Leveraging Knowledge Assets

RFP # LCC/CDC 00-226

December 2002

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Executive Summary

Part 1: Introduction

Secured credit is an efficient form of lending, which, when implemented in a proper legal and institutional framework, can reduce transaction costs associated with borrowing and thus stimulate economic activity. Historically, secured lending laws and institutions associated with specific types of property have been reformed as that type of property assumed increased economic importance. Land was one of the first types of property used as collateral, but as the economy changed from an agrarian to manufacturing economy the focus shifted from land to moveable assets such as equipment and inventory, and from tangible assets to intangible assets such as accounts receivable. As intellectual property increases in importance it is not surprising that increased pressure has arisen to improve the framework for secured lending based on intellectual property rights ("IPRs"). It is not only technology sector enterprises which would benefit from this reform. Any modern enterprise, from manufacturing to the service sector, holds significant IP assets in the various forms from business software to licence rights. This Report discussed legal and institutional reforms which are needed to facilitate IPR-based secured lending.

For the purposes of this Report a distinction is to be drawn between "federal" IPRs, which fall within federal legislative jurisdiction, and provincial IPRs, which fall within provincial authority. The most important federal IPRs, which are the focus of this Report, are patents, copyrights, registered trade-marks. Reform is most urgent in respect of federal IPRs because it is the presence of federal title registries for the federal IPRs which present the most significant obstacles to IPR-based secured financing. Provincial IPRs can be accommodated within the existing provincial secured lending systems with relatively minor reforms.

The main challenges to secured lending based on IPRs are valuation difficulties and deficiencies in the legal and institutional secured lending framework. There is no reason to believe that cultural inertia on the part of lending institutions is a factor. Valuation challenges are discussed in Part 2 of the Report. We conclude that most valuation challenges are inherent to IPRs, though some improvement is to be expected as valuation techniques improve with experience. There are only modest improvements which can be accomplished through legal reform.

The balance of the Report discusses the legal and institutional secured lending framework. Part 3 describes the dramatic uncertainty introduced by deficiencies in the current system. Part 4 begins the search for solutions by examining the function of the federal IPR registries as they operate as records of ownership (title) interests as opposed to security interests. Basic reforms are described that would improve the legal reliability and operational efficiency of the federal registries at the title level.

Reform at the title level is necessary, but not sufficient, as security interests themselves must also be addressed. There are two basic approaches to security interests: under one approach, which is examined in detail in Part 5, validity and priority issues relating to the grant of security in federal IPRs would be governed by the secured transactions law in force in the jurisdiction where the debtor is located. If the debtor is located in Canada, provincial secured transactions law would apply, but if the debtor were foreign, foreign law would apply. We refer to this as the "choice of law" approach.

In an alternative approach security interests in federal IPRs would be registrable federally and all priority issues would be resolved by federal law. Part 6 discusses the scope of this "federal" approach, while Part 7 addresses the more significant of the registry design and structural issues that would have to be confronted if this approach were to be implemented.

It should be noted that it is clear that the federal government has authority over security interests in federal IPRs, by virtue of the same constitutional authority giving federal jurisdiction respecting the federal IPRs themselves. Provincial legislatures are also clearly competent to legislate in respect of security in intellectual property rights as an aspect of their general legislative authority over property and civil rights. Thus the federal and provincial governments both possess constitutional power to regulate secured transactions involving federal IPRs, though in the case of conflict federal laws would be paramount. Thus there are no constitutional obstacles to the implementation of either the choice of law approach or the federal approach.

Part 8 analyses a miscellany of discrete legal uncertainties that currently create unnecessary uncertainty in IPR-related secured lending transactions, and that are amenable to reform through relatively minor legislative amendments. The issues discussed in Part 8 generally arise regardless of whether a choice of law or a federal approach is adopted.

Part 2: Inherent Valuation Challenges

The inherent legal nature and characteristics of IPRs pose unique valuation risks for secured creditors compared to other types of movable and immovable property. To being with, most IPRs have a statutorily limited legal life. More importantly, since IPRs are by nature concerned with innovation, all IPRs have a potentially limited economic life, as any particular IPR is susceptible to being rendered obsolete by further innovation. In addition, IPRs are often most valuable in a specific application in a specific company and in consequence the liquidation value may be significantly lower than the use value. IPRs are also subject to being challenged for validity whenever they are enforced, which introduces a discount as well as uncertainty into the valuation process. Despite these difficulties, many IPRs are potentially valuable as collateral, either individually or when pledged en masse, but these inherent valuation challenges do introduce uncertainty as compared with other types of property.

In general, this valuation risk cannot be reduced by changing the legal incidents and attributes of IPRs without compromising fundamental policies of intellectual property law to an unacceptable extent. However, there are two aspects of current federal policy where reform might usefully be considered:

1) The policy justification for the rule whereby, if the first owner of the copyright is the author, ownership reverts to the author's heirs 25 years after the author's death notwithstanding any previous assignment, should be revisited to determine whether it is justified despite its negative impact on the predictability of the future value of copyright collateral.

2) The non-assignability of authorial moral rights reduces the value of copyrights and renders valuation more unpredictable. Although moral rights may be waived, the scope of the beneficiaries entitled to take advantage of a waiver is unclear under the current wording of the Copyright Act. The relevant provisions should be amended to confirm that subsequent assignees and secured creditors are entitled to invoke the benefit of a waiver executed in favour of a prior assignee in the absence of a contrary intention. Consideration might also be given to amending the Act to provide that in the case of registered copyrights, registration of the author's intention to retain moral rights is a pre-condition to the effectiveness of those rights against subsequent assignees and secured creditors.

These reforms, though potentially desirable, are likely to have only a relatively minor impact on valuation uncertainty. The greatest potential for reduction in valuation risks associated with IPRs is probably the improvement in valuation techniques which will occur with experience. Thus reducing other barriers to the use of IPRs as collateral is likely to have an indirect effect on reducing valuation risk; as the use of IPRs increased and experience is gained, valuation will become more reliable.

Part 3: Uncertainties in the Current Federal Registration and Priority Framework

The existing law relating to security interests in IPRs is radically uncertain. There is uncertainty at almost every level. Before security interests themselves are considered, the first step that any secured creditor, or more broadly, any potential assignee, must take is to ascertain the debtor's title to collateral. Though title registers exist at the federal level for all federal IPRs, these are not ideal for purposes of title investigation. Under three of the Acts – the *Trade-marks Act*, the *Industrial Design Act* and the *Integrated Circuit Topography Act* – registration of an assignment in the federal title is merely permissive, so that examination of the title register does not provide authoritative information regarding title. Under the remain three Acts – the *Patent Act*, the *Copyright Act*, and the *Plant Breeders' Rights Act* – an unregistered assignment is void against a subsequent assignee without notice who registers first. Even so, details of existing law mean that the register is not entirely authoritative. In particular, the first-registered assignee must take without actual knowledge of the prior unregistered assignment. This qualification creates residual uncertainty and has been eliminated in modern registry design in other contexts. Further, it has been held judicially that priority established by registration is subject to exceptions to first-in-time priority created by otherwise applicable principles of provincial property law, thus further undermining the integrity of the register as a source of title information.

When security interests are brought into consideration, the uncertainty increases dramatically. There is fundamental uncertainty with respect to virtually all aspects of priority. In the first place, it is not clear whether secured transactions even fall within the scope of the federal registration provisions. It is possible that all secured transactions are federally registrable; or that only those which are formally cast as assignments are registrable; or that none at all are registrable. Even if registration of a security interest does not establish priority of its own effect, it may be that annotation of such a registration may serve as notice or constructive notice, and so establish priority indirectly (though this is not clear).

In addition to this profound legal uncertainty, current registry practices are not sensitive to the informational needs of either prospective secured creditors or prospective assignees of federal IPRs. The patent, copyright and trade-marks databases are currently accessible on-line, but the on-line source were designed for other purposes, e.g. searching prior patents, and are not adequate for due diligence searching in respect of either financing or purchasing as they may be incomplete or out of date.

This uncertainty increases direct costs as lenders are routinely advised to register under both federal IPR law and provincial secured transactions law and to observe the formal requirements of both systems. But this practice does not eliminate priority uncertainty, and the profound uncertainties surrounding the priority effects of federal registration, and the interaction and potential conflict of the federal statutes with provincial secured transactions law, mean that secured creditors enjoy far less confidence in the quality of IPR collateral relative to other movable assets. This imposes an increased initial risk assessment and ongoing monitoring burden on secured creditors for which debtors ultimately pay in the form of less accessible and costlier secured credit.

Although the benefits of a reformed legal framework for IPR-based secured financing are difficult to quantify, the current uncertainties are sufficiently well documented and pervasive to conclude that reform will reap sufficient cost savings to justify the investment. The case for reform is especially pressing in view of the likelihood of an increased demand for IPR-based secured financing, and the likelihood that reform by itself will in turn fuel that demand by increasing access and lowering cost.

Part 4: Reform of the Ownership Disclosure Function of the Federal IPR Registries

Reform of the title aspects of federal IPR registries is an essential pre-requisite to any approach to reform of security interests in IPRs. Title level reform will facilitate the efficiency of all types of commercial transactions in federal IPRs, including secured transactions, by providing commercial parties with a cheap, efficient and reliable source of information as to the current ownership of IPRs. However, the statutes as presently drafted not only fail to achieve this potential, they actually introduce a further layer of confusion.

To resolve this deficiency in the title aspects of the federal IPRs registers, we recommend that the assignment and registration provisions of all six federal IPR statutes be strengthened to provide for the registrability of all transfers of ownership in federal IPRs, and to give conclusive legal effect to registered transfers as against unregistered transfers. In particular, we recommend that: successive assignments or transfers of the same IPR by the same assignor should be ranked on a strict first-to-register basis and that the scope of registrable transfers should include exclusive licences. Complementary structural and operational reform of the registries themselves to allow reliable on-line title searching is needed to support these substantive reforms.

A further reform should be considered. The suggested reforms are cast in a manner designed to accommodate the fact that the federal IPR registries currently operate as archival registries in a manner analogous to a traditional deed registry for land. Implementation of a title guarantee (Torrens) system would give a superior level of conclusiveness to registered title. We therefore recommend that this reform option also be explored (except in the case of copyright where the asset identification difficulties make a title guarantee system unworkable). This is subject to an important caveat. A full-fledged title guarantee system is workable only if the federal approach to the registration and priority status of secured transactions in federal IPRs discussed in Parts 6 and 7 of the Report is adopted. It would not be workable under the choice of law approach discussed in Part 5.

Part 5: Choice of Law Approach

The reforms recommended in Part 4 would improve the ability of prospective secured creditors to investigate a prospective debtor's legal title to the collateral, thus reducing one important source of the legal uncertainties identified in Part 3. But further reforms are needed to address the uncertainties in the priority of claims to the same federal IPR between competing secured creditors and between a secured creditor and a federally registered assignee. Part 5 addresses a "choice of law" approach to this second problem, while Parts 6 and 7 discussed a "federal" approach.

Under the choice of law approach, the federal government would defer to the law of the debtor's location as the law applicable to the registration, effects of registration or non-registration, and priority of security granted in any federal IPR. For Quebec debtors the relevant provisions of the CCQ would apply; for debtors located in the other provinces and territories, reference would be made to the relevant PPSA. For non-Canadian debtors, foreign secured transactions law would govern, e.g. French law for French debtors.

If this approach is adopted, we recommend that it be implemented by a federal choice of law rule specifying the law of the debtor's location as the applicable law. The alternative would be to remain silent on this point and allow the choice of law rules of the litigation forum to specify the applicable law. For litigation in Canada, this would also result in the application of the law of the debtor's location, but there is sufficient provincial variations at the level of detail that this approach would result in uncertainty and potential conflict in the applicable law. For similar reasons we recommend that federal law also specify a priority rule ranking assignees and secured creditors according to the respective times of registration of their interests in the relevant federal IP registry and in the secured transactions registry of the province or territory where the debtor is located.

The disadvantages of the choice of law approach stem from the fact that it severs the law applicable to the registration and priority status of security rights in federal IPRs from that applicable to their ownership and assignment; the law of the debtor's location would apply on the security side, federal law would apply on the ownership and assignment side.

This has two main disadvantages. First is the chain of title problem. In order to ascertain priority a prospective secured creditor must search the chain of title to the IPR federally and then search all the various registries corresponding to the location of the prior owners disclosed by that title search in order to determine whether those prior owners had granted prior security interests had been granted. Thus the existence of the federal title register makes searching significantly more complicated that in respect of traditional personal property. Further, lack of uniformity in debtor/owner name rules between provincial and federal registries means that valid security interests granted by prior owners may remain entirely undiscoverable, even after a full search. The only way to eliminate this source of uncertainty would be to implement uniformity in provincial debtor name rules. This in itself would be a major law reform undertaking. "Gateway" searching in which a single on-line portal would automatically query multiple registries, could relieve some of the technical burden of searching multiple jurisdictions, but it would not eliminate the need for multiple searches, nor could it eliminate the problems arising from lack of uniform debtor names.

The second main disadvantage of the choice of law approach is the foreign debtor problem. Under the choice of law approach security interests in Canadian IPRs granted by foreign owner/debtors would be valid encumbrances if adequately publicized according to the law of the debtor's location. This means that verifying encumbrances affecting an IPR could necessitate searching a foreign registry (and gateway searching would obviously not be possible). Worse, many countries outside of North America do not operate general encumbrance registries of the kind established by the provincial and territorial secured transactions regimes in Canada and by Article 9 in the United States. Thus valid prior security interests might be entirely undiscoverable.

Part 6: Federal Substantive Approach

The alternative to the choice of law approach is a federal approach under which the federal IPR statutes would be amended to explicitly provide for the federal registration of security rights in federal IPRs. Priorities between a secured creditor and an assignee, or between competing secured creditors would then be governed by the order of federal registration. That is, security interests as well as outright assignments would be registrable federally, and once so registered would have priority over any competing assignment or security which was not so registered.

While we refer to this as a federal approach, the reach of federal law would be limited in the version which we recommend. First, it would apply only to federal IPRs. Provincial IPRs would be treated as general intangibles under existing provincial secured transactions law. Further, only security interests in federal IPRs themselves would be subject to the federal regime. Security interests in IPR related rights, in particular security interests in rights to royalty payments, would be excluded. And even with respect to security interests in federal IPRs themselves, the registration and priority rules of the secured transactions law in effect in the debtor's home province or country would be preempted only for the purposes of resolving a contest involving at least one federally registered claimant. A security interest in a federal IPR which was only registered provincially, though subordinated to any federally registered interest, would nonetheless be effective to establish priority against any interest which was not registered federally, and as against the debtor's insolvency administrator.

Part 7: Structural and Operational Reforms of the Federal IPR Registries to Accommodate the Federal Approach

Some legal and structural reforms to the federal registry system are necessary or potentially desirable to accommodate the federal registration of security interests. For the most part the necessary reforms should be undertaken in any event to modernize the title aspects of the federal IPR registries. These legal and design issues were discussed in Part 4. Reforms specific to security interests are discussed in Part 7. The most basic specific reform to the federal registries needed to implement the federal approach to security interests in IPRs is simply to make specific provision for the federal registration of security interests. This should be technically very minor if carried out in conjunction to the title-side reforms discussed in Part 4.

There are two ways in which a registration might be implemented. In a document registration system the actual security documentation would be filed, whereas in a notice registration system only a notice setting out only the basic factual particulars needed to alert third parties to the potential existence of a security interest. Experience at the provincial registry level has proven that the notice registration system is far superior to the document registration system, and we strongly recommend that it be adopted for federal registration of security interest. Incidentally, it would also be technically easier to implement than document registration.

There are various options in registry design depending on the degree of integration of the security interest and title registries and the registries for various types of IPRs. We do not make any recommendation as to which integration option should be implemented. So long as the registries are all available on-line and uniform debtor/owner name rules are used for all federal registries, both of which we recommend, a 'gateway' approach to searching would allow the various registries to be queried as effectively as if they were unified, regardless of the degree of physical integration.

It is sometimes suggested that because the federal registries are indexed and searched according to each specific item of IPR, adoption of a federal priority regime would impede creditors who hold security in the whole of a debtor's present and after-acquired movable assets from effectively perfecting their security in the debtor's after-acquired federal IPRs so as to ensure priority over competing claimants. We believe this concern is ill-founded. In fact, it is easier to deal with after-acquired property under the federal approach than under the choice of law approach. The most basic solution would be to create a separate federal name-indexed registry for security interests and similar encumbrances. A searcher would first search the federal ownership registry to determine the chain of title to the relevant IPR and then search the federal encumbrance registries for encumbrances granted or registered against all owners in the chain. This would be simpler than under the choice of law approach because only two registries would be searched, instead of multiple registries, and the problem of non-uniform names is avoided.

A more sophisticated approach would enable asset based searching while eliminating the need for any chain of title search. This approach would require a system for automatic cross registration of a security interests against any IPR newly acquired by a debtor who had granted a security interest in after-acquired (including after-created) property. While this system would require more significant effort to implement than would the basic system, it would also offer very significant advantages. While we do not make a firm recommendation that such a system should be adopted, we are of the view that is deserves further serious consideration if the federal approach is chosen.

Part 8: Additional Reform Issues

Part 8 discusses a number of miscellaneous issues which were raised by the prior research as being possible impediments to IPRs based secured lending but which are not directly related to the core issue discussed in the preceding Parts, namely the choice between the federal and choice of law approaches. Thus the discussion of the various issues in this Part is generally applicable no matter which of these two approaches is taken.

On the question of the effect of a contractual restriction on the assignment or grant of security in a licensee's rights, we recommend that such a restriction would be ineffective only to the extent that it would otherwise prevent attachment of a security interest. However, the licensor could still rely on the contractual restrictions to refuse to recognize the rights of a non-approved purchaser from the secured creditor.

The next issue is the effect of a contractual prohibition restricting the assignment or grant of security in the royalty payments or licence fees owed by the licensee to the licensor. We recommend that the approach of UCC Article 9 be adopted. Under this approach anti-assignment clauses affecting general intangibles other than monetary claims are ineffective only to the extent that they impair the creation, attachment or perfection of a security interest, while anti-assignment clauses affecting royalty payments and certain other monetary claims are also ineffective to prevent a secured creditor or assignee from directly collecting the monetary receivables from the account debtor, i.e. the licensee in this context.

We also recommend that interests in IPRs acquired in the ordinary course of business would be taken free of any prior security interest, including registered interests, whether or not the security interest was granted by the immediate transferee. We further recommend that the ordinary course rule not apply to any assignment or licensing transaction that is subject to federal registration. This exception to the ordinary course rule is needed to maintain priorities against subsequent transferees or secured creditors.

We recommend that a debtor/owner's right to sue for damages for infringement of its IPRs should be recognized as an asset which may be validly used as collateral.

Current law for moveable property recognizes a super-priority for secured creditors who provide purchase money financing. We tentatively recommend that the same policy be adopted in respect of IPRs, but it is possible that the IPR context is sufficiently distinct to justify a different approach and we recommend further investigation of this point.

Finally, in order to facilitate ultimate enforcement of security interests in federal IPRs, we recommend that an express procedure should be provided under federal law whereby on presentation of a transfer document executed by the secured creditor in the prescribed form, the Registrar of the federal IPR registry would be required to record the purchaser as the new owner.

Part 9: Conclusion

Secured lending based on IPRs faces challenges both because of valuation difficulties and because of the inadequate legal regime governing security interests in IPRs. We conclude that formal governmental action directed at improving the valuation expertise of financiers of IP collateral is not required. Valuation expertise has been and will continue to be developed by the private sector as the importance of IP assets increases.

In contrast action is needed to modernize the legal regime governing security interests in IPRs. The present framework is radically uncertain in essentially every respect. Modernizing and rationalizing the rules governing security in IPRs will improve access to and lower the cost of secured credit based on IPRs. It will also indirectly improve valuation; lowering this barrier to the use of IPRs will help set up a “virtuous circle” in which increased demand for IPR based security will increase lender familiarity with IPR collateral and thus indirectly improve valuation techniques.

Our conclusions will not revisit our recommendations for reform in detail. Instead we will concentrate on the two main approaches canvassed in this Report to resolving the principal source of the prevailing legal uncertainties: this is the legal risk currently faced by IPR secured lenders as a result of the uncertain interaction between federal and provincial law on registration and priority issues.

There are two basic approaches addressing this source of uncertainty. Under the choice of law approach, registration and priority issues relating to security in federal IPRs would be governed by the secured transactions law of the jurisdiction in which the debtor/owner is located, subject to a special federal priority rule designed to coordinate priorities in a contest between a secured creditor and a federally registered assignee of the same collateral. The second approach is the federal approach. Under this approach, the federal IPR statutes would be amended to explicitly provide for the federal registration of security rights in federal IPRs. Priorities between a secured creditor and an assignee, or between competing secured creditors would then be governed by the order of federal registration (i.e. the strict first-to-register rule recommended for competing assignees in Part 4 would be extended to secured creditors).

One of the perceived advantages of the choice of law approach is that the same registration and priority rules would apply in cases where federal IPRs were included as part of a broader package of intangible collateral, for example when a security interest is taken in all the debtor's present and future property. However, this point is not compelling. We conclude to the contrary, that search burden considerations strongly favour the federal approach.

Single jurisdiction registration will not always be possible under the choice of law approach because of variation in choice of law rules between the provinces, and dual searching will be required because of the need to verify the debtor's title to the IPR through a search of the federal ownership registry.

Further, searching under the choice of law approach faces two problems: the chain of title problem and the foreign debtor problem. In searching to establish its priority status under the choice of law approach, a potential secured creditor must first search the federal title registry to determine the names and location of all owners in the historical chain of title, and then search the registry systems in the province or territory in which each owner was located to determine whether that owner granted any prior security interest in the IPR. This means that different registries in several jurisdictions may need to be searched to determine the priority status. This problem is exacerbated because of variation in debtor name rules between jurisdictions. Without uniform debtor name rules, security interests validly granted by predecessors in title may be undiscoverable by a provincial search using the name revealed by the federal title register. This would result in irreducible uncertainty as to priority status, which would adversely affect the terms on which credit would be granted. Though a gateway approach to searching in which one query could automatically query various registries would help alleviate the technical aspects of searching, it would not resolve the need to conduct multiple searches, nor would it resolve the uncertainty stemming from variation in debtor name rules. And if a foreign owner is identified in the chain of title the problem is further exacerbated, since security interests which are valid under foreign law would have priority over the potential creditor's interest. At best this means that establishing priority would require searching a foreign registry; at worst, many countries do not operate general encumbrance registries, and any interests validly granted in such countries would remain undiscoverable. This is another source of irreducible uncertainty.

Both of these problems are radically reduced or eliminated under the federal approach. At most two registries would have to be searched: the federal title registry and the federal security interest registry. (In some implementations discussed in the Report, only a single registry would need to be searched.) Debtor name variation and the accompanying uncertainty would be eliminated. The foreign debtor problem would also disappear as foreign creditors, like any other creditor, would be required to register federally in order to establish their priority.

The second perceived advantage of the choice of law approach is that it would involve the expenditure of minimal law reform resources as compared to the federal approach. We are not persuaded that this perception is correct. Substantial improvement to the federal registries would be required even under the choice of law approach in order to allow effective searching of the federal title registries, which is essential to the chain of title search. The additional law reform required to implement the federal approach should be very modest. Moreover, the choice of law approach itself calls for significant law reform efforts which would not be needed under the federal approach. In particular, provincial uniformity in debtor name rules would be needed if the uncertainty created by non-uniform debtor names is to be addressed. Achieving such uniformity would be very significant law reform undertaking.

On the whole we recommend the federal approach. The choice of law approach faces an irreducible problem of due to the possibility of foreign debtors in the chain of title, and this problem is likely to get worse in an increasingly global economy. The law reform effort to implement either approach is likely to be roughly similar. We should note, however, that our recommendation is based on a comparison of the best forms of the federal and provincial systems. In particular, if the basic reform of the federal ownership registry which we consider essential to the effective operation of either a provincial or federal system are not implemented, both the provincial and federal approaches would suffer, but they probably would not suffer equally. The comparison of the two systems would be different in such a "second-best" world. It is not possible in this Report to compare the various approaches under all possible scenarios, but we hope that this Report will provide a framework for so doing.

1 Introduction

1.1 Purpose of this Report

Secured credit is a well-known and deep-rooted phenomenon. The basic idea is an intuitively simple one. Security gives a creditor the right, should the debtor default, to satisfy its claim out of the value of those assets that the debtor previously agreed would be charged with security.[1]

A secured creditor has a priority and enforcement advantage.[2] The priority advantage consists in the secured creditor's right to follow the charged assets into whosoever's hands they may be and to extract payment out of the value of those assets in preference to the claims of other creditors. The enforcement advantage consists in the availability of specialized and expeditious remedies against the charged assets without the time and expense of having to obtain a formal judgment and initiate judgment enforcement proceedings.

The idea of secured credit has existed as long as ideas of private property and freedom of contract. However, its legal and practical incidents have undergone periodic change in response to the emergence of new forms of property. Historically, land and luxury tangible things were the principal objects of security. With the transformation of much of the world from an agrarian to an industrial economy, the locus of material wealth began to change. The focus shifted from immovable to movable assets – equipment, raw materials and inventory – and from tangible to intangible assets – the account receivables owing to a business and its reified intangibles such as negotiable instruments, securities and documents of title. That change forced fundamental reform of the legal and institutional framework for secured credit. In Canada, reform began with the relatively rudimentary federal *Bank Act* regime of the late nineteenth century,[3] and culminated in the sophisticated and

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[1]Although security can also arise by operation of law in specified creditor-debtor relationships, this Report is concerned only with consensual or conventional security, i.e. security created by private agreement between a debtor and creditor.

[2]See, e.g. art. 2660 of the *Civil Code of Quebec* (CCQ).

[3]Today, see the *Bank Act*, S.C.1991, c.46, s. 427, am. 1992, c.27, s.90.

comprehensive reforms effected to the movables security laws of all Canadian provinces over the last several decades.[4]

The wheel has turned again. With the modern shift toward an information, technology and service based economy, intellectual property rights (IPRs) have begun to capture an increasing share of the value of the asset base of firms. This has brought with it a natural interest in reform aimed at facilitating access to IPR-based secured credit. This Report identifies and analyzes the practical and legal obstacles that may need to be addressed to optimize the collateral value of IPRs. The Report was commissioned by the Law Commission of Canada in connection with its partnership in the Commercial Law Strategy of the Uniform Law Conference of Canada, and builds directly on a series of research papers solicited by the Law Commission and presented at a Conference entitled "Leveraging Knowledge Assets: Security Interests in Intellectual Property" held in November 2001.[5]

1.2 Interested Constituencies

Increasing access to credit for enterprises with significant intellectual property assets can be seen as one element of a more comprehensive strategy for enhancing the competitiveness of Canada's

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[4] For Quebec, see *Civil Code of Québec*, S.Q. 1991, c. 64., in force 1 Jan. 1994, Book Six, Prior Claims and Hypothecs, Title Three, Hypothecs, articles 2660-2802; Book Nine, Publication of Rights, especially articles 2934-296; for consensual security rights in movables created by transfer or retention of title, see articles 1745-49 (instalment sales), 1750-56 (sales with right of redemption), 1845 (leasing), 1852 (lease), and 1263 (security trust). For the common law provinces and three territories, see the *Personal Property Security Acts* (*PPSA*s). In order of implementation, see: ONTARIO, 1976 (SO 1967, c. 73, in force 1 Apr 1976, replaced by SO 1989, c. 16, in force 10 Oct 1989); MANITOBA, 1978 (SM 1973, c. 5, in force 1 Sept 1978, see now R.S.M. 1987, c. P35); SASKATCHEWAN, 1981 (SS 1979-80, c. P-6.1, in force 1 May 1981, replaced by SS 1993, c. P-6.2, in force 1 Apr 1995); YUKON TERRITORY (OYT 1980, c. 20, 2d Sess, in force 1 June 1982, see now RSY 1986, c. 130); ALBERTA (SA 1988, c. P-4.05, in force 1 Oct 1990); BRITISH COLUMBIA (SBC 1989, c. 36, in force 1 Oct 1990); NEW BRUNSWICK, 1995 (SNB 1993, c. P-7.1, in force 18 Apr 1995); NOVA SCOTIA, 1997 (SNS 1995-96, c. 13, in force 3 Nov 1997); PRINCE EDWARD ISLAND, 1998 (SPEI 1997, c. 33, in force 27 Apr 1998); NEWFOUNDLAND, 1999 (SN 1998, c. P-7.1, in force 13 Dec 1999); NORTHWEST TERRITORIES (S.N.W.T. 1994, c. 8, in force 7 May 2001); NUNAVUT (Nunavut Consolidated Acts, in force 7 May 2001).

[5] The Conference was held at the University of Western Ontario in London, Ontario on 16-17 November 2002, and was presented by the Law Commission of Canada in partnership with the Richard Ivey School of Business and the Faculty of Law of the University of Western Ontario. Publication of the Conference papers in book form by Carswell is forthcoming. The Conference versions are on file with the authors: for details, see the Bibliography in Appendix A of the Report.

information based enterprises.[6] One economist succinctly described the costs to the economy of impediments to the use of IPRs as collateral as follows:

> First, loans secured with intellectual property are more costly to negotiate and administer if they can be arranged at all. Second, alternative but less suitable and less efficient financial arrangements may be used in place of loan contracts. That is, proposed projects will still proceed but alternative and less appropriate financial arrangements may be used. For example, there may be more reliance on self-financing or love money than would otherwise be the case. Third, either because alternate financing is too costly or because alternate forms of financing cannot be obtained, some otherwise viable projects simply will not be undertaken.
>
> The resulting losses to the economy are of two kinds. On the projects which proceed using alternate forms of finance, the cost to the economy is the excess cost of the alternative contract. On the projects which do not proceed, the economy loses any excess of the return on the projects not undertaken over the returns on the projects undertaken instead.[7]

Although IPR-intensive enterprises would benefit particularly from improved access to IPR-based lending, the advantages would reverberate throughout the economy. There are very few enterprises today whose operations do not depend on some form of IPR. Even those that do not rely on intellectual property to produce revenue directly are likely to be dependent on some form of IPR-related asset – e.g. computer software – to enhance the marketability of their tangible goods or traditional services, and the efficiency with which these are delivered to the market. It follows that the aggregate collateral value to a secured lender who holds security in all the assets of an enterprise *except* its IPR-related assets is substantially less than it would be with them.

Borrowers and lenders, and their respective legal advisors, are not the only stakeholders who are or should be interested in reform. Canadian society as a whole would benefit at two levels. First, and most obviously, enhanced access to secured credit will enable businesses to develop their full market potential, particularly the small and medium sized enterprises who depend most acutely on this source of financing and on whom the Canadian economy in turn most acutely depends. The

[6]Other measures, such as improving the ability of firms to retain skilled employees, might be an equal or more important part of a competitiveness enhancement strategy. In other words, increasing access to IPR-based secured credit would complement rather than replace the other elements of an overall strategy.

[7]McFetridge at 2.

second and perhaps less obvious benefit is at the more general economic level. Effective reform will enable scarce dispute resolution and advisory legal resources to be devoted to issues not amenable to *a priori* legislative solutions.

1.3 Terminology: "Federal" and "Provincial" Intellectual Property Rights

Before examining possible reform strategies, we need to be clear about what we mean by the term intellectual property. For the purposes of this Report, it is necessary to draw an initial distinction between intellectual property rights that fall within federal legislative jurisdiction ("federal IPRs") and those that fall within provincial authority ("provincial IPRs"). Federal IPRs consist of patents,[8] copyrights,[9] registered trade-marks,[10] industrial designs,[11] integrated circuit topographies,[12] and plant breeders' rights,[13] all of which are governed by their own discrete federal Acts.

Provincial IPRs cannot be so easily defined. Widely-accepted examples include trade secrets and confidential information, personality rights, domain name rights, and unregistered trade-marks used within a province.[14] However, defining the exact boundaries of provincial IPRs is to some extent

[8] Patent law is expressly within federal jurisdiction by virtue of s. 91(22) of the *Constitution Act, 1867*, "Patents of Invention and Discovery." Canadian patent law is contained in the federal *Patent Act*, R.S.C 1985, c.P-4.

[9] Copyright law is expressly within federal jurisdiction by virtue of s. 91(23) of the *Constitution Act, 1867*, "Copyrights". Canadian copyright law is contained in the federal *Copyright Act*, R.S.C. 1985, c. C-42.

[10] Federal trade-mark jurisdiction is based on Parliament's trade and commerce power. Canadian trademark law is contained in the federal *Trade-marks Act*, R.S.C. 1985, c. T-13.

[11] Protection for industrial designs is provided by the federal *Industrial Design Act*. R.S.C. 1985, c.I-9.

[12] Protection for integrated circuit topographies is provided by the federal *Integrated Circuit Topography Act*, S.C. 1990, c.37.

[13] The federal *Plant Breeders' Rights Act*, S.C. 1990, c.20, provides protection to new varieties of prescribed categories of plants.

[14] The protection afforded trade-marks by provincial law is substantively very similar to the protection provided by the federal *Trade-marks Act*. Nonetheless, federal and provincial trade-marks constitute conceptually distinct items of collateral. Though it now appears that an action cannot be brought under provincial law so long as the mark in question is registered under the federal Act (see *Molson Breweries v Oland Breweries Ltd.* 2002 Ont. C. A. LEXIS 234), a mark may be protected by provincial law even though it is not registered under the *Trade-marks Act*.

subjective. Fortunately, it is not necessary to come up with a precise inventory for the purposes of this Report. As we shall soon see, it is the presence of federal title registries for the federal IPRs which present the most significant obstacles to IPR-based secured financing.[15] Provincial IPRs can be accommodated in the existing provincial secured lending systems with relatively minor reforms.

In identifying and analysing those obstacles, this Report will focus primarily on patents, copyrights and trade-marks, as being the most practically significant of the six categories of federal IPRs (although the analysis is readily translatable to industrial designs, integrated circuit topographies and plant breeders' rights). We offer a very brief synopsis here of the basic nature and source of these types of federal IPRs:

> *Patents*: All patents are creatures of the federal *Patent Act* in the sense that, regardless of the merits of any particular invention, no patent protection exists until the patent has been issued. For this to occur, the patent application must first be scrutinized by the Patent Office. Only if it is found to be novel, useful and not obvious will a patent be issued.[16]
>
> *Copyrights*: Unlike patents, no formal application process is required to bring a copyright into existence. Copyright subsists in "every original literary, dramatic, musical and artistic work"[17] (with "literary work" including computer programs[18]) as soon as it is expressed in material form. Unregistered copyrights are pervasive and important.
>
> *Trade-marks*: Patents and copyright both give rights in information goods. In contrast, trade-marks protect an association between the particular goods or services and the provider of those wares by allowing the provider to exclusively identify their wares with a distinctive mark.

[15]See Part 1.4 ("Overview of the Report") immediately following.

[16]See *Patent Act* ss.28.2, 28.3 and s.2 (definition of "invention"). There is an appeal process, ultimately to the Federal Court, for an applicant who is dissatisfied with a rejection: *ibid* s.41.

[17]*Copyright Act* s.5.

[18]*Ibid* s.2 definition of "literary work." The *Copyright Act* also protects so-called "neighboring rights" such as performers' rights in their performances. The assignment and registration provisions of the *Copyright Act* apply equally to these neighboring rights (see s. 54 and s. 2, definition of "copyright") and so for the purposes of this Report these neighboring rights are assimilated to copyright *per se*.

1.4 Overview of the Report

The perceived obstacles to IPR-based secured lending examined by the papers presented at the Conference on Leveraging Knowledge Assets[19] divide into two broad categories. The first consists of impediments associated with the unique nature of IPRs, in particular "the culture of traditional lenders and valuation problems". The second consists of the increased legal risk for secured lenders created by substantial uncertainties and gaps in the current legal framework governing IPR-based secured lending.

To begin with the first category, it is our view that cultural inertia can be dismissed as a significant obstacle. The previous research does not provide any reason to believe that access to IPR-based secured financing is negatively influenced by an irrational lack of appreciation of the collateral value of IPRs compared to other forms of movables on the part of traditional financial institutions. Indeed, the contrary is suggested by the emergence, despite the other impediments, of specialized IPR-based lending techniques by lenders in some industries, film financing in particular.[20] It follows that efforts to improve access to credit by sensitization of lenders to the world of IPRs would not be a fruitful allocation of resources. This Report will not therefore deal further with the issue of cultural inertia.

As for the unique valuation challenges presented by IPRs, there is no question that these are complex and substantial. The reasons are outlined in detail in Part 2 of the Report. As we shall see, IPRs are particularly sensitive to marketplace risk (e.g. a 'better mousetrap' may be invented). Moreover, their very existence depends on legal requirements that are open to challenge at any time (e.g. by a subsequent showing that a 'copyrighted' work was not original). Finally, protection of

[19]See above Part 1.1.

[20]See the discussion in Townend of film financing in the U.K.. For a discussion of film financing in the U.S see the prepared statement of Fritz Attaway, Senior Vice President for Congressional Affairs and General Counsel, Motion Picture Association of America (MPAA), submitted as part of the Intellectual Property Security Registration: Hearings Before the House Subcomm. on Courts and Intellectual Property of the House Comm. on the Judiciary, 106th Cong., 1st Sess. (June 24, 1999) available at http://commdocs.house.gov/committees/judiciary/hju62500.000/hju62500_0f.htm, p.62. See also the description by Mann of the role of secured debt in software development and software acquisition financing.

IPR ownership is heavily qualified in order to protect the collective public interest in access to the ever-accumulating store of human knowledge (e.g. the duration of IPR ownership is limited by statute to a set term of years on the expiry of which the IPR can be exploited by anybody).

Although IPRs present increased valuation challenges relative to more traditional kinds of collateral, Part 2 concludes that legislative or other formal governmental action cannot ameliorate the problem without unacceptably compromising the principles and goals of intellectual property law. This is not to say that there are not certain features of Canadian intellectual property law that might bear re-thinking in terms of whether their perceived benefit is worth the valuation uncertainties, and Part 2 offers several recommendations for possible reforms in this vein. However, such reforms will, at best, effect only a minor reduction in the valuation difficulties associated with IPRs. For the most part, the only effective solution is a practical one: time and experience will lead to enhanced expertise by valuation specialists.

Part 3 of the Report introduces the most important issue within the second category of identified impediments to IPR-based secured lending. This is the legal risk currently faced by IPR secured lenders as a result of the uncertain interaction between federal and provincial law on registration and priority issues. All six of the federal IPR statutes establish specialized public registries for recording the existence and the assignment of ownership of the IPRs within their scope.[21] However, the Acts provide either no guidance, or only incomplete guidance, on the role of registration (or failure to register) in ordering priority between successive assignees of the same federal IPRs. Although provincial property and priority rules operate to fill these gaps, the uncertain legal effect of the federal provisions produces a corresponding uncertainty as to the nature and effect of the legal rules produced by the interaction between the two sources.

Even more fundamentally, it is unclear whether the federal registration and priority provisions apply only to true assignments of federal IPRs (i.e. outright transfers of ownership) or also extend to assignments made for security purposes, a source of uncertainty that is exacerbated by the registry

[21] *Patent Act,* s. 50; *Copyright Act,* s. 57; *Trade-marks Act,* s. 26 *Industrial Design Act,* s. 13; *Plant Breeders' Rights Act,* s. 31. *Integrated Circuit Topographies Act,* s. 15.

practice of recording security assignments despite the lack of a clear legislative mandate to do so. It follows that the uncertainties surrounding the scope and effect of the federal provisions in resolving competing claims to ownership also infect priority competitions between a secured creditor and a prior or subsequent assignee, and between different secured creditors.

Part 3 goes on to examine the impact of these legal uncertainties on access to IPR-based secured credit. We conclude that while not quantifiable as such, the impact is real and negative. Because of the uncertain scope of the federal IPR registries, and their uncertain interaction with provincial law, secured creditors face the cost of having to register in the federal IPR registries and in the general provincial registries for movable securities.[22] Worse, even if they satisfy this dual registration burden, confusion as to the content and scope of the applicable mix of priority rules means that secured creditors still can't confidently predict the extent to which their security rights will prevail against competing claimants.

The need for secured creditors to compensate for the fundamental priority risk they presently face inevitably results in a substantial discount in the collateral value that can be attributed to a debtor's federal IPRs below their actual realizable value in the abstract. So, while one may not be able to put a dollar value on the benefit, it is difficult to disagree with the widespread assumption that resolving the current legal uncertainties would have a significant positive impact on the availability and cost of IPR based secured credit.[23] Improvement in valuation expertise and experience would then follow as a desirable indirect benefit.

This priority risk is a problem which is unique to federal IPRs as no equivalent 'title' registries exist for the provincial IPRs, or, indeed, for any other type of movable asset regulated by provincial law.[24] Consequently, Part 4 begins the search for solutions by examining the function of the federal

[22]See Part 1.1 above for references to the provincial regimes.

[23]As reflected by the views of the lenders, valuation specialists, and legal practioners and scholars who participated in the LCC's Conference on Leveraging Knowledge Assets referred to in Part 1.1 above.

[24]Modern electronic registries for movables have been established pursuant to the secured transactions laws of all thirteen provinces and territories referred to in Part 1.1 above. However, the provincial movables registries are encumbrance registries, not title registries, meaning that they are primarily designed to give notice that the identified secured creditor may hold security in the identified collateral of the identified debtor. In other

IPR registries. There is of course no question of simply abolishing them. With the exception of copyright (and the partial exception of certain trademark rights), registration of a claim to a federal IPR is a necessary element to bring the right into existence. So our analysis in Part 4 instead centres on the role of the federal registries as the venue for public registration of the ownership and assignment of ownership of federal IPRs. We conclude that the IPR registries have the potential to provide a cost effective and reliable source of information about the ownership of federal IPRs for the wide range of parties who have an interest in ascertaining current ownership of specific IPRs. These include not just potential lenders, but also potential assignees and licensees, judgment creditors of the owner, and, indeed, those wishing to challenge the validity of IPR claims. However, these benefits are not being realized at present both because the relevant statutes fail to adequately address the role of registration in ordering priorities between competing assignees of a federal IPR and because of technical deficiencies in the timeliness, transparency, and accessibility of the registry data bases. Accordingly, Part 4 goes on to describe the basic reforms that would need to be implemented to improve the legal reliability and operational efficiency of the federal registries as an accurate record of current ownership.

Adoption of the reform measures proposed in Part 4 would enable prospective secured creditors to confidently rely on the federal records as an efficient and certain source of information about the potential debtor's title to any federal IPRs offered as collateral. However, this by itself would not resolve all the existing uncertainties. Prospective secured lenders also need certainty and predictability as to the priority of their claims against prior and subsequent assignees and as against secured creditors to whom the debtor, or the debtor's predecessor in title, may have granted security. The grave uncertainty currently surrounding these questions can be fully resolved only if secured creditors have access to a certain, predictable and comprehensive set of clear cut priority rules. The previous research identifies two possible routes to that goal.

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words, the issue of the debtor's title to the identified collateral is left to be settled by the background documentation and evidence, and one cannot register title or assignments of ownership (except for a general assignment of claims or receivables) . In addition, registrations in the provincial encumbrance registries are generally indexed by reference to the name of the debtor rather than the specific item of collateral (subject to a few exceptions for serial numbered goods) whereas the federal IPR registries (like the federal ship's registry) are closer to the concept of an immovables registry insofar as registration and searching is possible against the specific item of property. The significance of these differences is addressed in later parts of the Report.

Under the first possible approach – examined in detail in Part 5 – validity and priority issues relating to the grant of security in federal IPRs would be governed, as a general rule, by the secured transactions law in force in the jurisdiction where the debtor is located.[25] The interaction between the federal registration and priority rules and general secured transactions law would be indirect; registration in the federal registries would regulate who was the owner of the IPR, while the secured transactions law of the location of the owner (as debtor) would supply the rules to govern the validity and third party effectiveness of any security right granted by the IPR owner. Priority competitions between IPR secured creditors would be resolved according to the general priority rules of the debtor's home law, while competitions between an IPR secured creditor and a federally registered assignee of the same IPR would depend on whether the assignment was registered before or after the security right was taken and perfected pursuant to the debtor's home law. If before, the assignee would acquire the IPR free of the secured creditor's claim; if after, the assignee would take subject to the security.

This approach is sometimes loosely termed the "provincial" solution. But because it would be implemented through the referential incorporation of the validity and perfection requirements imposed on secured creditors by the IPR owner/debtor's home law, provincial law would in fact apply only if the particular debtor were located within Canada. For foreign country debtors, foreign country law would apply (e.g. for U.S. debtors, this would be the version of UCC Article 9 in force in the State where the debtor is located; for French debtors, French secured transactions law would apply). For the sake of greater accuracy, this Report will therefore refer to this approach as the "choice of law" approach.

[25] Current provincial and territorial choice of law principles refer issues of registration and priority to the law of the debtor's location. For Quebec, see *CCQ*, art. 3105, para 1 and 2. For the common law provinces and the three territories, see, e.g., NB *PPSA*, s. 7(2)(a), Ont *PPSA*, s. 7(1)(a)(i).) In litigation before a Canadian court, it follows that the law of the debtor's location would apply without the need for explicit reform at the federal level beyond explicit clarification that the federal registry regimes do not cover secured transactions. However, for reasons elaborated in Part 5, unqualified application of the provincial rules governing priority between a secured creditor and a purchaser of the collateral would undermine the reliability and integrity of the federal registry from the point of view of the registered assignee. To avert this, we recommend that if this solution is be implemented, this should be done by enactment of a federal rule stipulating that a federally registered assignment is subordinate to a security interest granted by the current owner, or any predecessor in title of the current owner, provided the secured creditor complied with the requirements imposed by the law of the location of that owner/debtor for obtaining an effective security right against third parties.

Recognizing that this first solution is in fact a choice of law solution explains its limitations as outlined in detail in Part 5. First, the marketability of Canadian IPRs may be negatively affected in cases where the IPR owner/debtor is located outside of Canada in a country whose secured transactions law does not provide an efficient and reliable system for publicly registering notice of the grant of security. Second, the risk assessment burden for prospective secured creditors (and prospective assignees) could become quite formidable in the relatively common case where the IPR has been the object of numerous successive partial or entire assignments. In order to protect themselves against the risk that no prior-ranking security had been granted by a predecessor in title of the current owner/debtor, a secured creditor would have to investigate the registration and priority regimes applicable to each and every previous owner in the chain of title. In the case of Canadian IPR owner/debtors, the investigative burden could be eased by co-ordinating the federal and provincial registry searching process. Part 5 explores this possibility in detail. As will be seen, a high level of relatively complex cooperation among all levels of government at both the legislative and registry operational level would be needed. Moreover, informal coordination of the federal and provincial registries in this fashion will not and cannot ease the investigatory burden to the extent that any of the successive owners are located outside Canada.

Part 6 therefore turns to the alternative reform possibility that emerges from the previous research. Under this second approach, security in federal IPRs would be registrable federally, and priorities between secured creditors, and between a secured creditor and a federally registered assignee, would be determined by the order of federal registration (i.e. the first-to-register rule recommended for competing assignees in Part 4 of the Report would be extended to secured creditors). For the sake of brevity, we will refer to this second approach as the federal substantive approach, or simply the federal approach. However, the limited reach of federal law should be underscored. The general secured transactions law of the debtor's home province or country would be preempted only on issues of registration and priority, and then only for the purposes of a priority dispute involving a federally registered competing claimant.

The details of the federal approach, and the additional reforms necessary to implement it, are examined in the balance of Part 6 and in Part 7 of the Report. Part 6 goes on to analyse the substantive priority issues that would need to be addressed, including the scope of the proposed federal priority regime (for example, we conclude that IPR-related royalties should be excluded) and the question of whether any other claims to federal IPRs (for example, the claims of the IPR owner's judgment creditors) should be registrable federally so as to also enjoy the advantage of a federal first to register priority regime. Part 7 then addresses the more significant of the registry design and structural issues that would have to be confronted if this approach were implemented.

Part 8 analyses a miscellany of discrete legal uncertainties that currently create unnecessary uncertainty in IPR-related secured lending transactions, and that are amenable to reform through relatively minor legislative amendments. For the most part, the issues addressed here – for example, the effectiveness of a prohibition on assignment contained in an IPR licensing agreement – arise regardless of whether a choice of law or a federal approach is adopted (although the resolution of this latter question may affect the manner in which reform is implemented).

1.5 Constitutional Considerations

Although doubts are occasionally raised with respect to the scope of federal constitutional authority over secured transactions covering federal IPRs, in our view such doubts are misplaced. We say this because of the unquestionable federal power over issues relating to ownership of copyright, patents, federal trademarks, and ancillary categories of federal IPRs. The ability to grant security is one of the bundle of rights associated with ownership. The grant of security potentially results in an involuntary transfer of ownership should the debtor default and the secured creditor seek to exercise its enforcement powers against the charged property. In other words, authority over ownership and its transfer necessarily includes authority over transactions involving the proprietary incidents of ownership, including a security transfer or hypothecation. There is nothing in any prior research which challenges this straightforward analysis. (It is worth noting that doubts as to the federal authority in this area are almost always raised informally.)

On the other hand, the provincial legislatures are also clearly competent to legislate in respect of security in intellectual property rights as an aspect of their general legislative authority over property and civil rights. By virtue of federal paramountcy, provincial laws of general application are rendered inapplicable only to the extent that federal law governs the particular issue. So, in the absence of positive federal law, there can be no constitutional objection to the application of the provincial security regimes. Moreover, unless there is a direct conflict, the double aspect doctrine would support the concurrent application of both federal and provincial law.[26]

Consequently, this Report proceeds on the assumption that the federal and provincial governments possess constitutional power to regulate secured transactions involving federal IPRs, though in the case of conflict federal laws would be paramount.

1.6 Summary

Secured credit is an efficient form of lending, which, when implemented in a proper legal and institutional framework, can reduce transaction costs associated with borrowing and thus stimulate economic activity. Historically, secured lending laws and institutions associated with specific types of property have been reformed as that type of property assumed increased economic importance. Land was one of the first types of property used as collateral, but as the economy changed from an agrarian to manufacturing economy the focus shifted from land to moveable assets such as equipment and inventory, and from tangible assets to intangible assets such as accounts receivable. As intellectual property increases in importance it is not surprising that increased pressure has arisen to improve the framework for secured lending based on intellectual property rights (“IPRs”). It is not only technology sector enterprises which would benefit from this reform. Any modern enterprise, from manufacturing to the service sector, holds significant IP assets in the various forms from business software to licence rights. This Report discussed legal and institutional reforms which are needed to facilitate IPR-based secured lending.

For the purposes of this Report a distinction is to be drawn between “federal” IPRs, which fall

[26]See e.g. Mercier & Haigh at 77: “Both the federal intellectual property legislation and the respective provincial PPSAs are valid under their own jurisdictions and, if challenged would not fail the first part of the test. . . . The most that could be said is that the security provisions under the PPSA legislation and the registration provisions under the federal intellectual property statutes have a double aspect to them,” and generally *ibid* at 72ff.

within federal legislative jurisdiction, and provincial IPRs, which fall within provincial authority. The most important federal IPRs, which are the focus of this Report, are patents, copyrights, registered trade-marks. Reform is most urgent in respect of federal IPRs because it is the presence of federal title registries for the federal IPRs which present the most significant obstacles to IPR-based secured financing. Provincial IPRs can be accommodated within the existing provincial secured lending systems with relatively minor reforms.

The main challenges to secured lending based on IPRs are valuation difficulties and deficiencies in the legal and institutional secured lending framework. There is no reason to believe that cultural inertia on the part of lending institutions is a factor. Valuation challenges are discussed in Part 2 of the Report. We conclude that most valuation challenges are inherent to IPRs, though some improvement is to be expected as valuation techniques improve with experience. There are only modest improvements which can be accomplished through legal reform.

The balance of the Report discusses the legal and institutional secured lending framework. Part 3 describes the dramatic uncertainty introduced by deficiencies in the current system. Part 4 begins the search for solutions by examining the function of the federal IPR registries as they operate as records of ownership (title) interests as opposed to security interests. Basic reforms are described that would improve the legal reliability and operational efficiency of the federal registries at the title level.

Reform at the title level is necessary, but not sufficient, as security interests themselves must also be addressed. There are two basic approaches to security interests: under one approach, which is examined in detail in Part 5, validity and priority issues relating to the grant of security in federal IPRs would be governed by the secured transactions law in force in the jurisdiction where the debtor is located. If the debtor is located in Canada, provincial secured transactions law would apply, but if the debtor were foreign, foreign law would apply. We refer to this as the “choice of law” approach.

In an alternative approach security interests in federal IPRs would be registrable federally and all priority issues would be resolved by federal law. Part 6 discusses the scope of this "federal" approach, while Part 7 addresses the more significant of the registry design and structural issues that would have to be confronted if this approach were to be implemented.

It should be noted that it is clear that the federal government has authority over security interests in federal IPRs, by virtue of the same constitutional authority giving federal jurisdiction respecting the federal IPRs themselves. Provincial legislatures are also clearly competent to legislate in respect of security in intellectual property rights as an aspect of their general legislative authority over property and civil rights. Thus the federal and provincial governments both possess constitutional power to regulate secured transactions involving federal IPRs, though in the case of conflict federal laws would be paramount. Thus there are no constitutional obstacles to the implementation of either the choice of law approach or the federal approach.

Part 8 analyses a miscellany of discrete legal uncertainties that currently create unnecessary uncertainty in IPR-related secured lending transactions, and that are amenable to reform through relatively minor legislative amendments. The issues discussed in Part 8 generally arise regardless of whether a choice of law or a federal approach is adopted.

2 Inherent Valuation Challenges

2.1 Introduction

This chapter focuses on the unique valuation challenges posed by federal IPRs that were identified in the Commission's previously commissioned research and which partially explain why financial institutions are often perceived to be particularly cautious when it comes to IPR-based secured lending. We refer to these valuation challenges as "inherent" because they arise from the particular economic and legal incidents of IPRS, which, with a few minor exceptions, we conclude cannot be ameliorated through formal market intervention or legislative change.

2.1.1 Limited legal life

The legal protection afforded to IPRs is based on the theory that economic reward provides an incentive to would-be inventors and artists, thereby stimulating ongoing innovation. But this must be balanced against the public interest in access to the ever accumulating store of human knowledge so as to promote further cycles of innovation. The balance between these two policies is achieved in part by limiting the duration of the legal existence of patents and copyrights, at the conclusion of which the knowledge falls into the public domain and can be exploited by anybody without legal interference.

In the case of patents, once the patent is issued, the patentee's monopoly over the subject matter of the patent[27] is limited to a term of twenty years from the date on which the application was filed,[28] subject to the payment of maintenance fees.[29] For copyrights, the term of protection is longer: the life of the author plus fifty years.[30] However, where the first owner of the copyright is the author,

[27] *Patent Act* s. 42 "Every patent granted under this Act shall . . .grant to the patentee. . .the exclusive right, privilege and liberty of making, constructing and using the invention and selling it to others to be used. . ."

[28] *Ibid* ss. 43, 44. This term applies to patents applied for after 1 October 1989.

[29] *Ibid* s. 46.

[30] *Copyright Act* s. 6.

ownership reverts to the heirs of the author 25 years after the death of the author notwithstanding a previous assignment to a second owner.[31] Trade-marks are not subject to any *a priori* legal life span. Registration under the federal *Trade-marks Act* protects the mark for an initial period of 15 years and may be renewed indefinitely. However, the trade-mark is lost if abandoned by the owner or, as explained later, if it loses its distinctiveness.[32] Because the legal life of trade-marks thus depends on vigilant and continuous monitoring by the owner, it too has a potentially limited legal life that must be taken into account by lenders at the initial valuation stage.

2.1.2 Limited economic life

IPRs have a limited economic life that can be much shorter than their legal life: "IP by its very nature is concerned with innovation, and because it is a monopoly granted to encourage further innovation, there is a fundamental problem in the valuation of IP: that IP can be made worthless through becoming obsolete in the market place."[33] The tendency to obsolescence is particularly accelerated for some forms of IPRs. For instance, computer software that "implements cutting edge technology can become fatally inferior to newly developed products in just a short time."[34]

Because the realizable value of the IPR may have become negligible by the time the debtor defaults and the creditor seeks to enforce its security, lenders must have the expertise to anticipate the extent to which this risk afflicts the particular borrower's IPRs and discount the value of the collateral accordingly. Even when existing circumstances suggest every reason for confidence in a lucrative return, the duration of the practical life of an IPR is still unpredictable to some degree since it depends in part on future factors beyond the control of the debtor (e.g. superior research efforts by competitors or unanticipated product deficiencies). This is also true of trade-marks, which may depend on future fashion trends and marketing to sustain their value.

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[31] *Ibid* s. 14.

[32] See Part 2.1.5 below.

[33] Townend at 17. See also Lipton, at 18 "Additionally, certain information products, such as a particular generation of computer software, whether or not protected by patent, may have a commercial value that lasts for a maximum of two or three years;" and Smith, at 19 "The average life of a patent is about 5 years."

[34] Mann at 139.

2.1.3 Idiosyncratic value

Some IPRs, such as many of the patents in the portfolio of a R&D intensive company, have no ready market. This is not to say that there is no market at all (although there may not be), but each IPR is to some extent unique and so valuing the asset is more difficult than in the case of more fungible goods, such as wheat or televisions, which are routinely traded on established markets. This increases the cost of valuing IPR collateral and so increases the cost of using it as security, particularly if the IPR is to be the primary security.[35]

The idiosyncratic value problem particularly acute if the enterprise is a new one without a proven track record that is in need of financing to fund it through the early development stage. For these would-be borrowers, access to financing is essentially limited to those financial institutions with sufficient accumulated experience to assess the credibility of the enterprise's business plan for the particular category of IP under development.[36]

2.1.4 High use value versus low liquidated value

The value of IPRs is often much higher in the hands of the debtor/owner compared to their value in the hands of a new user. For instance, patents and copyrights may be only aspects of an overall product that relies for part of its value on the know-how embodied in the debtor/owner or in a "hybrid, patent-trade secret combination."[37] Because the value of the IPR is thus dependent on unique characteristics of the particular debtor/owner, it may have little market value in the traditional secured lending sense under which a lender depends on the liquidated value of the collateral as

[35]"There is simply not an active market for intellectual property assets, and most often when they happen to be exchanged, the details are not publicly available. . . .The requirement for comparability is a substantial barrier to the use of the market approach for intellectual property. This property, by its nature, tends to be unique and sales of similar properties are very difficult to find." Smith at 8

[36]See e.g. Mann at 155.

[37]Smith at 25; see also McFetridge at 4.

protection against the risk of non payment by the debtor.[38] Should the debtor default, the only potential interested purchasers on a liquidation sale may be the debtors' competitors, who will likely already have their own IP in place, and will be willing to purchase the IPR only for the value comprised in keeping it out of the hands of a reborn competitor as opposed to its value in the hands of the debtor.[39]

A similar difficulty may limit the collateral value of an IPR purchased by a debtor from the original owner/developer. In many cases, the value of the IPR to the debtor/purchaser depends on having ongoing access to the technical advice and maintenance support of the original owner/developer, an obvious example being the continuing support including the provision of upgrades needed to maintain the value of software. Unless the secured creditor can force the original owner/developer to provide those ancillary services to a new purchaser, the liquidated value of the IPR is substantially diminished.

2.1.5 Uncertain validity or enforceability

The owner's ability to exploit the economic value of its IPRs depends on its ability to control the use and sale of the right by others. Yet the legal validity and enforceability of IPRs is not always predictable for reasons that vary as between patent, copyright, and trade-marks.

*Patent*s

Even after a patent has been issued, its validity may be challenged in court at any time during its life for any of the substantive reasons that would have justified the Patent Office in refusing to issue a patent in the first instance: i.e., lack of novelty or utility or obviousness. Because invalidity is not uncommonly a successful defence to a claim for patent infringement, the collateral value of a

[38] "Lenders should also be aware that the nature of intellectual property differs from most forms of tangible property, in that many forms of intellectual property will flourish only in the hands of their developers." Lipton at 22.

[39] "The sales team has to create a "legend" as to why this division's prospects were hampered by the corporate grip, so that some new owner might unleash its potential.. . .The only basis for selling the patents is to attest to the buyers about the incompetence of the prior managers (presumably the patents are still valid, and the market prospects remain good)." Rutenberg at 5.

debtor's patents, particularly at the early stages, must be discounted to account for this risk.[40]

Trade-marks

Invalidity may also be raised as a defence to a trade-mark infringement action. Because the function of a trade-mark is to provide the consumer with information about the origin of the wares associated with that trade-mark, the mark must be "distinctive" of the source of the wares: that is, there must be a unique association between the wares and a single source. If the wares lose distinctiveness – for example if a competing source provides the same wares under the same mark without interference from the holder of the mark[41] – the mark will become invalid.[42] Thus even if initially valid, trade-marks may become invalid if not properly maintained and policed by the owner. The secured lender must take this risk into account at the valuation stage.

The requirement for distinctiveness also means that secured lenders cannot rely on trademarks as independent collateral. At one time, trade-marks could not be assigned "in gross" which is to say they could not be assigned independently of the business as a whole. This was thought to be unduly restrictive of commercial practice and the Act now provides that a trade-mark "is transferable . . .either in connection with or separately from the goodwill of the business. . ."[43] However, the courts, still concerned with the ultimate goal of protecting the consumer, have held that though the Act provides that the mark may be assigned in gross, this is not a guarantee that the mark will necessarily remain valid after such an assignment. Thus if the mark is associated with one source, and the bare mark is assigned to another company which begins to use it on the same wares, the mark is now associated with two sources – the old and the new – and may therefore lose its distinctiveness and become invalid.[44] For this reason, it is risky to take a security interest in a bare

[40]McFetridge at 4.

[41]As occurred for example in respect of the mark WATS for telephone services: see *Unitel Communications Inc. v. Bell Canada* (1995) 61 C.P.R. (3d) 12 (F.C.T.D.).

[42]*Trade-marks Act* s.18(1)(b).

[43]*Trade-marks Act* s.48(1).

[44]See *Heintzman v. 751056 Ontario Ltd.* (1990) 34 C.P.R. (3d) 1(F.C.T.D.) for an example where this occurred.

trade-mark, since realization by selling the mark to a third party, unaccompanied by the goodwill in the business as a whole, may well lead to invalidity of the mark. This does not occur if the mark is transferred as part of the assignment of the assets generally, so a security interest in important trade-marks may still be a valuable adjunct to a general security interest in the aggregate assets of the debtor enterprise.

Copyrights

Registration of copyrights is not a pre-condition to their validity. The copyright comes into existence as soon as it is expressed in material form. Invalidity *per se* is not a common defence in a copyright infringement action.[45] The issue is more one of uncertain enforceablity. Either it is claimed that the defendant did not copy the plaintiff's work (copying may be more difficult to establish than one might imagine, given that copyright protection may subsist in somewhat abstract aspects of a work, such as a plot line); or that what was copied or allegedly copied was unprotectable, as copyright protects only the expression of the work, as opposed to the idea behind it.[46] The protected "expression" extends beyond the literal text of a work; for example fictional characters, if sufficiently well delineated, and detailed plot lines may be protected. But at the higher levels of abstraction, the idea or theme of a work is not protected. The valuation difficulty arises because it is not always possible to predict in advance of a court ruling the precise dividing line between protected expression and the unprotected underlying idea or theme.

Moral rights present a potential additional complication to the valuation of copyrights. The *Copyright Act* separately protects an author's "moral rights," including the right to the integrity of the work and the right to be associated with the work.[47] Although moral rights may be waived, they cannot be assigned. It follows that without proof of a comprehensive waiver, the value of the copyright in the hands of a subsequent assignee is reduced by the potential for continued authorial interference and control.

[45]Though lack of originality or expiration of the term of protection are possible attacks on the validity of the copyright.

[46]*Cuisenaire v. South West Imports Ltd.* (1968) 57 C.P.R. 76 (S.C.C.).

[47]*Copyright Act* s.14.1.

2.1.6 Valuation of IPR-associated collateral

It may be thought that valuation is not as serious a problem where the lender is primarily relying on the royalty payments derived from IPRs. After all, here the collateral is a monetary receivable. However, the valuation uncertainties surrounding IPRs have an impact on a secured creditor's ability to confidently assess whether the likely future royalties derived from the IPRs will be sufficient to fully amortize the secured obligation (and on the valuation of the securities to be issued where an assignment of IPR royalties is made in the context of a securitisation of royalty payments collateralized by IPRs). In the case of patents, for instance, the obligation to make royalty payments may end if the patent is later found to be invalid. Moreover, unlike loans collateralized by immovables and tangible movables where the obligor normally pays a pre-determined monthly sum, intellectual property royalties are frequently paid based upon actual ongoing sales. And sales can vary widely and unexpectedly, for instance, if a band becomes unpopular or a widely used patent is superceded by a superior one.

In addition, in cases where the value of particular IPRs to licensed end-users depends on access to the ongoing expert advice and service of the owner/debtor, the collateral value of the income stream owed by licensed end-users is also diminished. Once the defaulting debtor is no longer in business so that ongoing maintenance is no longer assured, end-users may claim that breach of this maintenance obligation relieves them of their obligation to make continuing payments.[48]

2.2 Possible Responses to Valuation Challenges

2.2.1 Introduction

The extent to which the inherent valuation challenges identified above diminish the attractiveness of IPRs as collateral for secured lenders can vary considerably from one transaction to the next. Some IPRs, for example, a patent on a 'blockbuster' pharmaceutical, or the copyright on a popular film, pose little in the way of valuation difficulties by reason of their proven track record. The

[48] See Mann at 141.

example of David Bowie's aggregate copyrights in his music mentioned by Knopf [49] shows that financiers may also be willing to rely on the value of a debtor's portfolio of patent or copyright rights aggregated as a whole provided that the economic value of at least some of the items within the portfolio have a sufficient historical track record even if the value of other items is unpredictable. In still other cases, lenders may be willing to rely on IPR as collateral by reason simply of the creator's established reputation in relation to past IPRs of the same genre.

These examples aside, it is clear that in many instances, the unique characteristics of IPRs impose inherent valuation constraints on IPR-based secured lending relative to more traditional types of collateral. What, if anything, can be done to reduce the impediments to the reliability of IPR as collateral that these valuation challenges inevitably pose for secured lenders?

The prior research solicited by the Law Commission indicates that the valuation challenges created by the "idiosyncratic" nature of IPRs will be lessened as lenders become more familiar with the intellectual property world and begin to acquire specialized experience and expertise. This is a process which will unfold naturally, without the need, in our view, for formal governmental intervention as IPRs inevitably acquire a larger and larger share of the assets of debtor enterprises.[50] And empirical research indicates that general institutional lenders are increasingly prepared to extend IPR-based secured financing even at the product development stage if venture capital financing is also in place so as to enable the bank to informally rely on the latter's expert and specialized judgment.[51] As IPRs become more commonly used as collateral, valuation techniques will improve thus allowing more widespread use of IPRs as security. In other words, a 'virtuous

[49]Knopf at 4.

[50]"The development of a successful IP security market depends on a growing market confidence. This comes first from established companies leading lenders into a more favourable attitude towards the risks of lending against IP. From this gradual change of attitude opportunities develop for smaller, younger companies as the market gains in confidence and extends the boundaries of the risks that it has experience of and will consider. This is based upon a prediction that the reform of the law will not simply open a new stall in the market place at which all the current lenders, including the traditional high street lenders, will lend to all IP-rich companies from the oldest to the youngest. Rather, the market will develop over time as non-specialist accountants, lawyers, patent agents, and bankers slowly become comfortable with the new security possibilities from IP." Townend at 20.

[51]See generally Mann.

circle' may be created.

2.2.2 Substantive IP Law Reform?

However, a number of the inherent valuation challenges identified above are not attributable to a lack of valuation expertise as regards IPRs. Rather they stem from substantive or procedural features of the current Canadian legal framework governing IPRs and related rights. While amendment of these features could reduce uncertainties at the collateral valuation level, this must be balanced against the possibility of undermining important principles of intellectual property law.

For instance, making registration of copyrights a pre-condition to their existence would enable secured creditors to more easily determine a debtor's copyrights. However, such a requirement would run afoul of Canada's international obligations under the Berne Convention which prohibits the imposition of formalities such as registration as a pre-requisite to the right to copyright protection. As another example, we noted earlier that lobbying by businesses to facilitate commercial transactions involving trademarks eventually led to legislative amendments to permit assignments "in gross."[52] However, the practical impact of this reform has been largely negated by judicial decisions holding that a trade-mark that is assigned independently of the business with whose it is associated is likely to be found invalid. This effect of this jurisprudence undoubtedly reduces the commercial and collateral value of trade-marks. However, it is fully compatible with the fundamental policy of trade-marks, which is to provide reliable information to consumers as to the source of the wares associated with the trademark.

It has been suggested that the valuation risk posed by potential invalidity could be reduced for patents and similar IPRs by limiting the time within which challenges can be made to validity. For instance, Townend suggests that a "successful security market for IP requires detailed scrutiny prior to registration or creation of the right and, leading from this, a limited time within which challenges can be made to the validity of IP, for example within the first year after the product is made

[52] See Part 2.1.5 above.

available to the public."[53] But this scheme would almost certainly immunize many invalid patents from challenge. It is extremely unlikely that the negative economic effects of thus protecting unjustified monopolies would be offset by the benefits obtained at the level of enhancing overall access to IPR-based secured credit. A less radical way of addressing the invalidity problem would be to devote more resources to initial examination of a patent application by the Patent Office in order to improve the quality of issued patents. However, it is by no means clear that such a step would be cost-effective, since this more stringent examination process would apply even to those patents which are never used as collateral or never challenged.

This is not to say that there are no changes at all to intellectual property law and institutions that would help to reduce valuation uncertainty without adverse substantive effects on the integrity of intellectual property legal policy. For instance, it was earlier noted earlier that where the first owner of the copyright is the author, ownership reverts to the heirs of the author 25 years after the death of the author notwithstanding any previous assignment.[54] The policy rationale for this rule is not clear even though the risks it poses to the predictability of duration of the legal life of an assignee/debtor's copyright protection has some negative impact on the value of the copyright as collateral.

Moral rights are another instance where legal reform might reduce valuation risk without damage to fundamental intellectual property policy. The non-assignability of moral rights may adversely affect the collateral value of the IP in the hands of an assignee/debtor because the author's retention of control reduces the liquidated value of the IPR should the debtor default. The valuation risk this poses is unpredictable since the circumstances in which the rights can be exercised are difficult to determine in advance. These difficulties can be alleviated by securing a waiver of moral rights from the author and it is common practice to require a waiver on taking an original assignment from the author.[55] In this respect, the Copyright Act provides that where "a waiver of any moral right is made in favour of an owner or a licensee of copyright, it may be invoked by any person authorized

[53] Townend at 22.

[54] See Spring-Zimmerman et al at 6 indicating that this is a concern for secured lenders. Presumably the effect is modest.

[55] Mercier at 65.

by the owner or licensee to use the work, unless there is an indication to the contrary in the waiver."[56] It is unclear from this wording whether a subsequent assignee or a secured creditor, or a purchaser of the copyright from a secured creditor on default, would be considered a person "authorized by the owner" to use the work so as to be entitled to invoke the benefit of such a waiver. The Act might usefully be amended to provide that in the absence of a contrary indication, the benefits of an authorial waiver extend to subsequent assignees and to the secured creditors of the original assignee and any subsequent assignee. In addition, in the case of registered copyrights, it would be useful at the level of efficient valuation if the author were required to disclose in the registration his or her an intention to retain moral rights on pain of non-enforceablity of the rights against subsequent assignees and secured creditors.

2.3 Summary and Recommendations

The inherent legal nature and characteristics of IPRs pose unique valuation risks for secured creditors compared to other types of movable and immovable property. To being with, most IPRs have a statutorily limited legal life. More importantly, since IPRs are by nature concerned with innovation, all IPRs have a potentially limited economic life, as any particular IPR is susceptible to being rendered obsolete by further innovation. In addition, IPRs are often most valuable in a specific application in a specific company and in consequence the liquidation value may be significantly lower than the use value. IPRs are also subject to being challenged for validity whenever they are enforced, which introduces a discount as well as uncertainty into the valuation process. Despite these difficulties, many IPRs are potentially valuable as collateral, either individually or when pledged en masse, but these inherent valuation challenges do introduce uncertainty as compared with other types of property.

In general, this valuation risk cannot be reduced by changing the legal incidents and attributes of IPRs without compromising fundamental policies of intellectual property law to an unacceptable extent. However, there are two aspects of current federal policy where reform might usefully be considered:

[56] *Copyright Act* s.14.1(4).

1) The policy justification for the rule whereby, if the first owner of the copyright is the author, ownership reverts to the author's heirs 25 years after the author's death notwithstanding any previous assignment, should be revisited to determine whether it is justified despite its negative impact on the predictability of the future value of copyright collateral.

2) The non-assignability of authorial moral rights reduces the value of copyrights and renders valuation more unpredictable. Although moral rights may be waived, the scope of the beneficiaries entitled to take advantage of a waiver is unclear under the current wording of the Copyright Act. The relevant provisions should be amended to confirm that subsequent assignees and secured creditors are entitled to invoke the benefit of a waiver executed in favour of a prior assignee in the absence of a contrary intention. Consideration might also be given to amending the Act to provide that in the case of registered copyrights, registration of the author's intention to retain moral rights is a pre-condition to the effectiveness of those rights against subsequent assignees and secured creditors.

These reforms, though potentially desirable, are likely to have only a relatively minor impact on valuation uncertainty. The greatest potential for reduction in valuation risks associated with IPRs is probably the improvement in valuation techniques which will occur with experience. Thus reducing other barriers to the use of IPRs as collateral is likely to have an indirect effect on reducing valuation risk; as the use of IPRs increased and experience is gained, valuation will become more reliable.

3 Uncertainties in the Current Federal Registration and Priority Framework

3.1 Sources of Uncertainty

3.1.1 Uncertain Reliability of Federal IPR Registries as Records of Ownership

The first step any prospective secured creditor must take is to identify the existence, nature and extent of the putative debtor's title to the proffered collateral. For all six categories of federal IPRs, this may seem like a straightforward exercise in view of the existence of specialized registries for recording the assignment and transfer of the IPRS falling within their scope. In fact, under the current wording of the Acts, a registry search is not a reliable indicator of a putative debtor's legal title.

Under three of the Acts – the *Trade-marks Act*, the *Industrial Design Act* and the *Integrated Circuit Topography Act* – registration of an assignment is merely permissive. Although the assignment may be registered, registration is not made a pre-requisite in any way to the effectiveness of the assignment against third parties who acquire a competing interest in the same IPR from or under the assignor. It follows that a prospective secured creditor (or indeed a prospective assignee) cannot rely with certainty on the results of a registry search as a guarantee against the risk that the putative debtor, even though the apparent owner of record, previously disposed of the IPR under an unregistered assignment.[57]

The other three Acts – the *Patent Act*, the *Copyright Act*, and the *Plant Breeders' Rights Act* – provide somewhat greater protection for prospective secured creditors (and prospective assignees) against the risks of an unregistered prior assignment. Under these Acts, an unregistered assignment is void against a subsequent assignee without notice who registers first. Consequently, if the assignment under which the debtor acquired title is registered, and assuming an unbroken chain of title from the original owner, a secured creditor can generally rely on the registry record as a reliable indicator of the debtor's title.

[57] Wood at 4.

Nonetheless, registration does not *guarantee* priority over a prior unregistered assignee. To obtain priority, the first-registered assignee must take without actual knowledge of the prior unregistered assignment.[58] This qualification creates some residual uncertainty since its application depends on the evidence as to the presumed state of knowledge of the first registered assignee at the time the second assignment to it was made.

Indeed, registration does not even guarantee that the registered assignee's title will necessarily prevail against a subsequent assignee from the same assignor. It has been held judicially that registration has negative priority effect only.[59] Registration precludes a prior unregistered assignee from prevailing against an innocent subsequent assignee who registers. But it does not create a positive first-to-register rule of priority so as to prevent a subsequent assignee from claiming the benefit of any exception to first-in-time priority created by otherwise applicable principles of provincial property law.

3.1.2 Uncertain Applicability of Federal IPR Statutes to Secured Transactions

The potential impact of the registration provisions of the federal statutes on the priority of security taken in federal IPRs has been extensively analyzed, but these analyses do not allow any firm conclusions to be drawn.[60] On the contrary, there is a general, indeed universal, consensus that there is fundamental uncertainty with respect to virtually any priority question that might conceivably be posed.

In the first place, it is unknown whether secured transactions even fall within the scope of the federal

[58] See Wood at 4 ff. The requirement that the subsequent assignee be without actual notice is express in the *Copyright Act* and the *Plant Breeders' Rights Act* and has been read into the *Patent Act* by the decision of the Appellate Division of the Alberta Supreme Court in *Colpitts v. Sherwood,* [1927] 3 D.L.R. 7. The *Colpitts* decision is consistent with the Supreme Court decision in *United Trust Co. v. Dominion Stores Ltd.,* [1977] 2 S.C.R. 915 holding that the doctrine of actual notice applies unless specifically ousted by legislation.

[59] See the controversial Federal Court decision to this effect in the *Poolman v. Eiffel Productions S.A* (1991) 35 C.P.R. (3d) 384 (F.C.T.D.) and the commentary in Spring-Zimmerman et al at 26ff and Wood at 30ff.

[60] In addition to the papers prepared for the Leveraging Knowledge Assets Conference/Roundtable by Wood, Spring-Zimmerman et al, Knopf, Adams & Takach, and Duggan see also Cuming & Wood; Wood, (2002); Mercier & Haigh; and Gold.

registration provisions. None of the statutes say so expressly. But can or should the provisions governing the making and registration of "assignments" of IPRs be read to include assignments by way of security?[61] If so, is their application limited to assignments created by a formal transfer of title or do they apply to all transactions that function to charge or hypothecate IPRs even where formal title is retained by the debtor.[62] The answers to both questions remain speculative.

The prevailing uncertainty on the basic question of the applicability of the federal IPR statutes to secured transactions necessarily results in uncertainty at the level of assessing priority in IPRs between a federally registered secured creditor and a federally registered assignee. Current registry practice compounds the confusion. For instance, the Registrar of Trade-marks will make an annotation on the record indicating that it has received a security agreement purporting to affect the trade-mark in question, but this practice has no legislative base. *A fortiori*, priority between a security right in a federally-registered IPR that is taken and registered under provincial secured transactions law, and one that is registered federally according to this kind of informal practice, is so obscure as to almost be beyond speculation.[63]

Moreover even if it were made clear that the registration provisions of the federal IPR statutes apply to security interests, this would not eliminate the existing uncertainty. As we have just seen,[64] the statutes as presently drafted are either silent on the priority implications of registration or provide only an incomplete priority code Although otherwise applicable provincial priority rules then apply to fill the gap, to what extent and to what result is almost entirely speculative.[65]

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[61]*Copyright Act*, ss. 27(1), 57; *Patent Act*, ss. 50(1), 51; *Trade-marks Act* s. 48(1); *Industrial Design Act*, s. 13(1); *Plant Breeders' Rights Act*, s. 31(1); *Integrated Circuit Topography Act*, s. 7(1), s.21.

[62]Wood at 4; Spring-Zimmerman at 18.

[63]Spring-Zimmerman at 20; Knopf at 50 ff.

[64]See Section 3.1.1. immediately preceding this seciton.

[65]Wood at 26 ff.

3.1.3 Operational Deficiencies

In addition to this profound legal uncertainty, current registry practices are not sensitive to the informational needs of either prospective secured creditors or prospective assignees of federal IPRs. The patent, copyright and trade-marks databases are currently accessible on-line, but the on-line source is not adequate for due diligence searching in respect of either financing or purchasing. None of the on-line databases are guaranteed to disclose all relevant information and such information as is disclosed may be several weeks out of date.[66] Security agreement information does not appear at all in the on-line patent database.[67] As Knopf notes "Such uncertainty does not exist and would not be considered acceptable in other Canadian registration regimes, such as those for real estate or PPSA filings."[68]

3.2 Reducing Uncertainty

It is no exaggeration to say that the law relating to the priority of security interests in federal IPRs could not be more uncertain. The question is, what, if anything, should be done about it. Prior research has tended to focus on the sources of current legal uncertainty, accepting that the case for reform is self-evident. No attempt has been made to quantify the impact of this uncertainty on the cost of lending.

It is questionable whether an accurate assessment is feasible given the evident difficulty in separating the additional costs created by legal risk at the level of an inadequate secured transactions legal framework from the additional costs created by the unique valuation difficulties posed by IPRs that were identified in Part 2.[69] This having been said, it is at least possible to identify the general nature of the additional costs created by the current legal uncertainty.

[66] Knopf at 43 ff.

[67] *Ibid.*

[68] *Ibid* at 44.

[69] McFetridge notes at 3 that "The loss to the economy due to the use of less efficient forms of finance would be difficult to measure in practice."

Dual registration is the most obvious source of additional costs. If the IPR collateral is sufficiently significant to the overall financing, lenders are routinely advised to register under both federal IPR law and provincial secured transactions law and to observe the formal requirements of both systems.

If dual registration were the only source of additional costs, it might be argued that investment in reform is not pressing. In fact, the problems go far beyond dual registration. The profound uncertainties surrounding the priority effects of federal registration, and the interaction and potential conflict of the federal statutes with provincial secured transactions law, mean that secured creditors enjoy far less confidence in the quality of IPR collateral relative to other movable assets. This imposes an increased initial risk assessment and ongoing monitoring burden on secured creditors for which debtors ultimately pay in the form of less accessible and costlier secured credit.[70]

For example, the prevailing uncertainty as to the very applicability of the federal registry regimes to secured transactions means that federal registration may be legally ineffectual to preserve the priority of the secured creditor's claim against competing secured creditors even if noted on the record of the applicable federal IPR registry by the federal registrar. On the other hand, the current legal uncertainty also leaves open the possibility that a federally registered true assignment may prevail over a prior provincially-registered security. It follows that even dual registration may be ineffective under current law to guarantee a secured creditor priority over competing assignees and competing secured creditors. The practical result of the pervasive uncertainty is that borrowers who depend on IPR collateral for access to secured credit can expect higher than usual borrowing transaction costs and increased reporting requirements.

The costs created by these legal uncertainties will only become more substantial as IPRs assume increasing importance in the economy, thereby also increasing borrower and lender demand for

[70] Robert Betteridge, "Pinning Jello To The Wall: Security Interests In Intellectual Property" On Record, Burnet, Duckworth & Palmer LLP http://www.bdplaw.com/articles/spring01/spring01d.htm as quoted by McFetridge at 2.

IPR-based secured financing.[71] Although satisfaction of this demand is likely to be retarded by the prevailing legal uncertainty, market pressures will nonetheless have an impact. As this occurs, there will be growing pressure to resolve the existing uncertainties through litigation or some more informal form of dispute resolution. But a process of incremental resolution of the uncertainties will in itself create additional costs as the lending community is forced to make continuing adjustments to its risk assessment rules and practices in response to the latest judicial ruling on the issues.

In contrast to the increasingly bleak scenario associated with reform inertia, immediate legislative reform would likely accelerate the demand for IPR-based secured financing, and simultaneously reduce costs for borrowers. As Townend has observed:

> ". . .[I]f the law was amended . . .to reduce the complexities for creating security, then the market could allow for more widespread securitization. Conversely, as the opportunities to use IP as security became more widely accepted by a broader group of lenders over a broader spread of IP, then there would be a further need for a reduction in complexity in the law and greater transparency in the rules. This would allow strangers to trust not in each other as the primary source of risk management, but in the vehicles of security and the reliability of the law. This must be the central aim in the reform of security legislation, to develop a legal environment that makes the taking of security over IP as common place as the taking of security over houses in the residential property market.[72]

3.3 Summary and Recommendations

The existing law relating to security interests in IPRs is radically uncertain. There is uncertainty at almost every level. Before security interests themselves are considered, the first step that any secured creditor, or more broadly, any potential assignee, must take is to ascertain the debtor's title to collateral. Though title registers exist at the federal level for all federal IPRs, these are not ideal for purposes of title investigation. Under three of the Acts – the *Trade-marks Act*, the *Industrial*

[71] This may not seem pressing in the current "dot com bust", but it is reasonable to suppose that this is no more than a cyclical downturn against the background of a secular trend towards an increasingly important role for IPRs in the economy's asset base. And a downturn creates its own demand for the the resolution of IPR- related legal uncertainties arising in bankruptcy and insolvency: see Knopf at 80.

[72] Townend at 44.

Design Act and the *Integrated Circuit Topography Act* – registration of an assignment in the federal title is merely permissive, so that examination of the title register does not provide authoritative information regarding title. Under the remain three Acts – the *Patent Act*, the *Copyright Act*, and the *Plant Breeders' Rights Act* – an unregistered assignment is void against a subsequent assignee without notice who registers first. Even so, details of existing law mean that the register is not entirely authoritative. In particular, the first-registered assignee must take without actual knowledge of the prior unregistered assignment. This qualification creates residual uncertainty and has been eliminated in modern registry design in other contexts. Further, it has been held judicially that priority established by registration is subject to exceptions to first-in-time priority created by otherwise applicable principles of provincial property law, thus further undermining the integrity of the register as a source of title information.

When security interests are brought into consideration, the uncertainty increases dramatically. There is fundamental uncertainty with respect to virtually all aspects of priority. In the first place, it is not clear whether secured transactions even fall within the scope of the federal registration provisions. It is possible that all secured transactions are federally registrable; or that only those which are formally cast as assignments are registrable; or that none at all are registrable. Even if registration of a security interest does not establish priority of its own effect, it may be that annotation of such a registration may serve as notice or constructive notice, and so establish priority indirectly (though this is not clear).

In addition to this profound legal uncertainty, current registry practices are not sensitive to the informational needs of either prospective secured creditors or prospective assignees of federal IPRs. The patent, copyright and trade-marks databases are currently accessible on-line, but the on-line source were designed for other purposes, e.g. searching prior patents, and are not adequate for due diligence searching in respect of either financing or purchasing as they may be incomplete or out of date.

This uncertainty increases direct costs as lenders are routinely advised to register under both federal IPR law and provincial secured transactions law and to observe the formal requirements of both systems. But this practice does not eliminate priority uncertainty, and the profound uncertainties surrounding the priority effects of federal registration, and the interaction and potential conflict of the federal statutes with provincial secured transactions law, mean that secured creditors enjoy far less confidence in the quality of IPR collateral relative to other movable assets. This imposes an increased initial risk assessment and ongoing monitoring burden on secured creditors for which debtors ultimately pay in the form of less accessible and costlier secured credit.

Although the benefits of a reformed legal framework for IPR-based secured financing are difficult to quantify, the current uncertainties are sufficiently well documented and pervasive to conclude that reform will reap sufficient cost savings to justify the investment. The case for reform is especially pressing in view of the likelihood of an increased demand for IPR-based secured financing, and the likelihood that reform by itself will in turn fuel that demand by increasing access and lowering cost.

4 Reform of the Ownership Disclosure Function of the Federal IPR Registries

4.1 Introduction

Verification of the debtor's title to the proffered collateral is a basic step in a prospective secured creditor's risk assessment process. Yet in Part 3 we saw that for various legal and operational reasons, none of the federal IPR registries is presently a reliable indicator of current legal ownership. This leads to the two issues that are the subject of this Part. The most obvious is how federal law and practice might be reformed to improve the reliability of the IPR registries for the purposes of determining a putative debtor's legal title. But the more fundamental preliminary question is whether reliable title registries for federal IPRs are needed at all. The answer to this latter question will dramatically affect the possible reform recommendations. After all, if true title registries for federal IPRs are infeasible or lacking in real value, the legislative 'solution' would be straightforward. The federal Acts should then be amended to make it clear that registration of an assignment has no third party effect whatsoever. This would not of course assist the secured creditor in the task of verifying the debtor's title. But it would at least eliminate the current uncertainties as to the effect of registration (or failure to register) to a federal IPR.

4.2 Are Conclusive Legal Title Registries Needed for Federal IPRs?

There is of course no question of altogether abolishing the federal IPR registries. With the exception of copyright,[73] registration is necessary element to the very coming into existence of the IPR. Until registration, the IPR does not exist. Even in the case of copyright, registration provides some benefits even under the present law. Since registration of initial ownership or an assignment of initial ownership provides prima facie evidence of current title in the absence of proof to the contrary,[74] the registered copyright owner is relieved of the need to prove the off-record

[73] Registration is not relevant to the coming into existence of a copyright or the initial copyright owners' rights to protection. Copyright exists and is entitled to protection immediately it is expressed in material form. Unlike both Canada and the United States, many countries have therefore have not elected to provide a public registration system for copyrights. See e.g. Patry at 394 ff.

[74]S. 53(2) of the *Copyright Act* provides that a certificate of registration of copyright is evidence that "the person registered is the owner of the copyright."

documentary evidence of title. This is particularly beneficial in cases where the current owner is at the end of a long chain of assignments. The utility of this feature of the copyright register is well recognized,[75] and there is no active movement to abolish the copyright register in Canada. We therefore take it that the need for a copyright register is sufficiently established.

Indeed, registration currently provides the same evidentiary benefits for IPR owners under the other five statutes. The *Industrial Design Act* clearly provides that a certificate of registration is proof of ownership in the absence of evidence to the contrary[76] so that ownership can be established without the need to prove off-record documentary evidence of the assignment by which title was acquired. The *Trade-marks Act* and the *Integrated Circuit Topography Act* probably have the same effect, although the statutory language is not as clear.[77]

So the question at stake here is not whether the federal IPR registries should be preserved – clearly they must be – but whether the priority effect of registration of an assignment should be strengthened so as to make registration of an assignment conclusive evidence of legal title as against competing unregistered assignees.

The argument in favour of reforming the federal IPRs registries to become true registries of legal title is straightforward. Enabling third parties to ascertain legal title by a simple search of the relevant IPR registry title would greatly facilitate the security of commercial transactions involving federal IPRs, not just for the purposes of enabling secured creditors to more confidently assess the debtor's

[75]See for example *Circle Film Enterprises Inc. v. Canadian Broadcasting Corp.* 20 D.L.R. (2d) 211(S.C.C.).

[76]*Ibid* s. 7(3)

[77]Under the *Trade-marks Act* assignments may be registered and a certified copy of the register is evidence of the facts set out therein (s. 54(2)) and in particular that "the person named therein as owner is the registered owner of the trade-mark" (s.54(3)). Similarly, a certificate of registration issued under the *Integrated Circuit Topography Act* is "evidence of the facts therein alleged" s. 19(3) and those facts include "the name and address of the registered owner of the topography" (*Integrated Circuit Topography Regulations* s. 23(a). Unfortunately, there is nothing in these Acts which says that the registered owner is the presumed to be the owner; cf the *Copyright Act* s. 53(2) which provides that a certificate of registration of copyright is evidence that "the person registered is the owner of the copyright" and the *Industrial Design Act* s. 7(3) which provides that "The certificate, in the absence of proof to the contrary, is sufficient evidence . . .of the person named as proprietor being proprietor."

title, but also for the purposes of assignment and licensing transactions.

Of course the same arguments would justify the establishment of a title register for any item of property, not just IPRs. Yet title registries have *not* been put in place for most categories of movable property (as distinct from immovables). For the most part the cost is not worth the benefit. Ether the asset value is too low, or the imposition of a registry obligation would impede the free circulation and transformation of the assets in the commercial marketplace, as for example, in the case of the inventory and accounts receivable of a business or in the case of negotiable collateral.

IPRs are different for two reasons. First, a registry system is already in place and there is no question that it will remain in place. Therefore we are not dealing with the question of whether reform resources should be expended to establish a registration system for this category of movable property. That policy decision already has been made. The question now is whether the existing registration system should be improved to better facilitate commercial dealings in IPRs by making the registry record conclusive as to current legal ownership.

In answering that question, it is useful to draw an analogy between IPRs and immovable property for which the utility of a legal title registry system is well established. IPRs are more analogous to land than to movable property at three relevant levels. First, IPRs constitute a relatively stable and durable form of property. Unlike tangible goods, they are not subject to destruction by fire or theft. And, unlike other types of intangible movables, IPRs cannot be destroyed by being transformed into cash and then dissipated in the marketplace (as happens, for example, where receivables are collected or negotiable instruments are negotiated prior to default and enforcement). Second, like land, IPR ownership is subject to being sub-divided among different owners either through partial assignments or through the grant of territorially confined exclusive licensees. Finally, like land, IPRs have a sufficiently lengthy life span to make successive transfers of ownership, and a correspondingly lengthy chain of title, a real likelihood. In short, establishment of a true legal title register for IPRs is justified for the same commercial efficiency reasons that apply to immovables.

Parliament already has made the basic policy decision in favour of a true title register in the case of the registries established under the *Patent Act*, the *Copyright Act* and the *Plant Breeders' Rights Act*. As we have seen, these three statutes already give some level of third party effect to registration of an assignment. However, their failure to provide a comprehensive regime leaves significant uncertainties. Thus, strengthening the priority effects of registration under these three Acts would not change the prevailing legislative policy. Rather, it would enable it to be more perfectly realized. The current policy with respect to the *Trade-marks Act*, the *Industrial Design Act*, and the *Integrated Circuit Topography Act* is less clear since these three Acts are silent regarding the third party effect of registration. On the other hand, all three Acts do provide that transfers may be registered, and registration is not entirely without legal effect. Moreover, it is difficult to see any feature of industrial designs or integrated circuit topographies which would justify different treatment from copyright. Both provide protection for subject matter which is very similar to that protected by copyright,[78] and the case for a true title registry is, if anything, even stronger for industrial designs and integrated circuit topographies since for these types of IPRs, unlike copyright, registration is a pre-requisite to the existence of the right.

The situation with trade-marks is somewhat different. Unlike the other categories of IPRs, there is no serious resale or 'subdivision' market for trade-marks as a separate asset owing to the risk that an assignment, unaccompanied by the goodwill in the business as a whole, may lead to invalidity of the mark for loss of distinctiveness.[79] Thus there is little practical risk of sub-division of ownership or multiple specific assignments of the same trade-mark to different assignees. It might therefore be reasonably argued that the commercial benefits to be derived from making the trade-mark registry a true register of legal title are not worth the burden and risk for assignees. However, assignees of a trade-mark already face a substantial incentive to register the transfer because of the need to receive notice of actions respecting the validity of the trade-mark. The continued validity of a trade-mark may be challenged at any time on application by any person willing to pay the prescribed fee. When this happens, the registered owner is notified of the challenge and if the owner does not

[78]The *Integrated Circuit Topography Act* was enacted to provide protection for topographies because it was uncertain whether the *Copyright Act* would encompass such functional works (topographies are now expressly excluded from the *Copyright Act*: see s. .64.2); and industrial designs would clearly fall within the scope of the *Copyright Act*s but for s. 64 of the *Copyright Act*.

[79]See Part 2.1.5 above.

respond in a timely manner the registration may be expunged.[80] A transferee who does not register the transfer and thereby provide an address for service[81] therefore runs the risk of expungement without notice. This means that requiring the transferee to register to preserve their title would place little additional burden on the transferee. Moreover, unlike the current position in Canada, in the United States an unregistered assignment is treated as void against any subsequent purchaser for valuable consideration without notice unless the assignment is registered in a timely manner.[82] This suggests that there is a sufficient assignment market for trademarks to justify the advantages of extending third party legal effect to registered title and registered assignments of title.

We therefore recommend that the ownership-disclosure function of the all six federal IPR registries be strengthened to make them conclusive legal title registries with the features described in the remainder of this Part of the Report. We emphasize that prospective secured creditors would not be the only beneficiaries of such reform. A reliable ownership registry would radically reduce the inquiry burden for all categories of persons who would have an interest in verifying title to a federal IPR, including prospective purchasers (assignees) and licensees, as well as judgment creditors of the apparent IP owner seeking to enforce their judgments through a forced sale of the debtor's assets. In other words, we regard this aspect of reform as driven not by the particular needs of secured transactions law but by the broader concerns of the commercial marketplace generally. The remainder of this Report will proceed on this assumption.

However, if a policy decision is made that the registers under the *Trade-marks Act*, the *Industrial Design Act*, or the *Integrated Circuit Topography Act* should not be strengthened to true title registries, these Acts should be amended to make it clear that registration of a transfer has no substantive effect on legal ownership, whether by way of constructive notice for the purposes of

[80]*Trade-marks Act* s. 44.

[81]A transferee must provide an address for service on applying to have the transfer registered: *ibid* s. 48(3).

[82]See 15 U.S.C. § 1060(a) (1994): "An assignment shall be void against any subsequent purchaser for valuable consideration without notice, unless the prescribed information reporting the assignment is recorded in the Patent and Trademark Office within 3 months after the date of the assignment or prior to the assignment."

supplementary provincial property law or otherwise.[83]

4.3 Substantive Registry Reform: Strict First-to-Register Priority

Modern registry reform experience demonstrates that the adoption of a strict first-to-register ranking rule for registrable interests is the best solution to ensuring the reliability of a registry.[84] Applied to the federal IPR context, a first-to-register rule would enable prospective assignees to ensure good title by registering promptly. And, since registered assignments would prevail over unregistered assignments, third parties could rely with confidence on a registry search as an accurate record of current ownership.

Implementation of this solution would do away with the existing uncertainties created by the current rule under which registration only has a negative priority impact, not a positive one.[85] It would also do away with the uncertainties created by the existing qualification to registration-based priority in the case of actual knowledge of a prior unregistered assignment.[86] Elimination of the actual knowledge doctrine is in line with contemporary legal policy for both land and movables registries.[87] Although priority based on actual notice can prevent sharp dealing in some circumstances, it can also lead to increased litigation by undermining the finality of the registry record.[88] In contrast, a straightforward first-to-register rule enables all interested parties to confidently rely on an external objective event – public registration – to assess legal ownership.[89]

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[83]The role of registration in establishing ownership in the absence of a challenge and proof to the contrary could be retained.

[84]See e.g. CCQ art. 2945, 2946.

[85]See Part 3.1.1 above.

[86]*Ibid*.

[87]See e.g. CCQ art. 2963: "Notice given or knowledge acquired of a right that has not been published never compensates for absence of publication."

[88]A discussion of the disadvantages of the doctrine which is still current is found in the 1857 Report of the Royal Commission on Registration of Title in England, quoted by Laskin C.J., dissenting, in the leading Canadian case on the issue, *United Trust Co. v. Dominion Stores Ltd.* [1977] 2 S.C.R. 915.

[89]A source of uncertainty may arise in principle in respect of unregistered copyrights. Because registration is not a pre-requisite to the existence of copyright, an assignee of an unregistered copyright faces

4.4 Scope of Federally Registrable "Assignments": Substance over Form

In determining the scope of the "assignments" that would be subject to a reformed federal first-to-register priority regime, we recommend inclusion of all licences which operate as the functional equivalent of a transfer of an interest in the IPR itself. Unless this kind of substance over form approach is taken, the reformed regime will fail in its basic mission to supply a *complete* record of who holds the entitlement to use and exploit the relevant IPR, this being the essence of IPRs as property.

In giving concrete guidance on characterization, we recommend, in line with the previous research, drawing a distinction between exclusive and non-exclusive licences, with only the former treated as the functional equivalent of a (partial) assignment for federal registration and priority purposes. A non-exclusive licence is normally an end-user licence. The licensee acquires the right to use the IPR but not the right to control its economic exploitation nor the right to prevent the licensor from granting the same right of use to others. In contrast, an exclusive licence gives the licencee the exclusive right to either use or re-licence the relevant IPR (or to do both) within the territory or for the time period specified in the licence. It is this element of exclusivity, even if territorially or time limited, that makes the exclusive licence the functional equivalent of the grant of a (partial) interest in the IPR itself.

In proposing the *exclusion* of the interests of *non-exclusive* licensees from the federal IPR registries, we do not mean to suggest that non-exclusive licences do not have an impact on the value of the underlying IPR itself.. On the contrary, the quantity of non-exclusive licences issued has a direct impact in the sense that the closer one comes to the point of market saturation, the more the value of the IPR itself is diluted. In follows that a prospective assignee or secured creditor will wish to know the scope and extent of non-exclusive licensing that has taken place in order to accurately

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the risk that the copyright was the subject of an prior assignment. The assignee can protect itself against this risk by registering the copyright, in which case its interest would prevail over any prior unregistered interest. But what if the assignee did not wish to register the copyright? The issue might arise in the case of works under continuous development, software being an example. In our view this is not a significant practical problem in the case of transfers of title to the copyright, since cases in which ownership is transferred and yet the transferee continues to develop the work are relatively rare. The problem is more important in the case of a security interest in the copyright. This issue will be dealt with in more detail in Part 7.4.3.2.

value the IPR (and indeed to accurately value any IPR-related assets such as royalty payments). However, we do not see the federal registries as capable of providing an antidote or short-cut to this aspect of the prospective assignee's or secured creditor's valuation burden since it would impose an unworkable registration burden on IPR owners to require them to effect the ongoing specific registration of every non-exclusive licence that they issue in the ordinary course of business.

Conversely, in proposing the *inclusion* of *exclusive* licenses within the federal priority regime, we do not mean to suggest that the interest of an exclusive licensee will always have significant economic value. The exclusive licence may be so limited as to territory or time as to make its characterization as the functional equivalent of a grant in the IPR itself inappropriate. There are two means of dealing with this practical reality. One would be to adopt an analogy from land law and exempt exclusive licenses from the federal registration and priority regime if they are less than a specified duration (one year?) or cover less than the territorial borders of any country or sub-national territorial unit. The other option would be to leave the question of whether the burden and expense of federal registration is worthwhile to the risk management discretion of each individual licensee. Because we think any attempt at a formal dividing line based on territory or time would be too arbitrary to work, we are inclined to recommend the latter approach.

4.5 Need for Complementary Structural and Operational Registry Reform

Reform of the substantive law to strengthen the conclusive effect given to registration of assignments of federal IPRs will produce little real benefit unless the federal IPR registries are significantly reformed to permit cheap and efficient remote access. Though considerable progress has been made in making federal IPR database information available on-line, these efforts have been aimed primarily at substantive searching for e.g. patent prior art, or similar trade-marks, and the systems remain inadequate for title searching. Some basic technological and operational changes will be needed to the federal IPR ownership registries if their title disclosure function is to be effectively improved. In particular, the systems themselves need to be overhauled to support legally reliable, up to date, on-line searching, including full chain of title searching for all IPRs (that is, grantor/grantee searching).

4.6 Title Guarantee or Archival System?

4.6.1 General

The analysis to this point has assumed that the existing IPR registration systems would continue to operate, as they do now, as archival registry systems, that is to say, in the same fashion as a traditional deed registry in the land context. Although failure to register can defeat title against a competing assignee, registration in an archival system does not constitute conclusive positive proof of title. Since the existence and validity of the underlying assignment is not assessed on registration, the most recently registered assignee is not definitively the owner. An invalid transfer anywhere in the chain of title can therefore nullify a security interest or assignment granted by a registered successor in title.

The alternative to an archival system is a title guarantee system analogous to a land titles (Torrens) system for land, whereby the current registered owner is statutorily declared to be the legal owner. In strengthening the role of the federal IPR registries as conclusive records of legal title, should policy makers go all the way and implement such a title guarantee system? Curiously this question seems not to have been considered previously.

In the land context a title guarantee (land titles) system is widely considered to be superior to a instrument registry system as it provides increased protection against the risk of a prior invalid link in the chain of title and reduces duplication of effort in investigating the chain of title. On its face, a title guarantee system would be desirable for IPRs for these same reasons.

Admittedly, there are differences between IPRs and land which make the analogy imperfect. The term of most IPRs is limited and IPRs become less valuable near the end of their term and so are increasingly less likely to be transferred. For both these reasons searching the chain of title to an IPR may be less onerous than searching a chain of title to land.[90] But the question is not whether a

[90]And of course a title guarantee system in the IPR context could only guarantee who the IPR belongs to; it would not be a guarantee that the IPR was valid.

title guarantee system for IPRs is as desirable as such a system for land, but whether it is more efficient than an archival system for IPRs.

The disadvantage of a title guarantee system is the additional burden it shifts onto the registry office to verify the background documentary evidence of ownership. The advantage is that third party searchers can rely on the current state of the title register rather than having to trace through the chain of title. This suggests that so long as IPRs are, on average, transferred more than once, a title guarantee system is preferable to an archival system.

The question of whether a title guarantee system should be implemented ultimately depends on the reform strategy adopted with respect to the interaction between the federal title registries and the general law of secured transactions. This latter issue is the focus of the next sections of the report. As we shall see, a title guarantee system can only be implemented if the federal approach to the priority of of security in IPRs, discussed in Parts 6 and 7 is adopted. This is because, under the choice of law approach discussed in Part 5, the full chain of title must be made available to allow parties dealing with a federally registered IPR to identify all prior owners in the chain of title in order to enable them to verify whether any of them granted a prior but still undischarged security in the IPR pursuant to the secured transactions regimes in force in their respective home provinces or countries. Since, in a title guarantee system, prior owners are hidden behind the registry "curtain", the choice of law approach would not be workable.

4.6.2 The Feasability of a Title Guarantee System for Copyright

A title guarantee system is probably infeasible for copyrights, primarily because of the difficulty of uniquely identifying the copyrighted work.[91] A title guarantee system requires that the registry staff examine the documents of transfer proffered by the registrant and verify the true ownership once and for all at the time of registration. The degree of certainty required means that the registry staff cannot rely on the title attributed to the copyrighted work by a registrant as conclusively identifying that work. Examination and comparison of the content of the work itself with other works bearing a

[91] This problem is discussed in more detail in Part 7.4 below.

different title but attributed to the same authorship would be necessary to ensure that the same work had not been registered under two different titles and this would present a prohibitively costly administrative burden. Further, where the first owner of the copyright is the author, ownership reverts to the heirs of the author 25 years after the death of the author notwithstanding an previous assignment.[92] Since this is a generally unknown group it would not be possible for a title register to automatically show the heirs as the owner.

4.7 Summary and Recommendations

Reform of the title aspects of federal IPR registries is an essential pre-requisite to any approach to reform of security interests in IPRs. Title level reform will facilitate the efficiency of all types of commercial transactions in federal IPRs, including secured transactions, by providing commercial parties with a cheap, efficient and reliable source of information as to the current ownership of IPRs. However, the statutes as presently drafted not only fail to achieve this potential, they actually introduce a further layer of confusion.

To resolve this deficiency in the title aspects of the federal IPRs registers, we recommend that the assignment and registration provisions of all six federal IPR statutes be strengthened to provide for the registrability of all transfers of ownership in federal IPRs, and to give conclusive legal effect to registered transfers as against unregistered transfers. In particular, we recommend that: successive assignments or transfers of the same IPR by the same assignor should be ranked on a strict first-to-register basis and that the scope of registrable transfers should include exclusive licences. Complementary structural and operational reform of the registries themselves to allow reliable on-line title searching is needed to support these substantive reforms.

A further reform should be considered. The suggested reforms are cast in a manner designed to accommodate the fact that the federal IPR registries currently operate as archival registries in a manner analogous to a traditional deed registry for land. Implementation of a title guarantee (Torrens) system would give a superior level of conclusiveness to registered title. We therefore

[92] *Copyright Act* s. 14.

recommend that this reform option also be explored (except in the case of copyright where the asset identification difficulties make a title guarantee system unworkable). This is subject to an important caveat. A full-fledged title guarantee system is workable only if the federal approach to the registration and priority status of secured transactions in federal IPRs discussed in Parts 6 and 7 of the Report is adopted. It would not be workable under the choice of law approach discussed in Part 5.

5 Choice of Law Approach

5.1 Introduction

Implementation of the reforms recommended in Part 4 would enhance the ability of prospective secured creditors to rely on the federal IPR registries to determine a prospective debtor's current legal title to the proffered collateral, thus reducing one important source of the legal uncertainties identified in Part 3. But they would not resolve the risks for secured lenders arising from uncertainties in resolving the priority of claims to the same federal IPR between competing secured creditors and between a secured creditor and a federally registered assignee.[93]

One possible solution to this latter problem put forward in the previous research would involve a choice of law as opposed to a substantive law reform strategy.[94] The federal government would, in effect, piggyback on extant secured transactions law by designating the law of the debtor's location as the law applicable to the registration, effects of registration or non-registration, and priority of security granted in any federal IPR.[95] For Quebec debtors, the relevant provisions of the CCQ would apply; for debtors located in the other provinces and territories, reference would be made to the relevant PPSA.[96] For this reason, this solution is often referred to as the "provincial approach." But this terminology is a misnomer since for non-Canadian debtors, foreign secured transactions law would govern, e.g. French law for French debtors. In the interests of precision, and because the potential application of non-Canadian secured transactions law to security granted in Canadian

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[93]The legal effectiveness of a federal IPR-based secured transaction against the debtor's judgment creditors, insolvency administrator, and other categories of third parties e.g. non-exclusive licensees, raise somewhat different issues. For this reason, and because their ultimate resolution is affected by the discussion in this Part and in Part 6, we defer these issues to Part 7 which addresses a number of additional priority considerations.

[94]See generally the so-called provincial reform approach identified by Wood, Duggan. While these authors do not use the language of choice of law, the provincial approach they discuss depends on a choice of law connecting factor. See generally Walsh.

[95]See Part 1.1 above for precise citations.

[96]On the question of reform at either the choice of law or substantive level in relation to issues of validity and enforcement, see Part 8.5 below.

IPRs by foreign debtors creates its own set of uncertainties and risks,[97] we prefer referring to this first possible reform approach as the "choice of law" approach.[98]

This part of the Report is devoted to an analysis of the mode of implementation of the choice of law approach, its advantages and disadvantages, and the legal and operational issues that would need to be resolved if it is to provide the desired level of certainty and clarity.

5.2 Mode of Implementation

In our view, implementation of the choice of law approach is best accomplished by federal enactment of a uniform choice of law rule for security in federal IPRs. Leaving the choice of law issue in provincial hands would not guarantee uniformity of substantive result since the current provincial conflicts rules are not entirely uniform. They all refer issues relating to the validity, registration, and priority of security rights granted in intangible collateral to the law of the jurisdiction where the debtor is located.[99] However, there are variations at the level of detail which mean that different substantive laws would potentially be applicable depending on the choice of law rule for intangible collateral of the province or territory in which a particular priority dispute happened to be adjudicated. Secured creditors cannot predict or control the litigation venue for future priority disputes involving competing third party claimants. Consequently, in the absence of a uniform federal rule, secured creditors would have to register and otherwise comply with the substantive priority requirements of all potentially applicable secured transactions regimes. So, for example, the CCQ and the PPSAs have different rules for determining the legal location of a debtor with branches in more one jurisdiction: under the CCQ it is the jurisdiction where the debtor maintains its registered office, whereas under the PPSAs it is the jurisdiction where the chief executive office is

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[97]As to which, see Part 5.6 below.

[98]As noted earlier in Part 1.4. The foreign debtor problem is addressed below in Part 5.6.

[99]For Quebec, see *CCQ*, art. 3105, para 1 and 2. For the common law provinces and the three territories, see, e.g., NB *PPSA*, section 7(2)(a), Ont *PPSA*, section 7(1)(a)(i). Although the *CCQ* and the *PPSA*s cover choice of law for issues relating to the validity of the security right and its registration, they do not explicitly address the choice of law for issues of priority except where it arises as an aspect of registration or failure to register. However, it is widely assumed that issues of priority are also most appropriately governed by the law of the debtor's location insofar as intangible collateral is concerned.

located.[100] If the debtor has its registered office in Montreal and its chief executive office in Toronto, the CCQ would apply if litigation arose in Quebec but the Ontario PPSA would apply if litigation arose in Ontario. Thus to be safe the secured creditors must register in both provinces. This is not only an increased cost and inconvenience; substantive risk is also increased. For example, if the secured creditor registers in a timely fashion in one jurisdiction but not in the other, the priority position vis-à-vis a competing secured creditor might be different in the two jurisdictions. It might be said that this risk can be avoided by good practice. But the counsel of perfection is always easier to give than to implement, and this is particularly so because of legal differences between the jurisdictions. Advance registration before the security agreement is actually entered into is permitted and common practice under the PPSAs, but under the CCQ the hypothec must first be in place. Thus simultaneous dual registration will sometimes not be possible. Secured creditors may therefore have to register in two different jurisdictions at two different times, significantly increasing the possibility of conflicting priority determinations. And when conflicting priorities do arise, it is not clear how they would be resolved. The cost of the uncertainty is not just the risk of being subordinated, but the risk of substantial litigation over an indeterminate question of law.

A uniform federal choice of law rule for security in federal IPRs would eliminate these burdens and uncertainties. It is true that the current lack of perfect provincial harmony means that secured creditors would continue to face the same problems in relation to other types of intangible collateral. However, the case for uniformity is particularly strong in respect of federal IPRs because, unlike other types of intangible collateral, federal IPRs have federal title registers. In the absence of uniformity, the registrar of the relevant federal IPR registry could potentially be faced with conflicting applications from different parties, each claiming the right to be registered as owner. Without a uniform federal rule, there is no easy way to fashion an appropriate resolution.

There is a second reason why implementation of the choice of law solution requires positive federal reform. As explained in detail in Part 5.4 below, the unqualified application of the secured

[100] Compare CCQ art. 307, "The domicile of a legal person is at the place and address of its head office," with e.g., NB PPSA s. 7(1)(b) "a debtor is located...at the chief executive office of the debtor, if the debtor has more than one place of business."

transactions law of the debtor's home province or territory would lead to unacceptable results in the case of a competition between a secured creditor and an assignee of a federal IPR who has registered federally (or between two secured creditors to whom successive federally-registered assignees of the same IPR have granted security). A specialized priority rule, designed to coordinate the interplay between the federal IPR registries and the provincial secured transactions regimes, is needed to adequately resolve such disputes. And, to ensure a coordinated and coherent policy that specialized rule must be articulated at the federal level.

5.3 Overview of Advantages and Disadvantages

One of the perceived advantages of the choice of law approach is that the same registration and priority rules would apply in cases where federal IPRs were included as part of a broader package of intangible collateral, e.g. along with the accounts receivable of the debtor, thereby lowering the costs of secured lending against this type of collateral. In fact, this advantage will not always be available. As we have just seen, a uniform federal debtor location conflicts rule for security in federal IPRs is needed to ensure uniformity of substantive result because of the existing variations in the provincial debtor location rules for security in intangibles. On the other hand, these same interprovincial variations mean that there will be some cases where the federal rule will lead to the application of a different substantive law for federal IPRs than for other categories of intangible collateral. Further, while reform may reduce the current uncertainty associated with choice of registration venue and the priority consequences of failure to register, general elimination of dual registration and searching is not possible given the existence of a federal ownership registry. While it is true that the federal system, discussed in Parts 6 and 7, requires dual searching and registration when a secured party wishes to take a security interest in all the debtor's property, non-IP as well as IP, the choice of law approach requires dual searching to discover prior transfers of IPRs whenever a security interest is taken in assets which include IPRs. We agree with Professor Wood's observation that "the elimination of dual searches is a quixotic enterprise in this particular field."[101]

[101] Wood (2001) at 38.

The second perceived advantage of the choice of law approach is that it would involve the expenditure of minimal law reform resources as compared to the federal approach discussed in Part 6. It is not clear that this perception is accurate. Part 3 of the Report has already showed that significant substantive reform of the existing federal IPR statutes is needed in any event to enable prospective secured creditors (and other third parties) to confidently and efficiently determine current legal title to federal IPRs. The legal and institutional reform required to implement the federal approach should be very modest. Moreover, the choice of law approach itself requires significant law reform efforts which would not be needed under the federal approach. This is because implementation of the choice of law approach would result in a severance of the law applicable to the registration and priority status of security rights in federal IPRs from that applicable to their ownership and assignment; the law of the debtor's location would apply on the security side, federal law (reformed along the lines recommended in Part 4) would apply on the ownership and assignment side. For the reasons canvassed in the balance of this Part, a significant investment of substantive and structural reform resources is needed if the resulting interplay between federal law and provincial secured transactions law is to work in a coherent fashion. Even then, there will be residual uncertainties in cases where the debtor is located outside of Canada, with the result that the content of the applicable secured transactions law is outside the control of both the federal and provincial levels of government.

5.4 The Coordination Challenge

5.4.1 Need for a Specialized First-to-Register Rule to Resolve Priority between Provincially Registered Secured Creditors and Federally Registered Assignees

The need to maintain the reliability of the federal IPR title registries (reformed along the lines recommended in Part 4) places some constraints on the extent to which a pure choice of law approach is capable of fully resolving the prevailing priority uncertainties faced by IPR secured creditors. In particular, the unqualified application of provincial secured transactions law to determine priority between a secured creditor and a federally registered assignee of a federal IPR would lead to unacceptable results. Under the extant provincial secured transactions regimes, a purchaser prevails over a secured creditor so long as the purchase is completed before the security is granted and registered.[102] Consequently, a prior assignee of a federal IPR would take free of a subsequent security right even if the assignee neglected to register its assignment in the federal IPR registry.

The provincial rules reflect the fact that outright sales of collateral are not registrable in the provincial registries. Whether the debtor has legal title to the described collateral is left to be determined by an examination of the background transactions by which the debtor purports to have acquired legal title. The rules were not designed to accommodate a situation where both interests are registrable, albeit under different registry regimes enacted by different jurisdictions, or, as here, by different levels of government.

It follows that additional substantive reform is needed to ensure coordination between the federal registration and priority regime applicable to outright assignments and the provincial registration and priority regimes applicable to secured transactions. The most obvious solution – and the most logical one in terms of preserving the benefits of reforming the federal title registries along the lines recommended in Part 4 – would be to supplement a federal choice of law rule deferring to the debtor's home law with a federal substantive priority rule ranking assignees and secured creditors according to the respective times of registration of their interests in the relevant federal IP registry and in the secured transactions registry of the province or territory where the debtor is located.

As an extension of this logic, in those jurisdictions in which judgment creditors may establish their priority vis-à-vis assignees generally by provincial registration, such registration would also the judgment creditor's priority vis-à-vis federally registered assignees.[103]

[102] All of the PPSA jurisdictions order priority between a secured creditor and a transferee according to whether the transferee acquired its interest before or after notice of the security was publicized by registration. If before, the transferee prevails unless he or she had actual knowledge that the debtor had already granted security. If after, the secured creditor prevails. See e.g. NB PPSA section 20(3). The result under CCQ art. 2663 is broadly similar except that a transferee of collateral prevails against an unregistered security even if the transferee had actual knowledge of the security at the time it acquired its own interest.

[103] Note that this implies that if an owner/debtor in the chain of title is located in Newfoundland, that province's judgment enforcement registry (established by the *Judgment Enforcement Act* S.N.L. 1996 c. J - 1.1) would have to be searched in addition to the personal property registry.

5.4.2 Potential Need for Chain of Title Searching of Multiple Provincial Registries

Under the priority rule suggested in the preceding section, prospective assignees would carry the burden of searching the secured transactions registry of the province or territory where the debtor is located to determine whether the debtor's federal IPRs are subject to a prior registered security right. This may seem to be a modest burden. In fact, chain of title considerations considerably complicate the inquiry exercise. If the current IPR owner is an assignee or licensee from the original owner, or if the relevant work is built on pre-existing creations, a prospective assignee must take into account the risk that the relevant IPRs are subject to security granted by one or more of the immediate registered owner's predecessors in title.[104] Consider the following hypothetical:

> *Debtor, located in Prince Edward Island, grants security in all its present and after acquired movable property. Secured Creditor registers notice of this security in the PEI Personal Property Registry. Without Secured Creditor's authority, Debtor assigns its federal IPRs to B1, located in Ontario. B1 registers its assignment in the relevant federal IP registries, and then assigns the same IPRs to B2 who also registers federally.*

Unless the Secured Creditor's right to follow the collateral into the hands of B2 is preserved in this scenario, security rights granted in federal IPRs would be vulnerable to destruction by the debtor's unilateral act of disposing of the collateral without authority. But to protect the secured creditor shifts the inquiry burden to latter assignees in the position of B2. As the chain of title grows longer, the inquiry burden on assignees becomes corresponding greater. It will not be sufficient simply to search the secured transactions registry of the province in which the current registered owner is located. To protect themselves, they will need to identify the names and location of all owners in the historical chain of title, and then search the registry systems in the province or territory in which each was located.

Moreover, secured creditors would face precisely the same onerous search burden. To protect

[104] For a detailed analysis in a U.S. context, see Brennan, (2001a), (2001b).

themselves against the risk that the immediate debtor/owner's IPRs are subject to a prior-registered security granted by a predecessor in title, they too will need to conduct full chain of title searching.

5.4.3 Lack of Debtor Name Uniformity

A further coordination complication is added by the fact that there is considerable variation among the different provinces and territories on the applicable legal rules for determining the correct name of a debtor for registration and searching purposes. This greatly complicates the inquiry burden for prospective assignees and secured creditors seeking to determine whether a federal IPR is subject to a provincially registered security right granted by a predecessor in title to the immediate registered owner. They will need to ensure that their search inquiry conforms to the debtor name rules of the province or territory in which each particular owner in the chain of title is located.

Further, there are at present no equivalent statutory or judicial rules governing the correct legal name to be used for the purposes of registering initial ownership or an assignment of ownership in the federal IPR registries. Consequently, without further reform, searchers would have no reliable means of verifying the correct legal names of each of the owners in the chain of title as disclosed by the federal IPR registries for the purposes of conducting provincial searches. This is a problem which does not arise in respect of secured transactions generally, since in the absence of a title register a prospective assignee or secured creditor will only search by the name of their immediate transferee/debtor searcher, in which case the exact legal name can be verified. In contrast, when searching for security interests granted by a remote owner in the chain of title, the searcher would have no information other than that revealed by the federal title register, and this will not always be sufficient to determine the correct debtor name according to the provincial rules. It follows that a security granted by a registered owner in the federal chain of title might be validity registered as a matter of provincial secured transections law yet be undiscoverable on a search using the name registered in the federal title register. Thus even after a provincial search against all the names revealed by a full chain of title search, there would be irreducible residual uncertainty.

Two steps are needed to fully address this problem. First, federal implementation of formal name rules for entering ownership and assignments of ownership in the federal title registries would be required. Second, uniformity between federal and provincial name rules is needed, and this requires uniformity between provinces. Both together are needed to ensure that all interests registered provincial can be discovered using a search by the name of a federally registered owner, and both steps raise problems.

First, how would formal name rules at the federal level be implemented? In particular, what would the penalty be for failure to conform to such rules? The problem of enforcing compliance with name rules is more difficult than under the provincial security systems because the rule used in provincial system, that a registration under a seriously misleading name is invalid, is unacceptable in a title system. It is true that if non-conformity resulted in a complete invalidity of the federal IPR registration, this would create a significant incentive for the initial owner and subsequent assignees to ensure that the rules were followed. However, it would seriously undermine the integrity of the title registry itself since an incorrect registration anywhere in the chain of title would invalidate the title of the current owner. How would a potential assignee, or indeed a secured creditor wishing to establish the debtor's title to the IPR, be able to ascertain whether a previous owner in the chain had registered under the correct name? Normally this information only becomes available in the event of conflict between two rival claimants. In general provincial secured transactions law this is acceptable as invalidity of the registration prejudices only the party who registered according to the incorrect name; but in the federal title system it would also destroy the title of subsequent purchasers.

A more palatable, less draconian solution would be to make the secured creditor's interest ineffective against a subsequent secured creditor or subsequent assignee if the debtor who granted the interest had not complied with the federal name rules applicable to registrations in the federal title registry. While this solution avoids the drastic result of wholly invalidating federal title registrations because of owner or assignee name entry errors, it presents its own compliance challenge. Such a rule would impose on secured creditors the practical burden of ensuring that the name of the debtor/owner as registered in the federal IPR registries conforms to the applicable federal rules even though the debtor would be the person initially responsible for effecting the federal registration in his or her capacity as the initial IPR owner or assignee. Thus it would not be enough for the secured creditor to ensure that it obeyed the relevant provincial or territorial name rules when registering notice of its security in the relevant provincial registry. The secured creditor would first have to ensure to ensure that all of the debtor's IPRs were registered in conformity with the federal name rules in the federal title register.

Further, this would only ensure that the debtor/owner in the chain of title was correctly registered according to the federal name rules. This in itself would not suffice to ensure that all security interests granted by prior owners would be discoverable if the federal name rules were not substantially the same as the applicable provincial name rules. In the absence of uniform criteria, provincial searches using the federally registered names of the owners in the chain of title, even if entered correctly under the federal name rules, would not necessarily disclose security interests granted and registered correctly under the applicable provincial name rules.

Thus uniformity in the applicable names rules, as between the provincial security registries *and* the federal ownership registries, is necessary to ensure that all provincially registered security interests in the chain of title are discoverable. Achieving federal/provincial uniformity is not straightforward because of the current provincial variations in the applicable debtor name rules. One approach would be for the federal name rules to require that registrations conform to all the potentially applicable provincial name rules, presumably by multiple registrations according to every provincial variation on what constitutes a correct legal name. This would vastly increase the registration burden and risk of error.

The need for this multiple registration at the federal level would be eliminated if uniform rules were adopted among the thirteen provinces and territories as well as between the federal and provincial levels. However, the likelihood of achieving this should not be overestimated given that even the PPSA jurisdictions have not managed to achieve uniformity to this point.

5.4.4 Additional Coordination Challenges in the Case of After-Created Federal IPRs

The ability to perfect a security interest in a debtor's future and after acquired property through a single registration is a very attractive feature of the existing provincial and territorial secured transactions regimes.[105] Replicating this in the federal IPR context is important in large part because many IPR intensive firms are constantly creating new IPRs. Under the provincial regimes, capturing after-acquired property is a simple matter of inserting a suitable generic collateral description in the registered notice of security.[106] But where the collateral consists of the debtor's after acquired federal IPRs, the existence of the federal IPR asset specific registries introduces complications even if we were to achieve perfect uniformity in the federal and provincial name rule. Consider the following example.

> *D grants security interest in all its present and after-acquired patents to SP, who registers a notice so describing the collateral against the correct debtor name in the appropriate provincial or territorial registry. D then obtains a new patent. In its patent application D identifies itself by an incorrect name and the patent is issued under that incorrect name with the result that the prior registered provincial notice claiming security in the new patent would not be discoverable by a prospective assignee or secured creditor who conducted a search against the name of the owner as registered federally. D then sells the patent to O2, who registers the assignment in the federal patent registry.*

If O2 were to prevail in a competition with SC, this would expose secured creditors who take security in after acquired IPRs to the risk of losing their security rights simply because D failed to enter the correct legal name when registering subsequent patents in the federal IPR registry. But if SC were to prevail, then it would not be sufficient for subsequent assignees in the position of O2 to

[105]See e.g NB PPSA sections 43(6)-(7).

[106]Because the federal registries are indexed and searched according to each specific item of IPR, it is sometimes thought that adoption of a federal registration-based substantive priority regime would impede the effectiveness of security interests granted in federal IPRs. We discuss this issue and its resolution below in Part 7.4.

ensure that their assignments are registered under their own correct name. O2 would need to also verify that the patent was initially registered under D's correct name to ensure that a search of the provincial registry using D's name will uncover the prior registered secured creditor's claim to D's after-acquired IPRs.

The additional burden faced by prospective assignees in the position of O2 in this respect parallels the prospective secured creditor's burden of ensuring that its prospective debtor's federal IPRs are all registered under the correct name that was discussed in the preceding section. Thus the desire to allow effective registration of security granted in after-acquired movables by a single provincial registration against the debtor's name means that both secured creditors and transferees will bear the burden of ensuring that their debtor's/assignor's federal IPRs are registered under the correct name in the federal IPR registries.

5.5 Possible Structural Solutions to the Coordination Challenges

5.5.1 Gateway Searching

Are there structural solutions capable of resolving these problems? In the United States context, a report by the Franklin Pierce Law Centre[107] ("FPLC Report"),commissioned by the USPTO, has proposed a one-stop gateway approach in which entry of a single query at a meta-search site would automatically search all the State Article 9 secured transactions registries and all the federal intellectual property ownership registries and return a single report. While the databases would be separate, in practice it would appear to the user as though only one registry was being searched.

Would construction of a common entry portal of this kind resolve or at least alleviate the inquiry burden on assignees and secured creditors who contemplate taking security in a Canadian IPRs? In theory, this solution would avoid the need to determine the precise provincial or territorial location of each debtor in the chain of title and to search each registry separately, since all registries would

[107] The FPLC Report is summarized in Ward & Murphy. It has not yet been formally accepted by the USPTO.

be automatically queried. Thus it would reduce the logistical burden of searching. (The fee implications of this approach would need to be worked out carefully, since querying all thirteen Canadian secured transactions registries for every owner in a long chain of title could be very expensive if the normal province-by-province tariffs were to apply. Presumably a revenue neutral solution would be possible, since an increased volume of queries would compensate for reduced fees for gateway searching.)

However, even at a logistical level, the advantages of a common gateway solution should not be exaggerated. The authors of the FPLC Report acknowledge that it would still be necessary to search the state secured transactions registries by debtor name for all predecessors in title to the immediate debtor whose names appear in the federal registry, but they imply that this process will be easy because the gateway approach allows a one-stop search of all databases.[108] While we agree that a common portal would provide a one-stop searching venue, it is incorrect to suggest that it would do away with the need for multiple searches. An initial separate search of the federal IPR registries would still be needed to establish the identity of the successive owners in the chain of title, followed by multiple separate searches of the provincial security registries according to the name of each owner in the chain of title. It would also be necessary to manually compare the timing of the provincial and federal registrations, for the purposes of resolving priority between a provincially registered secured creditor and a federally registered assignee.[109] Finally, a common gateway would not alleviate the search difficulties created by disharmony in debtor name rules discussed in the preceding section; independent harmonization of the provincial and federal rules and of the provincial rules *inter se* would still be needed to keep the registration and search burden manageable.

[108]The FPLC Report is not as clear as might be desired on this point. The entirely of the relevant discussion is as follows: "This integration [a meta-site or unified federal security interest registry] will make it possible to efficiently search UCC filings on grantors and grantees of record who show up under the various federal property numbers." Part VI.A.3, p64. Presumably owner name rules under the federal IP Acts would be amended to correspond to the state UCC rules, although the Report does not address this point.

[109]This problem does not arise in the current provincial system in which a security interest registered against a predecessor in title to the current owner is not discoverable except for those types of property for which asset indexing is required, in which case a subsequent interest taker takes clear unless the security interests was registered against that particular asset.

5.5.2 Debtor Name vs Asset Specific Registration/Search Criterion

The discussion to this point has assumed that provincial registrations and searches in relation to security granted in federal IPRs would be conducted according to name of the potential grantor of the security. But IPRs are already indexed by individual asset identifiers in the federal ownership registries, and asset indexing is not unknown to the provincial movable registries, which employ it for a restricted class of serial numbered goods.[110]

Provincial adoption of asset indexing for IPRs, using the federal IPR registration number, would alleviate the problems identified above stemming from the lack of uniformity in the debtor name rules of different jurisdictions. Asset indexing, in combination with a common gateway access to all the provincial registries, would also eliminate the need to conduct multiple searches against every owner in the chain of title to a federal IPR (although it would be necessary to conduct multiple federal and provincial searches for each individual item of IP).

However, there are problems with provincial asset indexing of federal IPRs which lead us to conclude that the benefits are not worth the complication and expense.

First, asset-indexing is not feasible solution for security in copyright. Copyrights do not have to be registered federally to come into existence. Yet to require provincial registration of the federal identification number would effectively force would-be debtors to first register all their specific copyrights federally before being able to grant an effective security in them. The federal registration burden would be particularly excessive for works of a kind that are continually evolving e.g. software. Moreover, even if this were considered worthwhile on a cost benefit analysis, copyrights cannot be reliably identified by reference to their individual federal registration numbers because the same work may be registered and described by two or more different names in the federal registry. Consequently, a search would still have to be made against the name of the owner/debtor.

[110]There is jurisdictional variation as to which items of collateral must be described by serial number. The PPSAs and the CCQ all require specific serial number registration for road vehicles. The non-Ontario PPSAs also require serial number registration for a number of other categories of high value uniquely identifiable tangible assets.

A second difficulty is that asset indexing, even if restricted to patents and trade-marks, would preclude provincial registration of an effective security interest in a debtor's future IPRs (because they could not be identified uniquely) or in generic categories of IPRs (because the cost and expense of entering an individual descriptor for each item within a generic portfolio of IPRs would likely outweigh the benefit). It is because of these considerations that the provincial registries currently restrict asset indexing to types of property that are both relatively durable and individually valuable: land and certain classes of personal property such as automobiles. In other words, asset indexing tends to be used only when the risk to subsequent transferees is highest and the burden relative to the value of the collateral is lowest. IPRs fall within an uncomfortable middle ground. They are relatively durable at least compared to most other categories of movable property and certain IPRs, such as a pharmaceutical patent on a major drug or the copyright on the flagship product of a software company, are individually very valuable. But other IPRs, such as the multitude of minor patents held by any firm with significant R&D may not be particularly valuable relative to the size of the loan and would be more efficiently charged *en masse* as simply "all IPRs" or even included as part of a charge on all the debtor's "present and after acquired property.[111]

It is unclear to us whether it would be possible to draw even a rough dividing line between those types of IPRs that might be efficiently indexed individually and those where a generic description would be commercially preferable. A middle ground solution would be to require registration by asset description for the security to be effective against subsequent secured parties or assignees. This would allow a secured party to exercise risk management by registering specifically where the value of the particular IPR makes the expense worth while and registering generically where the opposite judgment is made.[112]

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[111]In Part 6.3.4 below we a discuss a method of automatic cross-indexing in the context of the federal approach which would allow the grant of security interests in after-acquired property while preserving the ability to conduct asset based searches. In principle a similar system might be implemented provincially to overcome the problem described in the text accompanying this footnote. However, that approach would not be practical in the provincial context. The modified system would have to implemented thirteen times rather than once; and it is really only needed to address problems with IPRs, so that to implement it provincially would be a case of the tail wagging the dog.

[112]A problem with this approach is that a debtor in difficulty could milk the assets by granting security interests to a subsequent secured creditor who registered by asset description. This problem would be somewhat worse than in respect of the present class of serial numbered goods, as there is would be no strict cut-off below which it would not be necessary to register; ie the class of IPRs is not closed in the same way that the

At the end of the day, we are not persuaded that reform of the provincial registries to allow asset-indexing for security in IPRs is worth pursuing. The main advantage is to avoid the need to achieve interprovincial and federal/provincial uniformity in debtor name rules, and to alleviate the need for multiple debtor name searching back through the chain of title. While interprovincial uniformity as to the appropriate asset identifier should not be a problem for IPRs, uniform adoption by all provinces is likely to be since it would require a significant redesign of the existing hardware and software. Yet if the possibility of asset based indexing for IPRs was not uniformly adopted, the benefits would be significantly reduced. If there were even one non-compliant jurisdiction, it would be necessary to conduct a full chain of title search, determine if any predecessor in title in the chain was located in the non-compliant jurisdiction, and then conduct a name based search in that jurisdiction.

5.6 Irreducible Coordination Challenges in the Case of Foreign Debtors

The discussion to this point has assumed that we are dealing with a debtor/owner located in one or another of the Canadian provinces or territories. But not infrequently the owner/debtor will be located outside of Canada altogether. Consider for example the large number of Canadian patents issued to U.S. patentees.

We have seen that chain of title searching imposes significant hurdles in the way of the choice of law approach when only domestic debtor/owners are involved. The problems would be greatly exacerbated in cases where one or more of the owners in the chain of title is located in a foreign country. Application of the debtor location choice of law rule would mean that the secured transactions law of a foreign country would apply to determine the validity and priority of a security right granted by a foreign owner in Canadian IPRs, the manner and mode of publicizing it, and its priority ranking against third parties. This means that prospective assignees and secured creditors would need to search foreign registries in order to verify whether Canadian IPRs are subject to a prior registered security interest granted by a foreign owner in the chain of title. For example, any lender seeking to take security in Canadian patents belonging to a U.S. debtor would have to

class of serial numbered goods is closed. It is a judgment call as to whether the value of the IPR is too low to be worth registering, and a determined debtor could always grant interests in IPRs which fell below the line.

search the state Article 9 register of the state in which the debtor/owner is located. The same would be true if the lender was dealing with a Canadian debtor who had taken an assignment of the patent from an original U.S. owner.

Worse, many countries outside of North America do not operate general encumbrance registries of the kind established by the provincial and territorial secured transactions regimes in Canada and by Article 9 in the United States. Thus the law of the location of the debtor might not require or even enable registration of the security interest.

Because of the possibility that a foreign debtor/owner's home law does not provide for public registration of security rights, it would not be possible to state the rule governing priorities between a secured creditor and a federally registered assignee according to the respective order of registration of the security interest in the debtor/owner's home jurisdiction and registration of the assignee's interest in the federal IPR registries. Rather, a special rule to accommodate foreign debtor/owners located in a systems which lack a security registry would need to be crafted along the following lines:

> *Where the registered owner of a federal IPR is located outside of Canada, a subsequent assignee or secured creditor taking from or under the registered owner takes subject to any security interest granted by the registered owner if the secured creditor complied with all the requirements imposed by the secured transactions law of the jurisdiction where the owner was located for making a security interest effective against third parties.*

However, the practical result of such a rule is that any encumbrances granted by the foreign debtor may be entirely undiscoverable, in which event a prospective assignee or secured creditor will be forced to rely on the dubious security of the foreign owner's personal warranties and representations. Even then, it may be difficult to get satisfactory warranties if the foreign owner is a predecessor in title to the current debtor/owner.

It is true that most countries have established intellectual property registries to accommodate the registration of security rights in addition to ownership transfers in intellectual property, with the priority of the security right then determined wholly or partially in accordance with the order of registration.[113] However, these registries are territorially confined, like the federal Canadian registries, to intellectual property rights to be exploited within the borders of the particular country.[114] They are not designed to accommodate the registration of security in Canadian IPRs.

One possible solution would be to require secured creditors taking security in Canadian IPRs from foreign owner/debtors to register in one or another of the provincial Canadian secured transactions registries in order to prevail against federally registered assignees of the same IPRs. However, implementation of this solution is fraught with difficulties. There is no principled basis for choosing which of the provincial secured transactions regimes is to apply to security granted by foreign debtor/owners, leading to the risk of constitutional challenge on the basis of arbitrariness. While leaving the selection of the provincial registry up to the foreign owner/debtor might alleviate this problem, additional federal publicity rules would be needed to ensure disclosure to all interested third parties of the selected venue, thereby reducing the advantages of this solution in terms of a cost benefit analysis.[115]

5.7 Questionable International Status of a Debtor Location Choice of Law Rule for Security in IPRs

Despite its intangible nature, intellectual property has historically been treated as being just as territorially fixed as real estate. There is no universal concept of an intellectual property right. Even though international conventions may impose international minimum standards, intellectual property

[113] For an illustrative list of national registries and a summary description of their scope, see Brennan (2001a).

[114] The multilateral Madrid and Hague Systems constitute an exception. Under these systems, a trademark or industrial design owner in one of the member states can obtain protection for the mark or design in some or all of the other members by filing a single international registration with WIPO. These systems also accommodate the registration of changes of ownership as well as renewals (but not security interests). For further details, visit the WIPO web site: www.wipo.org.

[115] On all the points made in this paragraph, see generally Walsh.

rights still comprise a bundle of nationally-determined rights, the application of which is confined to the territory where the property is exploited. It follows that, as with land, intellectual property rights within each country are governed by the national law of that country.[116]

The territoriality principle that pervades intellectual property law, and its analogy to land, means that the location of the collateral as opposed to the location of the debtor or the current owner is the most widely accepted connecting factor for determining the choice of law applicable to the third party effects of property dealings in intellectual property, whether by way of sale or security. It is for this reason that the law governing the sale and grant of security in IPRs is typically integrated in most counties into a unified territorially-confined registration-based legal regime. This is the current rule in the United States with respect to copyright as a result of a Federal Court ruling in the famous *Peregrine* case.[117] It is true that reform efforts are underway in that country to return issues relating to security in copyright to the purview of state law, in particular Article 9. However, the debate is still controversial and even the Article 9 centred reform efforts contemplate close coordination with the federal law on IP ownership and its transfer.

It follows that even that even if the debtor location choice of law approach were adopted in Canada, its practical scope would be confined to Canadian IPRs. In view of the prevalence of the territorial principle internationally, a secured creditor taking security in a Canadian debtor's U.S. or European IPRs could not simply rely on compliance with the registration and priority rules of provincial secured transactions law. Any priority dispute involving the foreign IPRs would almost certainly be adjudicated in the country where they arise and the courts of that country would almost certainly apply their own substantive registration and priority rules to resolve it.

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[116]See e.g. Eugen Ulmer, *Intellectual Property Rights and the Conflict of Laws*, English trans., Deventer, Kluwer, 1978, Eugen Ulmer, "General Questions – The International Conventions", Ch. 21 in *International Encyclopedia of Comparative Law*, Vol XIV *Copyright and Industrial Property* (Eugen Ulmer, ed.) (J.C.B. Mohr (Paul Siebeck) Tubingen and Martinus Nijhoff Dorderecht, Boston, Lancaster: 1987); Graeme Austin, "Private International Law and Intellectual Property Rights: A Common Law Overview" (paper prepared for WIPO forum on private international law and intellectual property, Geneva, January 30 and 31, 2001); Fritz Blumer, "Patent Law and International Private Law on Both Sides of the Atlantic" (paper prepared for WIPO forum on private international law and intellectual property, Geneva, January 30 and 31, 2001); Martin Wolff, *Private International Law*, 2d ed (Oxford: Clarendon, 1950) at 547-48; James J. Fawcett and Paul Torremans, *Intellectual Property and Private International Law* (Oxford: Clarendon Press, 1998).

[117]*Re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (Bankr. C.D. Cal. 1990).

The fact that a uniform choice of law approach for Canadian and foreign IPRs is not practically feasible puts into question the wisdom of the debtor location rule as a solution to the current legal uncertainties facing secured creditors lending against federal IPRs. After all, if the debtor location choice of law rule ends up being confined to Canadian IPRs, but a territorial rule is applied to foreign IPRs, it would mean that a security interest in Canadian IPRs would bind third parties even though registered outside Canada (or not registered at all if the foreign secured transactions law did not require publicity) whereas a Canadian secured creditor lending to Canadian debtors against the security of their foreign IPRs would be required to conform to foreign registration and priority rules. It is not clear that the resulting prejudicial impact on the marketability of Canadian IPRs is justified.

5.8 Summary and Recommendations

The reforms recommended in Part 4 would improve the ability of prospective secured creditors to investigate a prospective debtor's legal title to the collateral, thus reducing one important source of the legal uncertainties identified in Part 3. But further reforms are needed to address the uncertainties in the priority of claims to the same federal IPR between competing secured creditors and between a secured creditor and a federally registered assignee. Part 5 addresses a "choice of law" approach to this second problem, while Parts 6 and 7 discussed a "federal" approach.

Under the choice of law approach, the federal government would defer to the law of the debtor's location as the law applicable to the registration, effects of registration or non-registration, and priority of security granted in any federal IPR. For Quebec debtors the relevant provisions of the CCQ would apply; for debtors located in the other provinces and territories, reference would be made to the relevant PPSA. For non-Canadian debtors, foreign secured transactions law would govern, e.g. French law for French debtors.

If this approach is adopted, we recommend that it be implemented by a federal choice of law rule specifying the law of the debtor's location as the applicable law. The alternative would be to remain silent on this point and allow the choice of law rules of the litigation forum to specify the applicable law. For litigation in Canada, this would also result in the application of the law of the debtor's location, but there is sufficient provincial variations at the level of detail that this approach would result in uncertainty and potential conflict in the applicable law. For similar reasons we recommend that federal law also specify a priority rule ranking assignees and secured creditors according to the respective times of registration of their interests in the relevant federal IP registry and in the secured transactions registry of the province or territory where the debtor is located.

The disadvantages of the choice of law approach stem from the fact that it severs the law applicable to the registration and priority status of security rights in federal IPRs from that applicable to their ownership and assignment; the law of the debtor's location would apply on the security side, federal law would apply on the ownership and assignment side.

This has two main disadvantages. First is the chain of title problem. In order to ascertain priority a prospective secured creditor must search the chain of title to the IPR federally and then search all the various registries corresponding to the location of the prior owners disclosed by that title search in order to determine whether those prior owners had granted prior security interests had been granted. Thus the existence of the federal title register makes searching significantly more complicated that in respect of traditional personal property. Further, lack of uniformity in debtor/owner name rules between provincial and federal registries means that valid security interests granted by prior owners may remain entirely undiscoverable, even after a full search. The only way to eliminate this source of uncertainty would be to implement uniformity in provincial debtor name rules. This in itself would be a major law reform undertaking. "Gateway" searching in which a single on-line portal would automatically query multiple registries, could relieve some of the technical burden of searching multiple jurisdictions, but it would not eliminate the need for multiple searches, nor could it eliminate the problems arising from lack of uniform debtor names.

The second main disadvantage of the choice of law approach is the foreign debtor problem. Under the choice of law approach security interests in Canadian IPRs granted by foreign owner/debtors would be valid encumbrances if adequately publicized according to the law of the debtor's location. This means that verifying encumbrances affecting an IPR could necessitate searching a foreign registry (and gateway searching would obviously not be possible). Worse, many countries outside of North America do not operate general encumbrance registries of the kind established by the provincial and territorial secured transactions regimes in Canada and by Article 9 in the United States. Thus valid prior security interests might be entirely undiscoverable.

6 Federal Substantive Approach

6.1 Introduction

This Part of the Report examines the alternative reform possibility that emerges from the previous research.[118] Under this second approach, the federal IPR statutes would be amended to explicitly provide for the federal registration of security rights in federal IPRs. Priorities between a secured creditor and an assignee, or between competing secured creditors would then be governed by the order of federal registration (i.e. the strict first-to-register rule recommended for competing assignees in Part 4 would be extended to secured creditors).

We have already noted that for the sake of brevity, this Report refers to this alternative reform approach as the federal substantive approach, or simply the federal approach.[119] However, the reach of federal law would be limited. First, it would apply only to federal IPRs. Provincial IPRs would be treated as general intangibles under existing provincial secured transactions law. And only security interests in federal IPRs themselves would be subject to the federal regime. Security interests in IPR related rights, in particular security interests in rights to royalty payments, would be excluded. And even with respect to security interests in federal IPRs themselves, the registration and priority rules of the secured transactions law in effect in the debtor's home province or country would be preempted only for the purposes of resolving a contest involving at least one federally registered claimant. If no secured creditor chose to register federally, priority would be resolved without reference to federal law; so too in a contest between a secured creditor and an assignee if neither had registered federally by the time their interests came into conflict.

The key difference between the choice of law and federal approaches would be the source of the priority rules. Under a choice of law approach, a federally registered assignment would be vulnerable to subordination to a prior security right granted and registered (if required) under the

[118] See e.g. Wood, Duggan, and Zimmerman for discussions of this second alternative. Zimmerman strongly endorses this approach; indeed she does not see any other solution as really feasible. Wood is more favourable to the choice of law solution while Duggan is ambivalent.

[119] See Part 1.1 above.

law of the debtor's location. In contrast, under the federal approach, both outright assignments and security interests would be registrable federally, and once so registered would have priority over any competing assignment or security which was not so registered. It follows that an assignment or a security right that was registered federally could never be subject to a security right granted and registered pursuant to the law of the debtor's location, but not federally.

Implementation of the federal solution would eliminate most of the problems that dominated our analysis of the choice of law solution in Part 5. The search burden would be simplified, as prospective secured creditors and assignees who intended to register federally would need to search only the federal IPR registries. There would be no need to search the secured transactions registries of the province or territory where the immediate debtor/owner, or any predecessor in title, is located. The reciprocal priority rights of secured creditors with federal IPR collateral would be subject to a single uniform registration venue and priority regime, so their priority status against competing secured creditors would not be vulnerable to change depending on the particular priority rules of the province or country where the debtor/owner happens to be located. The problem of difficult to search or undiscoverable security interests that might arise under foreign secured transactions laws where the debtor is located outside Canada would be eliminated since Canadian law, not foreign law, would govern exclusively. Finally, the federal approach would bring Canadian law fully in line with the widely accepted territorial approach to determining the third party effects of property dealings in IPRs.[120]

The remainder of this Part deals in greater detail with the scope issues that would need to be confronted if the federal substantive approach were to be implemented. In particular, which IPR-related items of collateral, and what precise range of priority disputes, would fall within the scope of the federal registration and priority rules?

Part 7 goes on to discuss the structural and operational reforms and related legal rules that would need to be addressed in the course of expanding the federal IPR registration system to accommodate secured transactions as well as outright assignments involving federal IPRs.

[120] See e.g. Austin, Walsh.

6.2 Scope of Collateral

6.2.1 Provincial IPRs

The principal argument in favour of the federal approach stems from the need to coordinate the rules governing the third party effects of the grant of security in federal IPRs with the existence of the federal IPR ownership registries. Because there are no ownership registries, either provincial or federal, for provincial IPRs, there is no reason to bring security interests granted in provincial IPRs within the scope of the federal substantive approach, even assuming this were constitutionally permissible. Rather they should continue to be governed by the secured transactions law applicable to other categories of intangible collateral.[121]

6.2.2 Trade-marks

6.2.2.1 Unregistered Trade-marks

Rights accorded to unregistered trade-marks under provincial law are provincial IPRs and as such would be excluded from the scope of the federal regime under the recommendation in the preceding section. It is true that once registered federally, a factually identical trademark may be entitled to protection as both a provincial IPR and a federal IPR. However, because the two sets of property rights are juridically distinct, there is no conceptual conflict in applying the federal registration and priority regime to disputes between competing secured creditors, or between a secured creditor and an assignee, where all the claimants are relying on federal law, and then applying provincial law to determine competing claims to the factually identical mark qua a provincial mark. Any operational conflict would then be resolved in favour of the person with the superior federal rights, as it has been held that federal registration gives exclusive rights to use the mark and is a complete defence to an action relying on provincial law.[122] While it would probably be desirable to establish

[121] As discussed in detail in Part 5, the existing provincial and territorial choice of law rules for registration and priority issues involving intangible collateral refer to the law of the location of the grantor of the security.

[122] *Molson Canada v. Oland Breweries Ltd.* (2002) 59 O.R. (3d) 607 (C.A.).

this rule more firmly with an express provision in the *Trade-marks Act*, the possibility of this kind of conflict should not be considered a disadvantage of the federal approach. Rather, it is inherent in the divided federal and provincial authority over trade-marks, as exactly the same conflict between provincial and federal trade-mark rights may arise when there is a competition between two parties who have independently begun to use the same mark, which only one party has registered.

6.2.2.2 Rights Under S. 7 of the *Trade-marks Act*

The federal *Trade-marks Act* provides two quite distinct sources of protection for trade-marks.

Registration confers one set of rights. For the purposes of claiming the benefit of those rights, it is correct to say that federal trademarks arise only on registration and are juridically distinct from rights granted to trade-mark owners under provincial law.[123]

However, section 7 of the *Trade-marks Act* confers a second set of rights on *unregistered* marks which is essentially identical to that provided to provincial trademarks by provincial law.[124] Although these section 7 rights are juridically distinct from provincial trademark rights, they arise independently of the federal trademark registry system and therefore do not raise the kind of problems presented by the need to reconcile the federal IPR title registry system with the rules governing priority between an assignee and a secured creditor or between secured creditors. Thus, even though the IPR rights arising under s. 7 of the Act are federal IPRs by virtue of their source, they would nonetheless fall outside the scope of a registry-based priority approach to federal IPRs.

[123]Confusion sometimes arises because the rights given in respect of a registered mark are very similar to the protection given to the owner of an unregistered mark under provincial law. For this reason it is sometimes said that registration does not give rise to the right, but only extends its scope nationally. This is not far from the truth as a practical matter, but it is strictly incorrect, as the *Trade-marks Act* is clear that the rights of exclusive use under the key sections of the Act are granted only in respect of registered marks: see the *Trade-marks Act* ss.19, 20 and 22.

[124]Sere s.7(b),(c) in particular. Somewhat surprisingly, the codification of provincial law found in these paragraphs has been held to be constitutional: see *Asbjorn Horgard A/S v. Gibbs/Nortac Industries Ltd.* (1987) 14 C.P.R. (3d) 314, 38 D.L.R. (4th) 544 (F.C.A.).

6.2.3 Unregistered Copyright

Copyright arises on creation of the work and does not depend on registration in the federal copyright register. Unregistered copyright is pervasive and important, as when software is in development or a film is in production. On the one hand it might be argued that since there is no title register for unregistered copyrights (by definition), these rights should be excluded from the scope of the federal approach. On the other hand, it would be practically feasible to extend the federal approach to permit registration by debtor name against a debtor's unregistered copyrights, and because of the need to resolve future priority conflicts in the event unregistered copyright collateral is later registered, there might be some advantages in so doing. We ultimately conclude that unregistered copyrights should be brought within the federal system, but because resolution of this issue is closely related to operational aspects of federal registry reform, further discussion is deferred to Part 7.[125]

6.2.4 Royalties and Other IPR Licensing-Related Collateral

The commercial value of an IPR stems from the owner's right to limit and control the use by others of the IPR without compensation. Control is typically exercised through contractual licensing arrangements, under which the owner-licensor authorizes a licensee to use its IPR in exchange for either an up-front payment or payments over time. The licensing transaction produces its own set of assets that can potentially be used as collateral by the IPR owner-licensor. These are the contractual benefits it derives from its licencing arrangements, most notably the stream of royalty payments owing by licensees.

Should the various revenues and contractual benefits associated with licensing transactions fall within the scope of application of a reformed federal substantive priority regime? Or should they continue to be regulated as a separate form of intangible collateral by the general secured transactions law of the province, territory or foreign country where the debtor is located?

[125] See Part 7.4.3.

We favour the latter solution. As we have seen, the principal argument in favour of a federal priority regime for secured transactions affecting federal IPRs derives from the existence of the federal ownership registries. Since there is no ownership registry, either provincial or federal, for IPR-derived royalty payments as distinct from the IPRs themselves, they should be treated no differently from assignments of provincial IPRs. Secured creditors would protect their security interest in royalty payments as they would an interest in any other accounts, by taking and publicizing their interest according to the law of the jurisdiction where the debtor is located. For Canadian debtors, this would make the relevant provincial or territorial movables registration the appropriate registration venue and priority regime.

In relegating security taken in royalties to the law of the location of the debtor, we are influenced by the further consideration that a federal substantive approach would intrude too greatly into the realm of general receivables financing. A secured creditor taking security in a debtor's general intangibles would lose out to a prior secured creditor (or a prior assignee) who had registered its claim to the royalties federally. In contrast, allowing such security interests (and assignments) to be governed by the law of the debtor's location ensures that all accounts and claims, whether derived from IPRs or otherwise, are governed by the same law. This solution also avoids having to resolve the difficult characterization issues that might otherwise arise. For example, would accounts due for technical support services provided by the licensor in respect of the licenced software be considered as royalty payments or as a separate account? Would it matter if the service agreement were in the original licence or in a separate contract?

This solution works well for security interests in royalties, but an outright assignment of royalties raises similar problems. However, this is true with accounts generally. For this reason, though the provincial and territorial registries are in general confined to the registration of security rights as opposed to the outright assignment of movables, by way of exception, provision is made for the registration according to assignor name of outright assignments of "accounts" or "claims" of the debtor against third parties.[126] Accordingly, it is possible, at least for Canadian owner-debtors, for

[126]See e.g. NB PPSA s. 3(2)(a) and CCQ art. 1642. But note that unlike the PPSAs, the Code sets out a different choice rule for priority issues relating to security in intangible claims than for outright assignments. The law of the location of the debtor applies to determine the priority of a secured creditor's claim, but in the

both assignees and secured creditors to look to provincial and territorial law to register and thereby ensure the priority ranking of their interest in the royalties.

The alternative solution would be to provide for federal registration of the existence of an assignment or grant of security in royalties. The main advantage of this approach is that it would eliminate the need for dual registration (in the federal and provincial systems) when the secured creditor wishes to take a security interest in the IPR and the associated royalties at the same time, as would commonly be the case, but not in any other non-IPR related accounts. We do not see this as a compelling advantage, since cases in which the secured party wishes to take a security interest only in IPRs and associated royalties but not in other assets would be relatively rare. And the burden of dual registration is not so large in any event as to counter-balance the advantages of a unified treatment of all accounts, no matter what the source.

In sum, we recommend that security interests in an owner-licensor's rights under a licence of an IPR, including the right to royalty payments and any other intangible rights, should continue to be treated as a separate form of collateral governed by the general secured transactions law of the province or territory or country in which the debtor-licensor is located. However, to ensure comprehensive priority ordering, we further recommend that to the extent the existing provincial and territorial regimes in Canada do not provide for the registration of the outright assignment of all IPR-related intangible rights, they should be amended to clarify this so as to enable both assignees as well prospective secured creditors to take advantage of the priority clarification and ordering potential of the provincial regimes.

6.2.5 Proceeds of IPRs

Should a secured creditor with security in a debtor's IPRs acquire an automatic security right in any royalties or other licensing benefits derived from the debtor's licensing transactions as "proceeds" of

case of an assignment, the assignee's priority rights are governed by the *lex situs* of the claim itself (i.e. the law of the jurisdiction where the person obligated to pay the royalty is located). The Code's failure to align the applicable choice of law rules for security and assignments produces priority uncertainties in the case of competing claims to the same claims or royalties between an assignee and a secured creditor and should ideally be repaired.

the original IPR? In a sense, the preceding discussion settles the issue so far as the possibility for resolving this question under federal law is concerned. The same considerations that dictated our conclusion that IPR-related proceeds in the form of royalty payments should not be subject to the federal regime as original collateral mean that they should not be subject to federal registration and priority rules insofar as they constitute proceeds.

This does not settle the proceeds issue entirely. It would be possible for federal law to give secured creditors an automatic right to claim proceeds derived from any federal IPR as collateral but then refer issues of registration and priority to the law of the debtor's location in the case of royalties and other forms of intangible proceeds. Alternatively, the provinces and territories might amend their secured transactions laws to give secured creditors an automatic right to claim proceeds of federal IPRs notwithstanding that the original collateral falls outside the scope of application of the provincial or federal regimes. However, it would be very difficult to implement this type of approach effectively, since some form of provincial registration would be required in either case. It would not be sensible to provide for provincial registration of a security interest in the IPR in order to perfect the automatic interest in the proceeds, given that the security interest in the IPR would not be within the scope of provincial law. And if a provincial registration is made in respect of cash or whatever form the proceeds are likely to take, then a separate automatic right in the proceeds is not required. In other words, it is impractical to provide for an automatic security interest in the proceeds of IPRs when the 'automatic' right must be perfected by registration in a different registry than the IPR itself.

Nor is such a right to proceeds necessary. A wide-ranging automatic proceeds right does not represent current secured transactions policy in Quebec.[127] The experience in that jurisdiction demonstrates that a secured creditor who desires an effective security right in proceeds can achieve it indirectly by contracting for and registering security in original collateral of the same generic kind that the proceeds are likely to take (e.g., accounts and other claims, money, cheques). We favour a similar contract solution in this context in the interests of simplicity. Even if the provincial regimes

[127]A secured creditor's right to proceeds under art.s 2674, 2677 of the CCQ is predicated largely on a theory of real subrogation, i.e. on the theory that the proceeds claim attaches only to property that replaces the original collateral as opposed to also including assets derived from a dealing in the original collateral.

were to directly recognize an automatic proceeds right, it would be necessary (as the Article 9 approach shows) to require provincial registration or some equivalent act of publicity suitable to the particular category of proceeds in order to adequately protect third parties. Since dual registration would be necessary under either approach we do not see any particular advantage in making the creation of the right to proceeds automatic as opposed to contractually-derived.

6.2.6 Licensee's Rights in Federal IPRs

In Part 4 of the Report we concluded that the adoption of a first-to-register priority rule for competing assignments should cover transactions that, while cast in the form of a licence, amounted in substance to the assignment of a partial interest in the IPR itself. In making that characterization, we further recommended drawing a distinction between exclusive and non-exclusive licences, with only the former to be treated as the equivalent of a (partial) assignment of the IPR itself.

Clearly, if the federal first-to-register priority regime is extended, as recommended earlier in this Part, to secured transactions covering federal IPRs, the same substance over form test should be applied in determining when the grant of security by a licensee-debtor is subject to that regime. For the reasons discussed in Part 4, we see this issue as turning on the distinction between exclusive and non-exclusive licences with only the former subject to the federal regime.

Federal authority over both the grant of security in and the assignment of exclusive licenses would have an additional benefit. The dividing line between the assignment and the grant of security in intangible assets is not always an easy one to draw. This characterization challenge is one reason why the drafters of the provincial secured transactions regimes decided to apply roughly the same registration and priority rules to both the assignment and grant of security in accounts and claims.[128]

A similar issue arises in respect of the interests of the holders of an exclusive IPR licence. A licence has some *prima facie* similarities to a security interest: a licensee often owes an obligation to make ongoing payments to the licensor, like a debtor does to a secured party, and the licensee's interest

[128] See e.g. NB PPSA s. 3(2) and CCQ art. 1642.

can be repossessed by the licensor for failure to make those payments.[129] So when is a licence to be considered a security interest? Is it necessary for federal law to adopt a substance over form approach to the question?

Under a choice of law solution to the priority of security rights in federal IPRs, characterization would be critical since registration in the wrong venue could render the interest ineffective at a priority level against third parties. The characterization issue becomes much less significant if both the assignment and the grant of security in exclusive licenses are brought within the scope of the same reformed first-to-register federal priority regime. If this is done, characterization would no longer be critical to the resolution of registration and priority issues. The same priority rule would apply in either case. A problem would remain if there were a distinction in the formal registration requirements for licences and security interests, in which case a true assignment which was incorrectly registered as a security interest would be ineffective against third parties. This problem can be avoided by designing the federal registration system so as to permit a common notice-based filing structure for assignments, exclusive licences, and secured transactions and we so recommend.

Characterization considerations also support bringing both the assignment and the grant of security in a licensee's rights under a non-exclusive license within the scope of the provincial secured transactions priority and registration regimes *qua* law of the debtor's location. This provides further support for our recommendation above to this effect.

6.3 Priorities

6.3.1 Secured Creditor vs Secured Creditors and Assignees

The essence of the federal approach is that federal registration of interests in federal IPRs is the principal priority ordering event for both secured creditors and assignees. But is it necessary to have a "pure" federal system in which a security interest which is not registered federally is entirely ineffective? Or is a "mixed" federal system preferable, in which a provincially registered interest is

[129] The issue was discussed in the drafting of the Revised Article 9: see Weise.

effective except in competition with a federally interest?

Our view is that the mixed system is preferable. Consider a priority contest between a secured creditor who has not registered federally and a competing secured creditor who has likewise elected not to take advantage of the federal priority regime. Since both parties have in effect elected not to place any priority reliance on the federal system, application of the registration and priority rules of the law of the debtor's location will not undermine the integrity of the federal records. The same would be true in the case of a competition between an unregistered secured creditor and an unregistered assignee.

In the well known and very controversial decision *Peregrine*[130] decision, Judge Kozinski favoured the opposite conclusion, holding that a security interest in copyright which was not registered in the federal registry was entirely ineffective against third parties, notwithstanding its registration in the state Article 9 registry. In his view, an exclusive federal system was preferable because it would limit searching by third parties to a single federal venue. This argument is unpersuasive. This same objective would be achieved even in a mixed system so long as federal registration, as outlined above, always trumped a competing interest claimed under the law of the debtor's location. Since federal registration would ensure priority over any competing interest that was registrable but not in fact registered federally, any person intending to register federally would only need to search federally. Any interests which were only registered or otherwise publicized in accordance with the law of the debtor's location could be safely ignored.

At this point we should re-visit our earlier recommendation[131] that the existing federal qualification on registration-based priority based on actual knowledge should be abolished in the context of a reformed ownership registry regime. It bears emphasizing here that it is essential to the effectiveness of the mixed federal approach that this policy also be adopted in respect of security interests. The holder of a federally registered interest must have priority over an interest that is not registered federally even if the interest in question was registered or otherwise publicized under the law of the

[130] *Re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (Bankr. C.D. Cal. 1990).

[131] See Part 4 above.

debtor's location, notwithstanding actual knowledge of the interest. In the case of Canadian debtors, situations of actual knowledge are likely to be very common as a result of general searches conducted in the provincial movables or personal property charge registries. If knowledge acquired in this way were to affect priority, the mixed federal approach would be fatally undermined.

6.3.2 Secured Creditor vs Debtor's Insolvency Administrator

In our view, there is likewise no need to make federal registration the exclusive means of establishing the effectiveness of security granted in federal IPRs against the debtor's insolvency administrator. The main purpose of requiring publicity here is to provide objective evidence of the existence of the security, thereby deterring fraud and easing the information burden faced by the insolvency administrator. Publicity has no effect on priority ranking in the sense of the first to register principle; rather, it is necessary merely to establish the effectiveness of the security right against any subsequent insolvency administrator. Given this function, there is no reason why the federal regime needs to be the exclusive mechanism for publicity. So long as the secured creditor has satisfied the publicity requirements of either the federal regime or the regime in place in the jurisdiction where the debtor is located, the purposes underlying the publicity rules are adequately satisfied without in any way undermining the reliability of the registry record.

6.3.3 Secured Creditor vs Debtor's Judgment Creditor

The situation with respect to judgment creditors of the debtor is a little more complicated. Under the CCQ, registration converts a judgment into a legal hypothec, giving the judgment creditor the benefit of the same first to register priority principle that applies to consensual security rights.[132] A growing number of the common law provinces have adopted a similar policy.[133] The rationale is a compelling one. This approach indirectly promotes the prompt satisfaction of judgment debt without the expense and burden of having to pursue active judgment enforcement measures. Once

[132]CCQ art. 2730.

[133]See, e.g., sections 2.2-2.6 of the NB *Creditors' Relief Act* combined with section 20(1) of the NB PPSA..

publicized by registration, the judgment debtor cannot easily dispose of its assets to third parties, or use them as the object of consensual security, without first paying the judgment debt and terminating the prior-ranking registered judgment creditor's claim. We conclude that the same policy should be adopted federally. That is to say, the scope of the reformed federal system should accommodate the registration of a notice of judgment by an IPR owner's creditors, with priority against competing registered interests ordered by the order of registration.[134] Of course, to maintain the integrity of the federal register as the sole authoritative source of priority ranking, federal registration would be essential to secure the judgment creditor's priority in competition with another federally registered interest, just as would be the case for a secured creditor seeking to publicize its interest. But as with secured creditors, if the judgment creditor elects not to take advantage of this possibility, there is no reason why it should not still enjoy the benefit of whatever priority status it might obtain under the law of the debtor's location as against interests that are not themselves registered federally.

6.3.4 Secured Creditor vs Debtor

The point of a substantive registration-based priority regime is to protect third parties and to achieve an efficient system of priority ordering. Since these concerns have nothing to do with the rights of the debtor and secured creditor *inter se*, a reformed federal priority regime should make it clear that failure to register federally does not affect the enforcement remedies against the collateral available to the secured creditor vis-à-vis the debtor under otherwise applicable law.

6.4 Federal Approach to Validity and Enforcement?

The discussion to this point has assumed that federal reform of the rules governing registration and priority of federal IPRs is sufficient to address current sources of legal risk faced by secured

[134]The priority effect of registration as against other judgment or unsecured creditors, however, should perhaps be left to the law of the debtor's location to decide. Under current provincial and territorial law in Canada, a judgment creditor normally has to share the dollar value of its priority pro rata with the debtor's judgment creditors even outside of formal bankruptcy: see e.g. the various provincial *Creditors' Relief Acts* and the more recent Alberta and Nfld *Judgment Enforcement Acts*. A choice of law reference on this point would therefore appropriately respect Canadian policy in the case of Canadian debtors. The other alternative would be to enact a similar substantive policy federally. On this point, we have no firm opinion as to which solution would be preferable.

creditors (as well as prospective assignees). In principle, however, it would be possible to take a more holistic approach in which all secured transactions issues would be dealt with by a comprehensive federal "Security in Intellectual Property Act."[135]

Such a holistic approach would not be significantly more difficult to implement. Registry system reform is required primarily to accommodate a reformed priority regime. Addressing issues of validity and enforcement would be primarily a matter of substantive drafting.

There would be certain advantages in addressing non-priority secured transactions issues federally. For example, specialized enforcement procedures might be useful for IPRs and enactment of a comprehensive enforcement regime would avoid the need to amend the provincial systems and territorial systems in this respect. It would also allow more effective integration of enforcement and title issues, as it would be straightforward to provide for transfer of ownership as an enforcement mechanism.

A comprehensive federal Act would also avoid the need to resolve the difficult question of the law applicable to the substantive enforcement rights of a secured creditor on the debtor's default, a question on which there is no consensus as to the appropriate choice of law rule at present. This is a particularly relevant concern in the case of foreign debtors. For Canadian proceedings, uncertainty on this matter could be resolved through federal legislation recognizing the effectiveness of the provincial or territorial enforcement processes. But what is or should be the effect of a foreign judgment ordering the transfer of ownership in a Canadian IPR?

On the other hand, many of these issues might be adequately addressed by reform at the provincial level and minor complementary reforms at the federal level.[136] And certainly the primary source of uncertainty in IPR based secured lending is at the priority level. Thus although we see some advantages to a more comprehensive federal regime, we are not inclined to make any positive or

[135] See e.g. CBA proposal for an "Intellectual Property Personal Property Security Act."

[136] See Part 8.5 discussing reforms which would ease federal acknowledgement of the effect of provincial enforcement proceedings.

negative recommendation on this matter. Our report has addressed the major issues of prior reform identified in the previously solicited research. A good deal of additional research and thinking would have to take place before any more general recommendation could be made on more comprehensive federal reform. This is a matter on which the Law Commission might usefully consult in the course of seeking input into this report.

6.5 Summary and Recommendations

The alternative to the choice of law approach is a federal approach under which the federal IPR statutes would be amended to explicitly provide for the federal registration of security rights in federal IPRs. Priorities between a secured creditor and an assignee, or between competing secured creditors would then be governed by the order of federal registration. That is, security interests as well as outright assignments would be registrable federally, and once so registered would have priority over any competing assignment or security which was not so registered.

While we refer to this as a federal approach, the reach of federal law would be limited in the version which we recommend. First, it would apply only to federal IPRs. Provincial IPRs would be treated as general intangibles under existing provincial secured transactions law. Further, only security interests in federal IPRs themselves would be subject to the federal regime. Security interests in IPR related rights, in particular security interests in rights to royalty payments, would be excluded. And even with respect to security interests in federal IPRs themselves, the registration and priority rules of the secured transactions law in effect in the debtor's home province or country would be preempted only for the purposes of resolving a contest involving at least one federally registered claimant. A security interest in a federal IPR which was only registered provincially, though subordinated to any federally registered interest, would nonetheless be effective to establish priority against any interest which was not registered federally, and as against the debtor's insolvency administrator.

7 Structural and Operational Reforms of the Federal IPR Registries to Accommodate the Federal Approach

7.1 Introduction

If a reformed federal IPR registry system is to provide effective public access to information about potential security rights in federal IPRs, it must be accessible, efficient, transparent, and cost effective. For the most part the necessary reforms should be undertaken in any event to modernize the title aspects of the federal IPR registries. These legal and design issues were discussed in Part 4. In this Part we look at the reforms to the federal system which are specific to security interests and which, accordingly, would be needed only if the federal approach to security interests in IPRs were to be adopted.

7.2 Notice-Registration versus Document-Filing

The most basic specific reform to the federal registries needed to implement the federal approach to security interests in IPRs is simply to make specific provision for the federal registration of security interests. This should be technically very minor if carried out in conjunction to the title-side reforms discussed in Part 4.

Legally, a choice must be made between a document filing approach and a notice filing system. Unlike a document-filing registry, a notice-registration system does not require the actual security documentation to be filed or even tendered to the registry.[137] Instead, registrants submit a separate notice of the security right in standard format, setting out only the basic factual particulars needed to alert third parties to the potential existence of a security right against the identified debtor's identified assets.

There is a widespread consensus on the superiority of notice-registration over document filing in the

[137] There is some ambiguity in usage as to whether notice filing is simply opposed to document filing or automatically implies perfection of after-acquired property. We use it in the former sense. The issue of whether a single registration can capture after-acquired property is separate and is addressed later in this Part.

context of a secured transactions registry. Notice-registration dramatically reduces the registry's administrative and archival costs, owing to the minimal nature of the registered particulars and the fact that they subsist in a standardized notice format, independent of the actual charge documentation. These same factors facilitate the efficient operation of multi-lingual registries, the efficient computerization of the registry record and registry access, and more effectively protect the privacy concerns of both the secured creditor and the debtor.

Notice-registration is also superior from the point of view of reducing transaction costs for registry clients. Instead of having to wade through complex lengthy documentation, third party searchers can quickly and efficiently access the essential particulars. From the point of view of secured creditors, notice-registration reduces their ongoing registration burden. The terms of their security agreement can be amended in response to ongoing circumstances without the secured creditor having to worry about rectifying the registration record so long as the changes do not affect the registered particulars. Indeed, notice registration makes it possible for registration to take place even before the charge transaction is completed, and to have a single registration cover successive agreements between the same parties.[138]

The superiority of a notice registry for secured transactions has been widely accepted in Canadian law. The federal *Bank Act* registries and the provincial movables registries are all notice registries and the same model has been proposed for security in land.[139] There is no reason why notice filing would be any less advantageous in respect of a registry for security in intellectual property.[140]

Accordingly, we recommend that notice filing be adopted in any federal registry system that might

[138]See e.g. NB PPSA s. 43(5)-(6).

[139]See Siebrasse and Walsh, *Proposal for a New Brunswick Land Security Act.*

[140]The only suggestion to the contrary in the prior research is found in the Statement of Marybeth Peters, U.S. Register of Copyrights, before the Subcommittee on Courts and Intellectual Property on Recordation of Security Interests in Intellectual Property 106th Congress, 1st Session June 24, 1999. Peters' objections, which are based on lack of information in the public record, are not specific to secured lending in respect of IPRs, but apply to any form of secured lending. In view of this we believe that experience with notice-registration under the PPSA and Article 9 demonstrates conclusively that her objections are entirely without foundation.

be established for security in federal IPRs.

7.3 Integrated or Separate Federal Security and Ownership Registries?

A federal registry-based priority regime can be implemented in different ways, depending on the degree of unification of the federal IP registries that is feasible and desirable.

Perhaps the most obvious approach, and the one we have assumed to this point, would be to adapt the existing separate federal IPR registries to accommodate more efficient registration and searching; that is, security interests and assignments affecting registered copyright would be registrable in the copyright registry, patent related security interests and assignments would be registrable in the patent registry, and so forth.

Alternatively, a unified encumbrance registry for all types of IPRs could be established. This alternative itself can be further broken down. The current separate federal IPR registries might be maintained as ownership registries only and a new unified registry could be established for security interests (and for notices of judgment or other non-consensual encumbrances) in all categories of federal IPRs. Another option would be to integrate all existing and proposed federal IPR registries into a single "grand unified" IPR registry that would provide a single registration venue and priority regime for all types of interests, ownership and encumbrances, for all types of federal IPRs. This option would avoid some of the coordination challenges that would arise with separate registries, but it might well present significant technical hurdles, particularly to the extent different search fields would have to be programmed into the system for the different kinds of IPRs.

In our view this issue is not central. The advantage of either type of unified federal registry is that it would provide a 'one-stop' search and registration venue. But this can equally well be achieved using a gateway approach to searching multiple registries in which a single search at an electronic meta-site would automatically be routed to all relevant registries with the results returned as a single report. Thus to the user, the registry would appear to have only one data base, no matter how the data bases are configured technically.

In the discussion in Part 5 of the choice of law solution, we noted that one impediment to the effective implementation of a gateway concept as between a federal registry and the provincial and territorial registries was the difficulty of achieving uniform debtor name rules among all fourteen interested levels of government. Under the federal approach, coordination would not present the same difficulty even if separate federal IPR registries were maintained since all would fall within federal jurisdiction. There is no substantive reason for different name criteria for the different federal registries and if they were modernized it should be very straightforward to ensure standardized rules. Once this is accomplished, the legal problem is solved and the issue of whether the federal IPR registries should be unified either wholly or in part turns into a purely technical question of whether it is easier to build a unified gateway or an entirely new registry.

7.4 After-Acquired IPRs and Asset-Based Registration and Searching

7.4.1 Introduction

It is sometimes suggested that because the federal registries are indexed and searched according to each specific item of IPR, adoption of a federal priority regime would impede creditors who hold security in the whole of a debtor's present and after-acquired movable assets from effectively perfecting their security in the debtor's after-acquired federal IPRs so as to ensure priority over competing claimants. We believe this concern is ill-founded. After-acquired property presents no more of a challenge under the federal approach than it would under the choice of law approach. Indeed, with a properly designed federal registry the federal approach can deal with the issue more effectively than can a choice of law approach because of the absence of any need for coordination with the provincial and territorial registry regimes and the elimination of the problems posed by foreign country debtors.

7.4.2 Priority of Security Granted in Other Categories of After-Acquired IPRs

7.4.2.1 Basic Solution

Difficulties arise in respect of after-acquired property because of the specific asset based indexing and searching system currently used for the federal IPR registries. Leaving aside copyright, which is discussed in the next section of this Part, it is the desire to allow reliable asset-specific searching that puts obstacles in the way of permitting a single federal registration to cover a debtor's present and after-acquired federal IPRs. If a searcher is to be able to find all interests, including security rights, in a specific IPR using an asset based search alone, then all interests must be indexed and searchable according to an asset-specific identifier. Since any IPRs that the debtor later acquires are not owned by the debtor at the time the security agreement is entered into (and may not yet even be in existence), it is obviously not possible to index the security interest by reference to the IPR itself.

Traditionally in asset indexed systems, such as land titles, a lender who has taken security in after-acquired property is entitled to register against new property as it is acquired by the debtor, but the security does not take effect, at least as against third parties, unless it is specifically so registered. This need for ongoing asset-specific registration makes financing based on after-acquired property much less efficient. It is particularly problematic where the debtor, as is not uncommon in the IPR context, is constantly acquiring new assets within the same generic category on an ongoing basis.

The choice of law approach addresses this problem by abandoning the principle that a searcher should be able to discover all interests using only an asset-based search. As described in Part 5, a searcher who wished to find all encumbrances against a particular IPR would have to first search the federal ownership registry to determine the chain of title, and then search the secured transactions registries by debtor name in the jurisdictions where the debtor and each antecedent owner is located (to the extent such registries actually exist in the case of foreign country debtors).

Exactly the same method could be adopted under a federal substantive approach if a separate federal name-indexed registry were to be created for security interests and other registrable interests and encumbrances in IPRs. A single registration would then be effective to establish the priority ranking of a security right in all the debtor's after-acquired IPRs. A searcher would first search the federal ownership registry to determine the chain of title to the relevant IPR and then search the federal encumbrance registries for encumbrances granted or registered against all owners in the chain.

There would be some inconvenience for searchers in assessing the search result since it would be necessary to determine whether a predecessor in title had acquired title to the relevant IPR when the security was granted in order to know whether the security right was effective. But, as we saw in Part 5, this same inquiry burden and inconvenience would also arise under the choice of law approach. A secured creditor or transferee would also bear the burden of ensuring that the name of the debtor/transferor from whom it acquired its interest was validly registered, but again, the same inquiry is necessary under a choice of law approach.

In other respects the federal solution would greatly reduce the inquiry burden on third parties as compared to the choice of law solution. It would only be necessary to search the federal registry system rather than having to make inquiries in each jurisdiction where the debtor and the debtor's predecessors in title are located. This may not be a decisive advantage, as we have seen that for Canadian debtors the problem of searching multiple provincial or territorial registries under the choice of law approach could be ameliorated using a gateway search technique.[141] The more important advantage of the federal substantive reform model is that it would eliminate the problem of debtor name uniformity and the foreign debtor problem which arise under the choice of law approach.

[141]Part 5.5 above (although note that the level of federal/provincial and interprovincial cooperation that would be needed is quite formidable).

7.4.2.2 Automatic Cross-Indexing of Name and Asset Records

7.4.2.2.1 Overview

A more sophisticated approach to after-acquired property, which still would enable true asset-based searching, is possible under an appropriately designed unified federal ownership/encumbrance registry system. It should be possible to design the system so that when a new IPR is indexed against the debtor's name the system would automatically search for prior security interests registered against that same name and then automatically re-register a notice against the specific asset.[142] For convenience we will describe such a system as an automatic cross-indexing system. If implemented, automatic cross-indexing would greatly reduce the burden of providing specific asset descriptions in the initial registration as well as allowing automatic registration for priority purposes of security rights in after-acquired IPRs.

To effectively automatic cross-indexing, uniform name rules would have to be developed and applied to all registrable interests, not just security rights. Otherwise, the necessary matching between the asset and name indices would not necessarily reflect all interests. Further, a specific check box or field on the registered notice would be needed to enable registrants to indicate whether the underlying security agreement covers after-acquired property so as to create an automatic trigger for cross-indexing to occur.[143]

The system could be implemented in either an archival system or a title guarantee system,[144] though it would be more certain under a title guarantee system. The system would operate by matching the debtor name against which the security interest is registered with the name of the owner of any

[142] That is, either debtor-owner name or asset description could be used as search criteria; a search by name would disclose all IPRs belonging to that person; conversely, a search by asset description would reveal the owner and any encumbrances. This approach is based on Siebrasse & Walsh, *A Proposed Land Security Act for New Brunswick*, s.15 Priority of Judgment Creditors, p.51, "Priority in After-Acquired Lands."

[143] In the case of registered judgments, we assume that the cross-indexing system would be triggered in every case since the advantage of registration for judgments is precisely to capture after-acquired assets of the judgment debtor.

[144] See further Part 4 for a comparison of the two kinds of systems.

newly registered property. In an archival system the most recently registered transferee is not definitively the owner, since ownership depends on the efficacy of the instrument itself, which is not assessed on registration. An invalid transfer in the chain of title will invalidate the security interest. As a practical matter this should be a relatively minor problem.

7.4.2.2.2 Manual or Computerized Cross-Indexing

In principle, a cross-indexing system could be implemented even in a manual or paper based registry system. A rule could be implemented that whenever a party seeks to have title to a federal IPR registered in his or her name, he or she must present a recent search result of the debtor name index using his or her name. If the search result discloses a prior registration of a security right covering the applicant's after-acquired IPRs, the registry staff would then register that security interest against the new IPR.

However, as a practical matter, a cross-indexing system would need to be electronic in order to implement the automatic perfection feature efficiently. A paper-based system would be more costly than a computerized system because of the extra paperwork and searching required on the part of both the registrant and the registry staff. These costs would be incurred in respect of each registration, even when there was in fact no prior security covering after acquired IPRs. Nor could such a system provide the same level of security as an automated system.

7.4.3 Copyright

7.4.3.1 Copyright and Asset Based Searching

Asset based searching is not feasible for copyrights. Asset based searching requires a unique identifier for each property such as a motor vehicle serial number or a geographical parcel identifier in the case of land. This criterion is clearly satisfied for patents and trade-marks which are assigned unique identifiers on registration. Copyrights, however, are probably incapable of being sufficiently reliably identified to form the basis for asset based searching. Asset indexing under the current copyright registration system is by reference to the title assigned to the copyright work by the registrant. But the title of the work is probably not an adequate identifier for the purposes of asset based searching.[145] Unlike a motor vehicle serial number or a patent number, the title of a copyrighted work is not unique. Different works with the same or similar titles are common. Thus, without actually comparing the two works, a prospective secured creditor cannot determine by a mere registry search whether the song "Loving You" which already has a security interest registered against it is different from the song of the same title which their debtor is proffering as collateral.[146]

An even more significant hurdle arises from the fact there is no single legal title of a copyrighted work. The title of a work for the purposes of registration is whatever the copyright owner says it is. How can a searcher know whether the book "Revolt in the Desert" which is unencumbered is different from the book "The Seven Pillars of Wisdom" which has a security interest registered against it?[147] The current provincial systems for serial numbered goods are premised on the notion that the serial number is in fact a unique identifier, and the dispute is largely as to when the burden of registration by serial number should be imposed. In contrast, if asset based searching were implemented for copyright, it would be necessary to provide special rules to determine priorities when the security interest was not discovered because the title of the work it was registered against was not the title which the third party used to search, recognizing that neither title can be considered the true title.

It might be suggested that the CIPO could assign a unique number to each federally registered copyrighted work, but in order to ensure that the same work was not registered twice under

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[145]"The copyright registration system is based on the title of the registered work. In a situation where the author grants a security interest in a work whose title has changed, it becomes impossible to verify the ownership of rights in this work, any prior licences or assignments therein or even other security interests previously granted. One can easily imagine the schemes to which an unscrupulous debtor might resort in order to hide from a creditor the registration of another security interest in the same work." Spring- Zimmerman et al. at 23.

[146]Of course the secured party can always ask for a warranty from its debtor that the debtor was the first author, or other assurances that the work in question is different from the encumbered work. But if the secured party is willing to rely on warranties from the debtor then there is no need for a registration system.

[147]*Revolt in the Desert* is the title given by D.H. Lawrence to his abridgment of *The Seven Pillars of Wisdom*.

different titles and so assigned different numbers, the copyright office staff would have to examine the works themselves and compare them to already registered works. The administrative burden and consequent cost makes this impractical. Thus, though asset based searching could be mandated for copyright, it would be so unreliable as to be scarcely worthwhile.

In brief, reliable rules for determining the correct legal title of a copyright work for the purposes of registration and searching would be impossible to implement. Thus it is not possible to implement a federal registry system for security in copyright in which a search by copyright title would be guaranteed to find all encumbrances against the asset. A debtor name search would be necessary (although even then the secured creditor would have to physically compare the content of the works registered against the debtor's name against which any encumbrances or assignments have been registered with the content of the works bearing a different title proffered as collateral.) This has the convenient further consequence that a system for registering and searching security interests in after-acquired copyright could be straightforwardly implemented by reference to debtor name as in the provincial security systems, without the need for automatic cross-indexing against the specific work,

This is not to say that copyrighted works should no longer be registered by title. Rather, we are simply of the view that it is not necessary to implement a system in which registration of a security interest against a debtor's copyrights would be invalid if the title of the copyrighted works was not correctly specified. However, description of the collateral by reference to the title of the works would still be useful in order to disclose the precise scope of the collateral covered by the security interest.

7.4.3.2 Unregistered Copyright

A secured creditor who takes security in a debtor's unregistered copyrights needs to be assured that it will not be defeated if the debtor subsequently registers the copyrighted works and then grants security or assigns the copyright to a secured creditor or assignee who registers federally. There are two ways in which the secured creditor could protect itself depending on whether or not security in unregistered copyrights is excluded from or included in the federal registry system applicable to security in copyrights.

If security in unregistered copyrights were excluded from the federal registry system, in order to fully protect its interest the secured creditor would need to register in the appropriate provincial or territorial security registry and then register promptly in the federal registry as soon as the debtor registered the copyrights federally. Provincial registration would protect the secured creditor's priority against subsequent secured parties and subsequent transferees so long as the copyrights remained unregistered but prompt federal registration would be necessary to preserve priority once the copyrights were registered as against a subsequent federally registered assignee or secured creditor.

However, to protect its interests the secured creditor would have to constantly monitor the federal copyright registry for new filings by the debtor in order to ensure that its security right is registered federally in sufficient time to preserve priority against a new secured creditor who registers federally. The secured creditor would also be liable to being defeated if the debtor assigned the copyright, still unregistered, to a new owner who then registered federally and granted a security interest in the now registered copyright.[148] In that case a federal search by the new secured creditor against the current owner's name would not disclose the security interest granted by the prior owner. In order to preserve the primacy of the federal register it would be necessary to provide that the first security interest would be ineffective against another secured party who registered federally against the name of the new owner, even if the first security interest were effective against the new owner under provincial rules regarding priorities between secured creditors and transferees. An express rule to that effect might be needed, depending on the wording used to exclude unregistered copyright from the scope of the federal system.[149]

Alternatively, security granted in unregistered copyrights might be included within the federal registry

[148]Or if the new owner had a prior federally registered security interest in its after-acquired copyright.

[149]Note that a similar problem arises in principle in respect of unregistered trade-mark. In that case the rule, derived from the *Trade-marks Act* itself, that a federal registration is a complete defence to an infringement action based on the provincial trade-mark rights (see the discussion in Part 6.2.2.2) serves to protect the primacy of the federal register.

system from the outset. The result would be that a single federal registration is all that would be needed to fully protect a security interest in both registered and unregistered copyright. This would mean that a potential assignee of the unregistered copyright would have to search the federal register in order to ensure there were no prior security interests. But the assignee would have to search for prior assignments in any event, so this is no additional burden.

The general argument against including provincial IPRs in the federal priority system is that it would be difficult to specify them all, and there is no particular advantage to including them. These arguments do not apply to unregistered copyright. As we have just seen, the federal registry system for security in copyrights would be debtor name indexed in view of the lack of reliability of asset descriptor indexing, a feature that would permit a single federal registration to cover all after acquired copyrights of the named debtor. Under this second approach, federal registration of a previously unregistered copyright by the owner would thus be treated in exactly the same way as the acquisition of a new copyright by assignment from a previous owner. In both cases the newly acquired work would be encompassed by a federal registration against all of the debtor's present and after-acquired copyrights.

7.5 Gateway Registration

One advantage sometimes claimed for the choice of law reform approach is that it would enable secured creditors to take advantage, at least where Canadian debtors are involved, of the provincial secured transactions rules facilitating the grant and registration of security interests in a debtor's present and after-acquired movables generically described.[150] However, just as a common gateway system can be established to reduce the search burden in a choice of law system,[151] so too can it be used to reduce the registration burden under a federal substantive approach. We have just seen that our recommended federal system would adopt notice filing for registering security in federal IPRs and automatic cross-indexing so as to make it possible to register a security interest in

[150]See e.g. CCQ art. 2666, 2670, 2710, NB PPSA s. 1 (definition of "security interest" and "personal property"), s. 10(1)(b) (generic collateral descriptions), s. 13 (after acquired property).

[151]See Part 5.5 above.

IPRs by debtor name rather than by specific asset. If these initiatives were implemented, then a gateway approach to registration of security could also be adopted in which a centralized request to register a security interest in all of a Canadian debtor's movable property would automatically register the interest federally against the debtor's federal IPRs as well as provincially in the province or territory in which the debtors or the assets are located as the case may be.[152] This functionality could either be provided through the extant provincial registry systems or through a commercial service provider.

Admittedly a gateway approach along these lines would not provide truly transparent "one-stop registration" without also establishing uniform name rules federally and provincially. Otherwise, to the extent the federal and provincial name rules differed, it would be necessary to provide different debtor names in different registration fields. In this sense the underlying dual registration would be seen by the user, searchers would have to enter all conceivable combinations of debtor names taking into account both the federal and the different provincial or territorial rules, and the system would not be truly seamless. Nonetheless, this option is worth exploring.

7.6 General Design Considerations

7.6.1 Introduction

It is not practical to cover all of the detailed design issues relating to the establishment of a federal security registration system for federal IPRs. This section of the Report deals with those issues that are relatively important or for which the IPR context raises some special considerations.

7.6.2 Effect of Errors or Omissions in Entry of Debtor Name

What should be the legal impact on the effectiveness of a registration if the registrant fails to register the correct name of the assignee, owner, or debtor. The error or omission might involve an error in

[152]Under the provincial systems, security granted in tangible collateral must generally be registered in the jurisdiction where the assets are located. See e.g. CCQ art. 3102, NB PPSA s. 5. The debtor location choice of law rule is restricted to intangible collateral.

the spelling of the name, or the substitution of a popular name for the official name as prescribed by the registry regulations, or the failure to follow the prescribed rules, e.g. failing to include the middle name. Is perfect accuracy necessary for the registration to take legal effect? Or is there some tolerance for error?

In principle, the impact of the error or omission should depend on its impact on the practical retrievability of registered notices by third party searchers. Under this approach, an error or omission would invalidate a registration only if the error or omission would be seriously misleading from the point of view of a hypothetical registry searcher.[153] It follows that a registration would be treated as invalid or a nullity only if a searcher using the correct debtor name as prescribed by regulation would not discover the notice.

In this respect, a computerized registry data base does not leave much room for error. If the system is programmed to return only exact matches to the search criteria entered, then even the slightest of errors on the part of the registrant will mean that the registered notice is a nullity. In most PPSA regimes, policy makers concluded that a system programmed to disclose only "exact matches" was too unforgiving from the registrant perspective. A search program was introduced that results in the retrieval of registrations that exactly match the registration-search criterion used by the searcher, *and* any registrations that are "similar matches" according to the coding system incorporated in the program software. The determination of what constitutes a seriously misleading error in a system of this kind depends on the form and number of similar matches disclosed when the correct search criterion is used. The fact that a defective registration is disclosed as a similar match on a search using the correct registration-search criterion does not invariably mean that the registration is valid despite the error. This depends on the determination of whether a reasonable searcher would recognize that the registration, disclosed in the result only as a similar match, related to the debtor in whom the searcher was interested.

[153] This is the test used in the PPSAs: see e.g. NB PPSA s. 43.

7.6.3 Access to Correct Debtor Name Information

Requiring an assignee or secured creditor to register by the correct prescribed name is not onerous in the case of assignments and secured transactions. In the former case, the assignee does not need proof from itself of its own correct name; in the latter, the debtor will usually be a cooperative source of information for the secured creditor. However, access to correct debtor name information has been problematic in the provincial systems for judgment creditors and we can anticipate a similar obstacle were the federal registry system were expanded to accommodate the registration of judgments as recommended in Part 6.3.3 above. To alleviate this it would be worthwhile to consider whether it would be possible to institute a summary procedure to enable judgment creditors to compel a judgment debtor to disclose documentary proof of the debtor's correct legal name so as to ensure that the judgement is effectively registered.

7.6.4 Access to Off-Record Information

Although priority in a notice-based registry takes effect from the date of registration, registration does not evidence the actual existence of the registered interest. It merely gives notice that a security right (or other interest) may exist in the identified collateral. The actual existence and extent of the interest depends on off-record evidence; for security rights, one must inquire about the existence of an actual security agreement and its current status.

Registry searchers in the position of potential assignees and prospective secured creditors are normally able to take the steps necessary to address the legal risk associated with acquiring an interest in collateral covered by a registered notice without having to investigate the off-record evidence as to the underlying security agreement. They can refuse to deal further with the debtor, require a discharge of the registration (in cases where the registration does not support an extant security right), or buy out the position of the registered claimant.

However, the position is different for existing creditors of the debtor, for their representatives such as an insolvency administrator, and for third parties with an existing ownership interest in the collateral. For these classes of third parties, the debtor may not be a cooperative or reliable source of information. To meet their informational needs, it would be desirable for a reformed federal regime to establish a summary procedure requiring the secured creditor of record, in response to a demand from third parties within these categories, to directly confirm the nature, details and current status of its charge relationship with the debtor.[154]

7.7 Summary and Recommendations

Some legal and structural reforms to the federal registry system are necessary or potentially desirable to accommodate the federal registration of security interests. For the most part the necessary reforms should be undertaken in any event to modernize the title aspects of the federal IPR registries. These legal and design issues were discussed in Part 4. Reforms specific to security interests are discussed in Part 7. The most basic specific reform to the federal registries needed to implement the federal approach to security interests in IPRs is simply to make specific provision for the federal registration of security interests. This should be technically very minor if carried out in conjunction to the title-side reforms discussed in Part 4.

There are two ways in which a registration might be implemented. In a document registration system the actual security documentation would be filed, whereas in a notice registration system only a notice setting out only the basic factual particulars needed to alert third parties to the potential existence of a security interest. Experience at the provincial registry level has proven that the notice registration system is far superior to the document registration system, and we strongly recommend that it be adopted for federal registration of security interest. Incidentally, it would also be technically easier to implement than document registration.

There are various options in registry design depending on the degree of integration of the security interest and title registries and the registries for various types of IPRs. We do not make any recommendation as to which integration option should be implemented. So long as the registries are all available on-line and uniform debtor/owner name rules are used for all federal registries, both of

[154]See e.g. NB PPSA s. 18.

which we recommend, a ‘gateway’ approach to searching would allow the various registries to be queried as effectively as if they were unified, regardless of the degree of physical integration.

It is sometimes suggested that because the federal registries are indexed and searched according to each specific item of IPR, adoption of a federal priority regime would impede creditors who hold security in the whole of a debtor’s present and after-acquired movable assets from effectively perfecting their security in the debtor’s after-acquired federal IPRs so as to ensure priority over competing claimants. We believe this concern is ill-founded. In fact, it is easier to deal with after-acquired property under the federal approach than under the choice of law approach. The most basic solution would be to create a separate federal name-indexed registry for security interests and similar encumbrances. A searcher would first search the federal ownership registry to determine the chain of title to the relevant IPR and then search the federal encumbrance registries for encumbrances granted or registered against all owners in the chain. This would be simpler than under the choice of law approach because only two registries would be searched, instead of multiple registries, and the problem of non-uniform names is avoided.

A more sophisticated approach would enable asset based searching while eliminating the need for any chain of title search. This approach would require a system for automatic cross registration of a security interests against any IPR newly acquired by a debtor who had granted a security interest in after-acquired (including after-created) property. While this system would require more significant effort to implement than would the basic system, it would also offer very significant advantages. While we do not make a firm recommendation that such a system should be adopted, we are of the view that is deserves further serious consideration if the federal approach is chosen.

8 Additional Reform Issues

8.1 Introduction

This section discusses a number of miscellaneous issues which were raised by the prior research as being possible impediments to IPRs based secured lending but which are not directly related to the core issue discussed in the preceding Parts, namely the choice between the federal and choice of law approaches. Thus the discussion of the various issues in this Part is generally applicable no matter which of these two approaches is taken.

8.2 Licencing Issues

8.2.1 Effectiveness of Contractual Clauses Restricting the Assignment or Grant of Security in a Licensee's Rights

A licensor's obligation to forbear from suing its licensee for infringement so long as the licensee abides by the terms of the licensing agreement gives the licensee's rights under the licence potential value as collateral. On the other hand, licensors often have good commercial reasons for caring about the identity of the persons to whom their intellectual property is licensed. For example, if a software developer granted an exclusive licence for a certain geographical region to a particular marketer, it would not want to see the licence acquired by its major competitor as a result of liquidation proceedings initiated by the licensee's secured creditor. For this reason, a licensing agreement typically prohibits the assignment or grant of security in a licensee's rights without the licensor's consent. An anti-assignment clause of this kind obviously reduces the collateral value of the licensee's interest since it makes the secured creditor's right to liquidate the collateral by reassignment of the licensee's rights dependent on the cooperation of the debtor's licensor.

Should an anti-assignment clause preclude the licensee from using its rights under the licence as collateral for a loan? If not, should the clause nonetheless be effective so as to prevent the secured creditor, on the licensee's default, from liquidating its collateral by assigning the licensee's rights to a new purchaser?

As to the first question, there seems to be general consensus that contractual restrictions on transferability contained in a licensing agreement do not prevent the licensee's rights from being considered property in the form of a *chose in action* (common law) or an intangible (PPSA) or an incorporeal right (CCQ). However, there is Ontario caselaw holding that a statutory 'licence' that is subject to statutory restrictions on transferability (e.g. an agricultural quota), does not constitute 'property' for the purposes of the Ontario PPSA.[155] There is some concern that to the extent that a licensee's rights under an IPR licensing arrangement are subject to contractual restrictions on transfer, this type of collateral would also be held to fall outside the PPSAs.

In the United States, Revised Article 9 provides that a contractual prohibition or restriction on the assignment or transfer of a licensee's rights is ineffective to prevent an Article 9 security interest from attaching to the licensee's rights.[156] We conclude, in line with the general opinion of analysts, that a similar provision should be incorporated in all of the provincial and territorial secured transactions laws. It was earlier recommended that exclusive licences be brought within the scope of the federal registry system, both where they are assigned, and where, should the federal approach be adopted, they are the object of a grant of security.[157] In the interests of clarity, a similar clarification should be added to federal law as part of the reforms recommended in Parts 4 and 6-7.

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[155] *National Trust Co. v. Bouckhayt* (1987), 7 P.P.S.A.C. 273 (Ont. C.A.). The Ontario position has been criticized and the more recent cases from that province take a somewhat softer line: *Canadian Imperial Bank of Commerce v. Hallahan* (1990), 69 D.L.R. (4th) 449 (Ont. C.A.), leave to appeal to S.C.C. refused; *Bank of Montreal v. Bale* (1992), 4 P.P.S.A.C. (2d) 114 (Ont. C.A.); *Tabily v. Kaloesai* (1995), 9 P.P.S.A.C. (2d) 221 (Ont. Gen. Div.). It is questionable whether the courts in other provinces would follow the Ontario caselaw on this point: compare *Saskatoon Auction Mart Ltd. v. Finesse Holsteins* (1993), 4 P.P.S.A.C. (2d) 67 (Sask. Q.B.). The Saskatchewan PPSA has been amended to explicitly confirm that statutory "licenses" constitute property that can be made the object of a PPSA security interest so long as the license is transferable, even if the transfer is subject to statutory restrictions or requires the consent of the licensing authority. See Sask PPSA ss. 2(1)(w) (definition of 'intangible'), 2(1)(z) (definition of 'license'). However, the secured creditor's power to realize its security by sale must be exercised in conformity with the statutory terms and conditions governing the transfer of the license. See Sask PPSA, ss. 57(3), 59(18).

[156] UCC art. 9-408(a) and (c)

[157] See Part 4.4 and Part 6.2.6.

As to the second question, there seems to be general agreement that an anti-assignment clause is effective to prevent enforcement without the licensor's consent.[158] Thus, in the United States, Revised Article 9 confirms that an anti-assignment clause is effective to prevent a secured creditor who takes security in the licensee's rights from realizing its security by an assignment of the licensee's rights without the consent of the licensor.[159] We recommend that a similar policy be codified in the PPSAs and the CCQ as achieving an appropriate balance between the interest of the licensor in controlling the identity of its licensees and the interest of the licensor in being able to grant security in what may be a valuable asset. The inclusion of a similar provision in federal law would be unnecessary unless the scope of federal substantive reform were extended to enforcement issues.[160]

In sum, under the suggested approach, a contractual restriction on the assignment or grant of security in a licensee's rights would be ineffective only to the extent that it would otherwise prevent attachment of a security interest. However, the licensor could still rely on the contractual restrictions to refuse to recognize the rights of a non-approved purchaser from the secured creditor.

8.2.2 Effectiveness of Contractual Clauses Restricting the Assignment or Grant of Security in Royalty Payments

The preceding section was concerned with the effectiveness of a contractual prohibition on assignment of a licensee's rights inserted in the licensing agreement at the instance of the licensor. However, the agreement may also contain a prohibition, inserted at the instance of the licensee, restricting the assignment or grant of security in the royalty payments or licence fees owed by the licensee to the licensor. It was concluded earlier in the Report that royalty payments should fall

[158]E.g., Spring-Zimmerman *et al* observe at 7 that since it is common for licence agreements to preclude any assignment by the licensee of its rights without the express consent of the licensor, it may be necessary for the secured creditor to obtain an acknowledgment and consent from the licensor to any subsequent assignment of the license agreement upon the debtor's default and the secured creditor's realization under the security agreement.

[159]See UCC 9-408(d).

[160]See Part 6.4.

completely outside the scope of any substantive federal reform.[161] Consequently, any substantive reform recommended on this issue would be limited to provincial and territorial secured transactions law, as opposed to also requiring complementary federal reform.

At present, the general secured transactions regimes do not speak with one voice on the question of the effectiveness of an anti-assignment clause affecting royalties and other monetary rights to payment.

The non-Ontario PPSAs expressly permit the grant of security in (and the assignment of) monetary claims owed by a third party ‘account debtor’ to the granter of the security, notwithstanding the presence of a prohibition on transfer or security in the contract under which the claim arises.[162] Although the account debtor remains free to claim damages from the granter of security for any actual loss or damage caused by breach of the "anti-assignment" clause, the security is effective and enforceable as between the assignor and assignee and as between assignee and the account debtor.

In cases falling outside the PPSAs, and in Ontario, the common law rule applies. At common law, such clauses do not nullify the grant of security as between the granter and the secured creditor, but the third party account debtor is entitled to plead the clause as a defence to a demand for payment by the secured creditor.[163] The practical effect of this is that while the secured creditor must enforce its rights through the granter of the security and cannot proceed directly against the account debtor, the grant of security will nonetheless be effective against competing third party creditors and the granter’s bankruptcy trustee.

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[161] See Part 6.2.4.

[162] See e.g. NB PPSA section 41(7).

[163] See *Rodaro v. Royal Bank of Canada* [2000] [QL] O.J. 272, approving *Yablonski v. Cawood* (1997), 143 D.L.R. (4th) 65 at 76 (Sask. C.A.) (which held that even if a contract contains a prohibition on assignment, the assignment would still be effective as between assignor and assignee; such a prohibition merely prevents the assignee from having direct recourse against the non consenting party to the assigned contract). Note that the Canadian Bar Association – Ontario Branch has recommended amendments designed to bring Ontario policy into conformity with the more liberal policy found in the other PPSAs on this point: see *Submission to the Minister of Consumer and Commercial Relations Concerning the Personal Property Security Act* (Toronto: Canadian Bar Association – Ontario, 21 Oct 1998) at 19-20.

The position in Quebec is uncertain. The validity and effects of anti-assignment clauses are not addressed explicitly in the Civil Code. However, some analysts believe that an assignment in breach of an anti-assignment clause would be valid, not only as between the assignor and assignee and as against third parties but also against the debtor, by virtue of the general codal article limiting the effectiveness of stipulations which attempt to restrict the free alienation of property rights by contract.[164]

Revised Article 9 adopts a similar policy to the first approach outlined above, that codified in the non-Ontario PPSAs.[165] Whereas article 9-408 provides that anti-assignment clauses affecting general intangibles other than monetary claims are ineffective only to the extent that they impair the creation, attachment or perfection of a security interest, article 9-406 provides that anti-assignment clauses affecting royalty payments and certain other monetary claims are also ineffective to prevent a secured creditor or assignee from directly collecting the monetary receivables from the account debtor, i.e. the licensee in this context.[166]

We recommend that this approach be incorporated in all of the provincial and territorial secured transactions regimes. We justify the difference in the degree of ineffectiveness of anti-assignment clauses affecting royalties as opposed to licensee's rights on the basis that a change in the identity of the person to whom the assigned obligation is owed does not produce the same potential prejudicial impact where the assigned obligation involves the payment of fungible monetary sum as opposed to an assignment of non-monetary performance obligations. Admittedly, the licensor may have ongoing obligations under the licence agreement (e.g. software support obligations) and some concern has been raised that the licensor will have less incentive to fulfill those obligations once the

[164]CCQ art.s 1212-1217.

[165]UCC art. 9-406.

[166]Under the Revised Article 9 definitional structure, a licensor's right to payment of royalties is an "account", and so falls under art. 9-406, while the licensee's right to performance by the licensor is a "general intangible" and so falls under art. 9-408: see art 9-408 Official Comment Example 2. Note that the definition account in the PPSAs is much broader than the UCC definition, embracing all monetary payment intangibles. For reasons that are not relevant to the present discussion, Revised Article 9 excludes some categories of monetary payment intangibles from the scope of the definition of "account". See R.C.C. Cuming and Catherine Walsh, "Revised Article 9 of the U.C.C.: Implications for the Canadian Personal Property Security Acts" (2002) 16 B.F.L.R.. 339.

right to payments is assigned.[167] But these arguments are not persuasive. The licensor may wish to assign its right to royalties precisely in order to raise money to carry out its obligations. And it is in the assignee's interest as well to ensure that the obligations are carried out, since breach of the obligations will normally entitle the licensee to stop or reduce its payments, and this will normally be effective against the assignee.

8.2.3 Rights of Licencee Taking in the Ordinary Course of the Licensor's Business

The existing provincial secured transactions regimes provide that a buyer of collateral takes free of a security interest, even when it is registered, in certain defined circumstances, the most important of which is when the collateral is sold in the ordinary course of the seller's business.[168] Revised Article 9[169] extends this protection to licensees of IPRs and similar reforms have been recommended to the PPSAs.[170] As Adams and Takach have observed, the arguments in favour of such a rule are compelling and we recommend its adoption in principle. The more difficult issue goes to implementation.

Clearly, an ordinary course of business rule is needed to protect holders of end-user non-exclusive mass market licenses. Once an end-user has made a decision to incorporate software, for example, into its business, the value of the continued use of the software may greatly exceed any licence fee it would pay at the outset, before a commitment had been made to any one of a set of competing products. If a secured creditor or assignee of the licensor were entitled to revoke the licensee's use rights, it would be able to expropriate this value. This vulnerability would reduce the amount the licensee would be willing to pay in the first place, thus reducing the revenue which the licensor

[167]See e.g. Weise at 1089: "The concern . . . is that if a licensor can assign its right to receive money, the licensor may lose its incentive to perform its future obligations under the license, to the detriment of the licensee." UCC art. 9-406 permits the creation and enforcement of a security interest in a right to payment arising out of a general intangible, including a license of software, even if the contract or other law restricts the licensor's right to assign its right to payment.

[168]See e.g. NB PPSA s. 30(2).

[169]UCC art. 9-321.

[170]Cuming & Walsh proposed s.30(2.1)

would use to service its debt. Thus it is in the interest of all parties to provide that the licensee would be protected in such a situation. It is clearly not practical for this end to be accomplished by having each individual end-user seek a subordination agreement from the secured party. We therefore recommend that the provincial and territorial secured transactions regimes be amended to provide that a non-exclusive licensee who acquires its licensing rights in the ordinary course of business of the licensor is immunized from any potential interference by the licensor's assignee or secured creditor, whether or not a notice of the assignment or grant of security in the identified debtor's rights as licensee has been registered in the relevant provincial or territorial registry.

The scope of the rule would need to be resolved. In PPSA jurisdictions, an ordinary course purchaser only takes clear of security interests granted by the immediate seller, whereas in Quebec the ordinary course purchaser takes clear of all security interests, including those granted by predecessors in title.[171] The two rules differ in their results when the debtor transfers to a purchaser/retailer not in the ordinary course and the retailer then transfers to an ordinary course purchaser. The disadvantage of the PPSA rule is that imposes a risk of an undiscoverable security interest by the remote debtor on the ordinary course buyer (the interest is undiscoverable because the provincial registries are necessarily name-indexed, as opposed to asset-indexed, for assignments and grants of security in intangibles). The disadvantage of the Quebec rule is the loss of the secured creditor's right to trace its collateral into the hands of remote transferees. However, the secured creditor is not entirely unprotected, as it would have, either by operation of law or contract, a continuing security interest in the proceeds of the licensing (though of course these might be dissipated) and it has some possibility of monitoring its debtor to detect a bulk sale or other non-ordinary course licensing arrangement in sufficient time to protect its interest. On the whole, we recommend the adoption of the more generous Quebec policy for the purposes of protecting non-exclusive licensees of IPRs. In our view, the need to protect the security of ordinary marketplace license transactions so as to sustain their market value outweighs the more particularized interests of secured creditors.

The question of whether a similar ordinary course of business exception should extend to assignees

[171] Compare e.g. NB PPSA s. 30(2) and CCQ art. 2700 para 1 (and note CCQ art. 1714 para 2).

and exclusive licensees of federal IPRs is more problematic. Under the current provincial secured transactions regimes, the ordinary course rule applies to outright assignments of collateral and a straightforward analogy would therefore extend protection to assignees and exclusive assignees of IPRs. However, the presence of an asset-based ownership registry for assignments (including exclusive licences) of IPRs makes a difference. In this respect IPRs are like land, for which an ordinary course of business subordination rule has never been applied or even suggested.

In their extensive discussion, Adams & Takach suggest that the ordinary course rule be limited to the "results of production" as distinct from the "tools of the trade" as best reflecting the expectations of all parties. While there is merit in principle to this approach, we are concerned that this distinction might be difficult to apply in practice. Further, we are of the view that the need to maintain the integrity of the federal title register is a key issue in addressing this question. We therefore recommend that the ordinary course rule not apply to any assignment or licensing transaction that is subject to federal registration in order to maintain priorities against subsequent transferees or secured creditors.[172] This is not simply a matter of a presumption against finding an ordinary course transaction in the context of federally registrable interests; rather it is a prohibition on applying the rule to such interests, so that a subsequent assignee or exclusive licensee would never take clear of a prior registered security interest without a subordination agreement.

Our conclusion that the ordinary course protection should not apply to exclusive licences accords with the position in the Revised Article 9.[173] In so concluding, we note that the policy justifications for granting ordinary course protection do not apply to assignees and exclusive licensees of federal IPRs. The justifications are implied consent on the part of the secured creditor and the need to maintain the security of title acquired in ordinary marketplace transactions. Keeping in mind that exclusive licences are those which are most likely to have a significant impact on the value of the IPR (so that we consider them matters of sufficient importance to potential subsequent interest

[172] Adams and Takach are not entirely clear as to whether they intend their recommendation to apply to exclusive licences and assignees whose interests are registered federally. They refer throughout their paper to the need to protect "transferees" but their specific examples all deal with non-exclusive licences. In particular they suggest that "where the debtor owns copyrights or patents, any disposal of ownership rights by the debtor. . .cannot be assumed to be in the debtor's ordinary course of business." Adams and Takach at 17.

[173] UCC art. 9-321(b).

holders to provide for federal registration), it is unlikely that a prior secured creditor would consent to that type of licence in the ordinary course.

As to the second justification for ordinary course protection – the need to preserve the security of title acquired by purchasers in ordinary marketplace dealings – this is a sufficient rationale only if an obligation to investigate the registry would impose an unacceptable burden on buyers so as to be detrimental to the marketability of the relevant assets. For federal IPRs, however, the federal registries are or should be designed to *enhance* marketability by providing prospective assignees and exclusive licensees with information about the current state of the assignor or licensor's title. If we permitted assignees and exclusive licensees who take in the ordinary course of business to instead take clear of the interests of a prior registered assignee or secured creditor, then the state of current title could not be determined from the face of the federal title register. This might be considered acceptable with respect to the initial assignee or exclusive licensee, who has some means of discovering the context of the licence, but a subsequent assignee or licensee would face insurmountable informational obstacles. As a corollary, a title guarantee system could not be implemented,[174] since the registrar could not adjudicate on whether every exclusive licence was granted in the ordinary course.

8.3 Assignment or Grant of Security in an IPR Owner's Right to Sue for Damages for Infringement

The debtor/owner's right to sue for damages for infringement of its IPRs constitutes a potentially important source of collateral in itself. In our view, secured transactions affecting this form of collateral are best regulated, like royalty payments and non-exclusive licences,[175] under general secured transactions law. However, the non-Ontario PPSAs at present exclude collateral in the form of a right to sue in tort from their scope (though arguably not the fruits of such a suit)[176] and this may exclude at least partially IP infringement causes of action. We therefore endorse prior

[174] As to which, see Part 4.6.

[175] As recommended in Part 6.2.4.

[176] See e.g. NB PPSA s. 4(i).

recommendations to eliminate this exclusion,[177] a reform that would bring the PPSAs into line with each other and with the CCQ .

8.4 Super-Priority for IPR Acquisition Financing?

If it becomes possible for a secured creditor to register a single notice to effectively publicize security in all of a debtor's present and after-acquired federal IPRs, whether under a choice of law or a federal approach, it would become necessary to address the issue of whether the first-to-register priority regime should be tempered by any exception. In the absence of any explicit exceptions, application of the first-to-register rule would mean that a secured creditor who registered a security over the present and future IPRs of the debtor would enjoy priority over subsequent creditors who later take and register security in specific IPRs. In general, this works efficiently and fairly, since the subsequent secured creditor can and should protect itself by searching the relevant registry before advancing credit.

But what about the situation where the later creditor provides the funding used by the debtor to acquire the very IPRs in which the second security is granted? In this scenario, unqualified application of the first-to-register priority rule is less obviously efficient. Since it is the later \second lender's credit that financed the debtor's acquisition of the additional IPRs, why should the first lender be entitled to claim their value simply because it registered first? The creation of an exception in favour of the second creditor would enable a debtor who has granted a general security on all its present and after acquired IPRs in favour of one creditor to retain practical access to competitive sources of credit to finance later IPR acquisitions. It is these justifications that explain why purchase-money super-priority for security in movables has been adopted by all the provincial and territorial secured transactions regimes.[178]

[177] See Cuming & Walsh, proposed s. 4(i).

[178] Under the *PPSA*s, both lenders and suppliers benefit from the rule: see e.g. NB PPSA, s. 34, s. 1 (definition of "purchase money security interest"). The *Civil Code of Quebec* similarly awards super- priority to hypothecary creditors who provide purchase money financing as against a prior hypothec on the debtor's after-acquired property. However, the rule is restricted to sales credit extended by vendors: *CCQ* art. 2954.. A hypothec to secure loan credit does not qualify, even if the purpose of the loan is to finance the acquisition of assets. Instead of relying on a vendor's hypothec, the supplier has the option of achieving super priority through a title retention arrangement designed to prevent the assets from entering the debtor's patrimony: e.g.

But the case in favour of purchaser money super-priority is not unimpeachable. The need to maintain practical access to competitive sources of credit is also the rationale given by the common-law courts for the rule that any subsequent secured creditor, not just a purchase money financier, should be able to secure priority over a prior secured creditor by giving actual notice of its subsequent interest.[179] This general argument has not found favour in the provincial security regimes applicable to moveables because of the counter-argument that a prior secured creditor who is unwilling to offer competitive terms or grant a subordination agreement can be displaced by refinancing the entire existing debt. Thus the argument in favour of purchase money super-priority turns not on generally applicable arguments of principle, but on the details of typical lending patterns and associated transaction costs. It is therefore possible that purchase money super-priority is desirable for moveables generally, and yet undesirable for IPRs in particular. It should be noted that Revised Article 9 restricts purchase money super-priority to tangible collateral, thereby excluding IPRs.[180]

Unfortunately the prior research did not deal at all with the issue of purchase money super-priority in the IPR context and so our views on this point are tentative. In the absence of some positive reason for believing that the problem of purchase money financing is less acute for IPRs than for moveables generally, we are inclined to recommend the adoption of the same policy for IPRs as for other moveables. However, we recommend further investigation of this point to determine whether the IPR context is sufficiently distinct to justify a different approach. In particular, such further investigation should consider the effect that the existence of the federal title registry for IPRs might have on this question, as well as considering the rationale for the Article 9 approach to purchase money security in intangibles.

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an installment sale pending payment of the price: *CCQ* art.s 1745, 1750.

[179] *Hopkinson et al. v. Rolt,* (1861), 9 H.L.C. 514, 11 E.R. 829; *West v. Williams* (1899) 1 Ch. 132.

[180] Revised Article 9 provides for purchase money super-priority in software, but only if the debtor acquires its interest in the software for the purpose of using the software in goods which are also subject to a purchase money security interest. See UCC art. 9-324(a) (general rule); art. 9-102 definition of "goods", which excludes general intangibles; art. 9-324(f), 9-103(c) regarding software. This is subject to the caveat that Article 9 may not apply to software or federal IPRs at all in view of the *Peregrine* decision discussed in Part 6.3.1.

8.5 Coordination of Enforcement and Title Registration

In our discussion of the federal approach in Part 6, we generally assumed that issues of validity and enforcement would continue to be governed by general secured transactions law. This would of course also be true in respect of the choice of law approach discussed in Part 4. The fact that enforcement proceedings which result in a transfer of title are governed at the provincial level which title registration itself is federal, raises a coordination problem. We therefore recommend enactment of a federal provision which would recognize and accommodate the secured creditor's standard default remedy of a forced sale of the collateral under provincial law. In order to exercise this remedy, there needs to be some mechanism to enable the buyer at the secured creditor's liquidation sale to be recorded as the new owner in the relevant federal IP registry. At present, secured creditors typically require the borrower to exercise an assignment in registrable form at the time of the initial borrowing that can be used if and when default occurs. Alternatively, the borrower is required to execute a power of attorney in favour of the secured creditor to do whatever is necessary on default to effectuate a sale of the collateral including the execution of an assignment and its submission for registration. The latter is the recommended course, particularly with trade-marks, to avoid any challenge that the mark has lost its distinctiveness in the absence of control by the assignee/secured creditor.[181]

In any event, these awkward and burdensome procedures of uncertain effectiveness could be eliminated if federal law were to provide an express procedure whereby on presentation of a transfer document executed by the secured creditor in the prescribed form, the Registry were required to record the purchaser as the new owner. Although a procedure of this kind has been recommended for inclusion in the PPSAs[182] to be fully effectual, reform at the federal level is required and we so recommend. A parallel reform should also be implemented to allow registration of a transfer of title resulting from a judgment creditor's enforcement proceedings.

[181] See Spring-Zimmerman et al.

[182] See Cuming & Walsh.

8.6 Summary and Recommendations

Part 8 discusses a number of miscellaneous issues which were raised by the prior research as being possible impediments to IPRs based secured lending but which are not directly related to the core issue discussed in the preceding Parts, namely the choice between the federal and choice of law approaches. Thus the discussion of the various issues in this Part is generally applicable no matter which of these two approaches is taken.

On the question of the effect of a contractual restriction on the assignment or grant of security in a licensee’s rights, we recommend that such a restriction would be ineffective only to the extent that it would otherwise prevent attachment of a security interest. However, the licensor could still rely on the contractual restrictions to refuse to recognize the rights of a non-approved purchaser from the secured creditor.

The next issue is the effect of a contractual prohibition restricting the assignment or grant of security in the royalty payments or licence fees owed by the licensee to the licensor. We recommend that the approach of UCC Article 9 be adopted. Under this approach anti-assignment clauses affecting general intangibles other than monetary claims are ineffective only to the extent that they impair the creation, attachment or perfection of a security interest, while anti-assignment clauses affecting royalty payments and certain other monetary claims are also ineffective to prevent a secured creditor or assignee from directly collecting the monetary receivables from the account debtor, i.e. the licensee in this context.

We also recommend that interests in IPRs acquired in the ordinary course of business would be taken free of any prior security interest, including registered interests, whether or not the security interest was granted by the immediate transferee. We further recommend that the ordinary course rule not apply to any assignment or licensing transaction that is subject to federal registration. This exception to the ordinary course rule is needed to maintain priorities against subsequent transferees or secured creditors.

We recommend that a debtor/owner's right to sue for damages for infringement of its IPRs should be recognized as an asset which may be validly used as collateral.

Current law for moveable property recognizes a super-priority for secured creditors who provide purchase money financing. We tentatively recommend that the same policy be adopted in respect of IPRs, but it is possible that the IPR context is sufficiently distinct to justify a different approach and we recommend further investigation of this point.

Finally, in order to facilitate ultimate enforcement of security interests in federal IPRs, we recommend that an express procedure should be provided under federal law whereby on presentation of a transfer document executed by the secured creditor in the prescribed form, the Registrar of the federal IPR registry would be required to record the purchaser as the new owner.

9 Conclusion

Secured lending based on IPRs faces challenges both because of valuation difficulties and because of the inadequate legal regime governing security interests in IPRs. We conclude that formal governmental action directed at improving the valuation expertise of financiers of IP collateral is not required. Valuation expertise has been and will continue to be developed by the private sector as the importance of IP assets increases.

In contrast action is needed to modernize the legal regime governing security interests in IPRs. The present framework is radically uncertain in essentially every respect. Modernizing and rationalizing the rules governing security in IPRs will improve access to and lower the cost of secured credit based on IPRs. It will also indirectly improve valuation; lowering this barrier to the use of IPRs will help set up a "virtuous circle" in which increased demand for IPR based security will increase lender familiarity with IPR collateral and thus indirectly improve valuation techniques.

Our conclusions will not revisit our recommendations for reform in detail. Instead we will concentrate on the two main approaches canvassed in this Report to resolving the principal source of the prevailing legal uncertainties: this is the legal risk currently faced by IPR secured lenders as a result of the uncertain interaction between federal and provincial law on registration and priority issues.

There are two basic approaches addressing this source of uncertainty. Under the choice of law approach, registration and priority issues relating to security in federal IPRs would be governed by the secured transactions law of the jurisdiction in which the debtor/owner is located, subject to a special federal priority rule designed to coordinate priorities in a contest between a secured creditor and a federally registered assignee of the same collateral. The second approach is the federal approach. Under this approach, the federal IPR statutes would be amended to explicitly provide for the federal registration of security rights in federal IPRs. Priorities between a secured creditor and an assignee, or between competing secured creditors would then be governed by the order of federal registration (i.e. the strict first-to-register rule recommended for competing assignees in Part

4 would be extended to secured creditors).

One of the perceived advantages of the choice of law approach is that the same registration and priority rules would apply in cases where federal IPRs were included as part of a broader package of intangible collateral, for example when a security interest is taken in all the debtor's present and future property. However, this point is not compelling. We conclude to the contrary, that search burden considerations strongly favour the federal approach.

Single jurisdiction registration will not always be possible under the choice of law approach because of variation in choice of law rules between the provinces, and dual searching will be required because of the need to verify the debtor's title to the IPR through a search of the federal ownership registry.

Further, searching under the choice of law approach faces two problems: the chain of title problem and the foreign debtor problem. In searching to establish its priority status under the choice of law approach, a potential secured creditor must first search the federal title registry to determine the names and location of all owners in the historical chain of title, and then search the registry systems in the province or territory in which each owner was located to determine whether that owner granted any prior security interest in the IPR. This means that different registries in several jurisdictions may need to be searched to determine the priority status. This problem is exacerbated because of variation in debtor name rules between jurisdictions. Without uniform debtor name rules, security interests validly granted by predecessors in title may be undiscoverable by a provincial search using the name revealed by the federal title register. This would result in irreducible uncertainty as to priority status, which would adversely affect the terms on which credit would be granted. Though a gateway approach to searching in which one query could automatically query various registries would help alleviate the technical aspects of searching, it would not resolve the need to conduct multiple searches, nor would it resolve the uncertainty stemming from variation in debtor name rules. And if a foreign owner is identified in the chain of title the problem is further exacerbated, since security interests which are valid under foreign law would have priority over the potential creditor's interest. At best this means that establishing priority would require searching a foreign registry; at worst, many countries do not operate general encumbrance registries, and any interests validly granted in such countries would remain undiscoverable. This is another source of irreducible uncertainty.

Both of these problems are radically reduced or eliminated under the federal approach. At most two registries would have to be searched: the federal title registry and the federal security interest registry. (In some implementations discussed in the Report, only a single registry would need to be searched.) Debtor name variation and the accompanying uncertainty would be eliminated. The foreign debtor problem would also disappear as foreign creditors, like any other creditor, would be required to register federally in order to establish their priority.

The second perceived advantage of the choice of law approach is that it would involve the expenditure of minimal law reform resources as compared to the federal approach. We are not persuaded that this perception is correct. Substantial improvement to the federal registries would be required even under the choice of law approach in order to allow effective searching of the federal title registries, which is essential to the chain of title search. The additional law reform required to implement the federal approach should be very modest. Moreover, the choice of law approach itself calls for significant law reform efforts which would not be needed under the federal approach. In particular, provincial uniformity in debtor name rules would be needed if the uncertainty created by non-uniform debtor names is to be addressed. Achieving such uniformity would be very significant law reform undertaking.

On the whole we recommend the federal approach. The choice of law approach faces an irreducible problem of due to the possibility of foreign debtors in the chain of title, and this problem is likely to get worse in an increasingly global economy. The law reform effort to implement either approach is likely to be roughly similar. We should note, however, that our recommendation is based on a comparison of the best forms of the federal and provincial systems. In particular, if the basic reform of the federal ownership registry which we consider essential to the effective operation of either a provincial or federal system are not implemented, both the provincial and federal approaches would suffer, but they probably would not suffer equally. The comparison of the two systems would be different in such a "second-best" world. It is not possible in this Report to compare the various approaches under all possible scenarios, but we hope that this Report will provide a framework for so doing.

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