, with the marks used as secured collateral. When a default occurred under that settlement agreement, the firm sued and recovered a judgment for several hundred thousand dollars, and then sought to foreclose on the trademark collateral by seeking a federal court order that the firm was the owner of the marks. According to the case docket, the case was voluntarily dismissed nine months after it was filed without a decision (usually a sign of a settlement).

This case raises the interesting question of what use the law firm would have made of the WHO'S YOUR DADDY registered marks, as the firm was not in the business of making consumer products like its former client. It further raises the question of whether any foreclosure would have in fact passed on the underlying goodwill of the marks when the debtor remained an operating company. But bringing foreclosure proceedings against valuable trademark rights belonging to a debtor that is an ongoing concern will almost certainly either bring the debtor to the settlement table or push it into bankruptcy.

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The *Fish & Richardson* case highlights a significant issue with regard to foreclosing on trademark security interests. Specifically, the reality is that most lenders have no real interest in engaging in their debtors' underlying business. This is particularly true where the underlying business requires permitting or is in a regulated industry, such as liquor or casino operations. In such cases, the lender must hope to find third parties in a position to obtain the proper licenses that will either purchase the trademark assets from the lender, if through strict foreclosure, bid on those assets at a UCC foreclosure sale, or acquire the assets from the lender if the lender obtains a court order declaring its ownership.

A Powerful Tool

Regardless of the method chosen by a creditor to exercise its foreclosure rights against trademark collateral, it remains imperative that any trademark assets being sold include the underlying goodwill and related underlying assets. A pledged ITU application cannot be assigned in a foreclosure sale unless use of the mark has already occurred in U.S. commerce and proper filings have been accepted by the USPTO. At the same time, the threat of foreclosing on trademark assets provides negotiating leverage favoring the lender.

The market for securing loans with trademark and other IP assets continues to morph. Because of the difficulty and expense in valuing such assets, the limited potential pool of potential bidders in a foreclosure scenario, and issues concerning transfer of goodwill and possible business regulatory compliance, such assets will likely remain valuable as part of a broader pledge of a debtor's hard assets. Nevertheless, obtaining security interests in valuable trademark rights creates a strong disincentive for default and provides extra value to a business seeking necessary working capital.

Although every effort has been made to verify the accuracy of items in the *INTA Bulletin,* readers are urged to check independently on matters of specific concern or interest.

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