Leveraging Knowledge Assets

Reducing Uncertainty for Security Interests in Intellectual Property

Law Commission of Canada
Commission du droit du Canada

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The Honourable Irwin Cotler
Minister of Justice
Justice Building
Wellington Street
Ottawa, Ontario
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Dear Minister:

In accordance with section 5(1)(c) of the *Law Commission of Canada Act*, we are pleased to submit the Report of the Law Commission of Canada on security interests in intellectual property. This report aims to support innovation and the transition to a knowledge economy.

Yours sincerely,

Nathalie Des Rosiers,
President

Bernard Colas,
Commissioner

Roderick J. Wood,
Commissioner

Mark L. Stevenson,
Commissioner

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Preface

Social arrangements and economic relationships are generally reflected in and supported by laws and legal instruments. As these arrangements and relationships evolve, so must the legal system and its tools. This report examines the demands being placed on our commercial infrastructure by the transition to an economy based increasingly on information, technology and services.

What changes are needed in our commercial practices to support a vibrant and innovative information-based economy? Is our legal infrastructure adapted to the new realities of an economy increasingly based on the production of knowledge instead of goods? Are the current organizational structures in government and in the commercial sector equipped to accommodate such economic transitions?

This report explores one of the many questions inherent in the transition to a knowledge-based economy: can intellectual property rights serve as collateral for credit? Investment in new forms of wealth often requires changes in commercial practices and commercial law. Examples include the creation of the corporate personality as a means of limiting liability, the invention of mechanisms to leverage the value of "movables" such as cars and shares, the facilitation of trade through credit instruments, and the development of franchising and condominium law. To continue to support innovation, we must ensure that people have access to effective mechanisms of credit and trade.

Leveraging Knowledge Assets – Resolving Uncertainty in Security Interests for Intellectual Property also deals with a vexing question in law and public policy: how does uncertainty affect trade and investment? There are many kinds of uncertainty; the political climate may be uncertain, the international situation may be full of unknowns and the market may be unstable. This report examines ambiguities in Canadian federal law relating to security interests in intellectual property. It argues that such ambiguities impose a cost on the economy and that they ought to be resolved to the greatest extent possible.

Finally, *Leveraging Knowledge Assets* also looks at the role governments play in supporting a legal infrastructure for trade and investment. As registrars and regulators, governments support the economic relationships in our society. This role should not be underestimated. It requires the capacity to respond to new demands and to develop tools that facilitate timely access to reliable information by economic actors, both nationally and internationally.

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We are immensely grateful to Professors Norman Siebrasse and Catherine Walsh who held the pen on this report.

Within the Commission, the coordination of this report was assumed by Executive Director Bruno Bonneville, Director of Research Dennis Cooley, and Commissioner and Vice-President Roderick Wood. We are very thankful for all their work.

The views expressed in this report, as well as any errors or omissions, are the responsibility of the Commissioners.

Executive Summary

Part 1: Introduction

Secured credit is an efficient form of lending that, when implemented in a proper legal and institutional framework, can reduce transaction costs associated with borrowing and thus stimulate economic activity. Historically, the reform of laws and institutions associated with specific types of property has tended to mirror changes in their economic importance. Land was one of the first types of property used as collateral, but as the economy shifted from farming to manufacturing, movable assets such as equipment and inventory became increasingly important forms of security, as did intangible assets such as accounts receivable. Today, with the growing importance of intellectual property, it is not surprising that there is mounting pressure to improve the framework for securing loans with intellectual property rights (IPRs). Enterprises in the technology sector would not be the only ones to benefit from this reform. Any modern enterprise, from manufacturing to the service sector, holds significant intellectual property assets, ranging from business software to licence rights. This report examines the legal and institutional reforms needed to facilitate IPR-secured lending.

The report draws a distinction between IPRs that fall within federal legislative jurisdiction and those that fall within provincial authority. It focuses on the most important federally regulated IPRs, namely patents, copyrights and registered trade-marks. The need for reform is most urgent for these IPRs since the existence of federal title registries for patents, copyrights and trade-marks is a significant obstacle to IPR-secured financing. Provincial IPRs, on the other hand, can be accommodated within the existing provincial secured lending systems with relatively minor reforms. The measures recommended in this report anticipate the ongoing creation of new forms of federal IPR. The ability to leverage them for credit will render these rights all the more valuable to their owners.

The main challenges to secured lending based on IPRs are valuation difficulties and deficiencies in the legal and institutional framework for secured lending.

Part 2: Inherent Valuation Challenges

Many IPRs are potentially valuable as collateral, either individually or when pledged *en masse*, but they pose unique valuation risks for secured creditors compared with other types of movable and immovable property. First, most IPRs have a statutorily limited lifespan. Next, and even more important, the economic value of an IPR is susceptible to erosion by the next generation of innovation. Moreover, because the value of an IPR is often linked to a specific application in a specific company, its liquidation value may be significantly lower than its use value. IPRs are also subject to legal challenge, which introduces a discount as well as uncertainty into the valuation process.

In general, this valuation risk cannot be reduced by changing the legal incidents and attributes of IPRs without unacceptably compromising fundamental policies of intellectual property law. The greatest potential for reducing the valuation risk associated with IPRs lies in improving valuation techniques. Those techniques will become more reliable as assessors gain practical experience in evaluating IPRs. Thus, eliminating other barriers to the use of IPRs as collateral will also indirectly reduce valuation risks.

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

The law relating to security interests in IPRs is uncertain. Before considering security interests themselves, any secured creditor, or more broadly, any potential assignee, must ascertain the debtor's title to the asset being offered as collateral. Although title registries exist at the federal level for all federal IPRs, these are not reliable for purposes of title investigation. Under three of the federal intellectual property 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; examination of the title register does not provide authoritative information regarding title. Under the remaining 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 registry is not entirely authoritative. In particular, the first-registered assignee must take the property without actual knowledge of the prior unregistered assignment. This qualification creates residual uncertainty and has been eliminated in modern registry design in other contexts. Moreover, the courts have held that priority established by mere registration is subject to the exceptions to first-in-time priority embodied in certain principles of provincial property law, thus further undermining the value of the registry as a source of title information.

When security interests are added into the mix, the uncertainty increases dramatically. Virtually all aspects of priority contain uncertainty. First, it is not clear which secured transactions fall within the scope of the federal registration provisions. Are all secured transactions federally registrable, or only those that are formally cast as assignments? It may be that none are registrable. Even if registration of a security interest does not establish priority of its own effect, annotation of such a registration may serve as notice or constructive notice and so establish priority indirectly.

In addition to this legal uncertainty, current registry practices are not sensitive to the information needs of either prospective secured creditors or prospective assignees of federal IPRs. The patent, copyright and trade-marks databases are currently accessible online, but these online resources were designed for other purposes, such as searching prior patents. They are not adequate for financing- or purchasing-related due diligence searches since they may be incomplete or out of date.

This uncertainty increases direct costs because lenders are routinely advised to register under both federal intellectual property law and provincial secured transactions law and to observe the formal requirements of both systems. Yet even this practice does not eliminate priority uncertainty of federal registration. And the interaction and potential conflict between federal statutes and provincial secured transactions laws undermine the confidence of secured creditors in the quality of IPR collateral relative to other movable assets. This increases both the initial risk and the ongoing monitoring burden for secured creditors, inconveniences for which debtors ultimately pay in the form of less accessible and costlier secured credit.

For many years, lawyers with expertise in intellectual property law have recognized that there is uncertainty in secured transactions involving intellectual property. In 1998, after the matter was studied by the National Intellectual Property Section, the Canadian Bar Association urged the Government of Canada to enact a national scheme for the registration of security interests in personal property.

Although the benefits of a reformed legal framework for IPR-based secured financing are difficult to quantify, the current uncertainties are so well documented and so pervasive that the cost savings are bound to justify the investment. The case for reform is especially pressing in view of the expected increase in demand for IPR-based secured financing that will accompany improved access and reduced costs.

Part 4: Reform of the Ownership Disclosure Function of the Federal Intellectual Property Registries

Reform of the title aspects of federal intellectual property registries is an essential prerequisite 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 about the current ownership of IPRs. However, the statutes as currently drafted not only fail to achieve this potential, they actually create confusion.

To resolve this deficiency in the title aspects of the federal intellectual property registries, we recommend that the assignment and registration provisions of all six federal intellectual property statutes be strengthened to provide for the registrability of all transfers of ownership in federal IPRs. The amendments should also 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 be ranked on a strict first-to-register basis, subject to an exception where fraudulent conduct is involved. We further recommend that the scope of registrable transfers include assignments and licences. Structural and operational reform of the registries themselves to allow reliable online title searching is needed to support these substantive reforms.

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 uncertainty identified in Part 3. But further reforms are needed to address the uncertainties in the priority of claims to the same federal IPR, both as between competing secured creditors and between a secured creditor and a federally registered assignee. Part 5 outlines a "choice of law" approach to this second problem, while Parts 6 and 7 discuss a "federal" approach.

Under the choice of law approach, the federal government would recognize the law of the debtor's location as the legal regime applicable to the registration, the effects of registration or non-registration, and the priority of security granted in any federal IPR. For Quebec debtors the relevant provisions of the *Civil Code of Québec* would apply; for debtors located in the other provinces and territories, reference would be made to the relevant personal property security act. For non-Canadian debtors, foreign secured transactions law would govern; for example, French law would govern French debtors.

If this approach is adopted, we recommend that it be implemented by a federal choice of law rule explicitly designating the law of the debtor's location as the applicable law. The alternative would be to have the law remain silent on this point and allow the choice of law rules of the litigation forum to determine the applicable law. For cases litigated in Canada the applicable law would therefore be the law of the debtor's location, but there is sufficient variation among provincial statutes that this approach would still result in uncertainty and potential conflict over the applicable law. For similar reasons, we recommend that a federal statutory provision be created that ranks assignees and secured creditors according to the order in which they registered their interests in the relevant federal intellectual property registry and the secured transactions registry of the province or territory where the debtor is located.

One of the features of the choice of law approach is that it invokes more than one legal system: the law of the debtor's location applies to the registration and priority status of security rights, while determinations relating to ownership and assignment of the IPRs are subject to federal law. This has two main disadvantages, the first of which is the chain-of-title problem. 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 to determine whether those prior owners had granted prior security interests. Thus the existence of the federal title register makes it more complicated for a prospective creditor to ascertain priority of security interest in a federal IPR than in a more traditional form of personal property. Moreover, the lack of uniformity in debtor/owner name rules between provincial and federal registries means that valid security interests granted by prior owners may remain invisible, 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 (a process whereby a single online portal automatically queries 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 owners 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 still, many countries outside 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 of the *Uniform*

Commercial Code 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 intellectual property 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 that was not so registered.

While we refer to this as a federal approach, 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. Further, only security interests in federal IPRs themselves would be subject to the federal regime; security interests in IPR-related rights, particularly 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 pre-empted only for the purposes of resolving a contest involving at least one federally registered claimant. Furthermore, although a provincially registered security interest in a federal IPR would be subordinated to any federally registered interest in that IPR, the provincially registered interest would, nevertheless, take precedence over any interest that was not registered federally, and over the debtor's insolvency administrator.

Part 7: Structural and Operational Reforms of the Federal Intellectual Property 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. As discussed in Part 4, the title aspects of federal intellectual property registries could be modernized through various design and legal reforms. Part 7 looks at how federal registries might be modified to implement the federal approach to security interests in IPRs. It recommends the enactment of a statutory provision enabling the federal registration of security interests. This reform should be very minor if carried out with the title-side reforms discussed in Part 4.

A registration could be implemented in one of two ways – through document-filing or notice-registration. In a document-filing system, the actual security documentation would be filed, whereas in a notice-registration system only a notice need be registered, setting out the barest 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-filing system, and we strongly recommend that it be adopted for federal registration of security interests. It would also be easier to implement than document-filing.

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 it would be necessary to search only two registries, and the problem of non-uniform names would be avoided.

Part 8: Implementation Strategy

Secured lending based on IPRs faces challenges both because of valuation difficulties and because of the inadequate legal regime governing security interests in IPRs. Governments can reduce the valuation risk by encouraging the development of expertise in the valuation of IPRs and the development of best practices in this domain. By sponsoring research and disseminating knowledge, governments can foster a climate that is more receptive to the use of IPRs as collateral.

Meanwhile, the legal expertise to support such reforms is dispersed among two types of specialists. Intellectual property lawyers are knowledgeable about IPRs, while commercial lawyers are knowledgeable about the creation of security interests. Unfortunately, there are very few lawyers well versed in both. As lenders increase their reliance on IPR-based collateral, lawyers will need to become conversant with *both* intellectual property law and commercial law. The Canadian Bar Association, the Intellectual Property Institute of Canada and the provincial law societies can help their members make this transition by creating the necessary education programs and materials.

Part 9: Conclusion

The federal government should modernize the legal regime governing security interests in IPRs. The current framework is fraught with uncertainty. Modernizing and rationalizing the rules governing security in IPRs will improve access to secured credit based on IPRs and lower its cost. Such reforms will also indirectly improve valuation techniques, as growing demand for IPR-based security increases lender familiarity with IPR collateral. Formal government action to strengthen the ability of financiers to evaluate intellectual property collateral is not required. Valuation expertise will be developed by the private sector as the importance of intellectual property assets increases.

Of the two basic approaches to law reform discussed in this report, we recommend the federal approach. The choice of law approach faces an unresolvable problem in the form of invisible foreign debtors in the chain of title. And their numbers are likely to grow in an increasingly global economy. Under the federal approach, only two registries need be searched – the federal title registry and the federal security interest registry. Debtor name variation and the accompanying uncertainty would be eliminated. The foreign debtor problem would also disappear since foreign creditors, like any other creditor, would be required to register federally in order to establish their priority.

1 Introduction

1.1 Purpose of This Report

Secured credit is a well-established concept. The basic idea is simple: security gives a creditor the right, should the debtor default, to claim repayment out of the value of the assets that the debtor previously agreed would be charged with security.[1]

A secured creditor has a priority advantage and an enforcement advantage.[2] The priority advantage inheres in the secured creditor's right to follow the charged assets into whoever's hands they may be and to extract payment from the value of those assets in preference to the claims of other creditors. The enforcement advantage consists of the availability of specialized and expeditious remedies against the charged assets, remedies that eliminate time and expense of obtaining a formal judgment and of having to initiate judgment enforcement proceedings.

The idea of secured credit has existed as long as ideas of private property and freedom of contract have. However, its legal and practical incidents have changed as new forms of property have emerged. Historically, land and luxury tangible were the principal objects of security. With the transformation of much of the world from an agrarian to an industrial economy, the focus of material wealth began to shift from immovable to movable assets (equipment, raw materials and inventory) and from tangible to intangible assets (accounts receivable, negotiable instruments, securities and documents of title). That change precipitated 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 comprehensive reforms effected to the movables security laws of all Canadian provinces over the last several decades.[4]

The wheel has turned again. As the economy has become increasingly oriented toward exchanges of information, technology and services, intellectual property rights (IPRs) have assumed a more prominent place among corporate assets, prompting interest in reforms that would facilitate 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 value of IPRs as collateral. Commissioned by the Law Commission of Canada in connection with its partnership in the Commercial Law Strategy of the Uniform Law Conference of Canada, the report builds directly on a series of research papers solicited by the Law Commission and presented at a 2001 conference entitled Leveraging Knowledge Assets: Security Interests in Intellectual Property.[5]

1.2 Interested Constituencies

Facilitating access to credit by enterprises with significant intellectual property assets could be one element in a multi-pronged strategy to enhance the competitiveness of Canada's information-based enterprises.[6] One economist succinctly described how impediments to the use of IPRs as collateral undermine the economy:

> 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 that proceed using alternate forms of finance, the cost to the economy is the excess cost of the alternative contract. On the projects that 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 be the first to benefit 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, such as computer software, to enhance the marketability of their tangible goods or traditional services or 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 better enables businesses to develop their full market potential. This is particularly true for the small and medium-sized enterprises that underpin the Canadian economy and that so depend on this source of financing. The second benefit is that scarce resources for resolving disputes and providing legal advice would be conserved for use on issues that are not amenable to *a priori* legislative solutions.

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

What is covered by the term intellectual property? First, it is necessary to distinguish those IPRs that fall within federal legislative jurisdiction (federal IPRs) from 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] Each is governed by a separate federal statute.

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 subjective. Fortunately, it is not necessary to come up with a precise inventory for the purposes of this report since the most significant obstacles to IPR-based secured funding derive from the presence of federal title registries for federal IPRs. Provincial

IPRs can be accommodated in the existing provincial secured lending systems with relatively minor reforms.

In identifying and analyzing those obstacles, this report will focus primarily on patents, copyrights and trade-marks, since they are 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.[15]
>
> *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"[16] (with "literary work" including computer programs[17]) 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. By contrast, a trade-mark protects an association between particular goods or services and the provider of those wares by allowing providers to exclusively identify their wares with a distinctive mark.

These federal IPRs are not set in stone, but have evolved over time to cover new forms of assets, such as computer programs. As well, new classes of IPRs have been created. It is inevitable that this process of growth and change will continue. For example, the Government of Canada in its June 2001 document, *A Framework for Copyright Reform*, indicated that it will examine whether the federal *Copyright Act* should be amended to create a new class of rights or alter existing rights to protect works of traditional knowledge. This would provide protection of the cultural expressions of Aboriginal people in Canada in their stories, songs, music, dances, plays, paintings, decorative art, apparel, architecture, totem poles and designs. The measures recommended in this report are capable of accommodating new federal

IPRs as they come into existence. Indeed, the ability to create security interests in these new federal IPRs will make such rights all the more valuable to their owners.

1.4 Overview of the Report

Potential obstacles to IPR-secured lending can be divided into two broad categories. The first relates to impediments associated with the unique nature of IPRs, in particular, "the culture of traditional lenders and valuation problems." The second relates to the heightened risks to secured lenders attributable to the uncertainties and gaps in the current legal framework governing IPR-secured lending.

As to the first category of obstacles, it is our view that cultural inertia does not significantly undermine IPR-based lending. There is no evidence that traditional financial institutions decline opportunities for IPR-secured lending because of an irrational lack of appreciation of the collateral value of IPRs compared with other forms of movables. On the contrary, despite other impediments, specialized IPR-based lending techniques by lenders in industries such as film are emerging.[18] It follows that efforts to improve access to credit by sensitizing lenders to the world of IPRs would not be a wise use of resources. This report will therefore not deal further with the issue of cultural inertia.

On the other hand, the unique valuation challenges presented by IPRs are complex and substantial for reasons outlined in detail in Part 2 below. As will be discussed, IPRs are particularly sensitive to marketplace risk (e.g., a 'better mousetrap' may be invented). Moreover, their very existence is contingent on the fulfilment of statutory criteria that can be challenged at any time (e.g., by the subsequent demonstration that a 'copyrighted' work was not original). Finally, the legal protection accorded IPR owners is heavily qualified 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 greater valuation challenges than do more traditional kinds of collateral, Part 2 concludes that legislative or other formal governmental action cannot substantially ameliorate the problem without unacceptably compromising the principles and goals of intellectual property law.

Part 3 of the report introduces the most important issue in the second category of obstacles to IPR-secured lending, namely the legal risk currently faced by IPR-secured lenders as a result of the interplay between federal and provincial law when it comes to registration and priority issues. All six of the federal intellectual property statutes establish specialized public registries for recording the existence and the assignment of ownership of the IPRs within their scope.[19] 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 IPR. 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 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-secured credit. We conclude that while not strictly quantifiable, the impact is real and negative. Because of the uncertain scope of the federal intellectual property registries, and the lack of certainty about how they interact with provincial law, secured creditors must assume the cost of registering in both the federal intellectual property registries and the general provincial registries for movable securities. 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 cannot confidently predict whether their security rights will prevail against competing claimants.

Since secured creditors must factor this priority risk into their calculations, the collateral value of a federal IPR is much lower than its actual realizable value in the abstract. Thus, although it may not be possible to quantify the benefits of legal reform, resolving the current legal uncertainties would have a significant positive impact on the availability and cost of IPR-secured credit.[20] Improvement in valuation expertise and experience would likely follow.

Priority risk is a problem unique to federal IPRs; no equivalent 'title' registries exist for provincial IPRs, or, indeed, for any other type of movable asset regulated by provincial law.[21] Consequently, Part 4 begins the search for solutions by examining the function of the federal intellectual property registries. There is, of course, no question of simply abolishing them. With the exception of copyright (and the partial exception of certain trade-mark 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 centres instead on the role of the federal registries as vehicles for publicizing the ownership and assignment of ownership of federal IPRs. We conclude that the intellectual property 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 interested 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 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 databases. 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 IPR 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 against secured creditors to whom the debtor, or the debtor's predecessor in title, may have granted security. The grave uncertainty that currently surrounds 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.

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.[22] 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 Article 9 of the *Uniform Commercial Code* in force in the state where the debtor is located; for French debtors, French secured transactions law would apply). For greater accuracy, this report will therefore refer to this approach as the “choice of law” approach.

Recognizing that this 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 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. 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 coordinating 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 burden of investigation in cases where any of the successive owners are located outside Canada.

Part 6 therefore examines another possibility for reform canvassed in earlier 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 registration approach, or simply, the “federal approach.” Note, however, the limited reach of federal law. The secured transactions law of the debtor’s home province or country would be pre-empted 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 this report. Part 6 examines 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 (such as the claims of the IPR owner's judgment creditors) should be registrable federally so as to also benefit from 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 discusses the implementation strategies that could be employed to assist the development of knowledge and expertise in the valuation of knowledge assets, in the documentation used to create security interests in these assets and in the operation of the new registry systems.

1.5 Constitutional Considerations

Although questions are occasionally raised about the scope of federal constitutional authority over secured transactions covering federal IPRs, such doubts, in our view, are misplaced given the unquestionable federal power over issues relating to ownership of copyright, patents, federal trade-marks and ancillary categories of federal IPRs. The ability to grant security is part 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 that challenges this 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 with respect to security in IPRs 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 inoperative 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.[23]

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

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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, for example, art. 2660 of the *Civil Code of Québec* (CCQ).

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

4 For Quebec, see CCQ, 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 2934–2968; for consensual security rights in movables created by transfer or retention of title, see art. 1745–49 (instalment sales), 1750–6 (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 (PPSAs). In order of implementation, see: ONTARIO, 1976 (S.O. 1967, c. 73, in force 1 Apr 1976, replaced by S.O. 1989, c. 16, in force 10 Oct 1989); MANITOBA, 1978 (S.M. 1973, c. 5, in force 1 Sept 1978, see now R.S.M. 1987, c. P35); SASKATCHEWAN, 1981 (S.S. 1979–80, c. P-6.1, in force 1 May 1981, replaced by S.S. 1993, c. P-6.2, in force 1 Apr 1995); YUKON TERRITORY (O.Y.T. 1980, c. 20, 2d Sess., in force 1 June 1982, see now R.S.Y. 1986, c. 130); ALBERTA (S.A. 1988, c. P-4.05, in force 1 Oct 1990); BRITISH COLUMBIA (S.B.C. 1989, c. 36, in force 1 Oct 1990); NEW BRUNSWICK, 1995 (S.N.B. 1993, c. P-7.1, in force 18 Apr 1995); NOVA SCOTIA, 1997 (S.N.S. 1995–96, c. 13, in force 3 Nov 1997); PRINCE EDWARD ISLAND, 1998 (S.P.E.I. 1997, c. 33, in force 27 Apr 1998); NEWFOUNDLAND AND LABRADOR, 1999 (S.N. 1998, c. P-7.1, in force 13 Dec 1999); NORTHWEST TERRITORIES, 1994 (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 2001, 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. The papers are published in H. Knopf (ed.), *Security Interests in Intellectual Property* (Carswell, Toronto, 2002).

6 Other measures, such as improving the ability of firms to retain skilled employees, might be equally or more effective. Facilitating access to IPR-based secured credit should be seen as a complement to other elements of a competitiveness strategy.

7 McFetridge at 271.

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 trade-mark 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 are 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*.

15 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.

16 *Copyright Act,* s. 5.

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

18 See the discussion in Townend of film financing in the United Kingdom. For a discussion of film financing in the United States, see the prepared statement of Fritz Attaway, Senior Vice President for Congressional Affairs and General Counsel, Motion Picture Association of America, submitted as part of the Intellectual Property Security Registration: Hearings Before the House Subcommittee on Courts and Intellectual Property of the House Committee on the Judiciary, 106th Cong., 1st Sess. (24 June 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.

19 *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 Topography Act*, s. 15.

20 As reflected by the views of the lenders, valuation specialists, legal practitioners and scholars who participated in the Law Commission of Canada's conference on Leveraging Knowledge Assets.

21 Modern electronic registries for movables have been established pursuant to the secured transactions laws of all 13 provinces and territories. 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 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 to the specific item of collateral (subject to a few exceptions for serial-numbered goods); whereas the federal intellectual property registries (like the federal Ships Registry) are closer to the concept of an immovables registry, insofar as it is possible to register and search for a specific item of property. The significance of these differences is addressed in later parts of the report.

22 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, for example, 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 implemented, it should be accompanied by the 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 that the secured creditor complied with the legal requirements of that debtor's location for obtaining an effective security right against third parties.

23 See, for example, Mercier and 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.

2 Inherent Valuation Challenges

2.1 Introduction

This chapter focuses on the unique valuation challenges posed by federal IPRs. Identified in earlier research commissioned by the Commission, these challenges partially explain why financial institutions are cautious about IPR-secured lending. We refer to these valuation challenges as "inherent" because they derive from the particular economic and legal incidents of IPRs, which, with a few minor exceptions, cannot be ameliorated through formal market intervention or legislative change.

2.1.1 Limited Legal Life

The rationale for recognizing and protecting IPRs is to provide an economic incentive to would-be innovators and artists. But the right to exclude others from profiting from one's invention must be balanced against the public interest in disseminating the ever-accumulating store of human knowledge. The balance between these two policies is achieved in part by limiting the duration of the legal existence of patents and copyrights so that the new knowledge eventually 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[1] is limited to a term of 20 years from the date the application was filed,[2] subject to the payment of maintenance fees.[3] For copyright, the term of protection is longer: the life of the author plus 50 years.[4] However, 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 a previous assignment to a second owner.[5] 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.[6] 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 marketplace."[7] The tendency to obsolescence is particularly accelerated for some forms of IPR. For instance, computer software that "implements cutting edge technology can become fatally inferior to newly developed products in just a short time."[8]

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 how vulnerable to devaluation a particular IPR is and to discount accordingly its value as collateral. Even when circumstances give 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., better-than-expected research efforts by competitors or unanticipated product deficiencies). This is also true of trade-marks, which may depend on future trends and marketing to sustain their value.

2.1.3 Idiosyncratic Value

Some IPRs, such as many of the patents in the portfolio of an 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 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 increases the cost of using it as security, particularly if the IPR is to be the primary security.[9]

The idiosyncratic value problem is particularly acute if the enterprise is a new one without a proven track record. Would-be borrowers seeking to finance a fledgling invention through the early development stage have a limited pool of potential financiers to draw on – namely those financial institutions with the requisite experience to assess the credibility of the business plan for the type of intellectual property under development.[10]

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 than in those of a new user. For instance, a patent or copyright may constitute just part of a product that derives its value from the know-how embodied in the debtor/owner or that depends on a "hybrid, patent–trade secret combination."[11] 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, i.e., under which a lender depends on the liquidated value of the collateral as protection against the risk of non-payment by the debtor.[12] Should the debtor default, the only likely purchasers in a liquidation sale would be the debtors' competitors, for whom the value of the asset would be that of keeping it out of the hands of another competitor.[13]

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 this debtor/purchaser is contingent upon the debtor/purchaser's continued access to the technical advice and maintenance support of the original owner/developer, such as, for example, the ongoing provision of technical support and upgrades to 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, and the reasons are different for patents, copyrights and trade-marks.

Patents

Even after a patent has been issued, its validity may be challenged in court at any time for any of the substantive reasons for which the Patent Office might have refused to issue a patent in the first place, e.g., because of obviousness or lack of novelty or utility. Because invalidity is commonly a successful defence to a claim for patent infringement, the collateral value of a debtor's patents, particularly at the early stages, must be discounted to account for this risk.[14]

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[15] – the mark will become invalid.[16] 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 trade-marks 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 . . ."[17] However, the courts, still concerned with the ultimate goal of protecting the consumer, have held that although 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. If the mark is associated with one source, and the bare mark is assigned to another company that begins using it on the same wares, the mark will then be associated with two sources – the old and the new – and may therefore lose its distinctiveness and become invalid.[18] For this reason, it is risky to take a security interest in a bare trade-mark. However, a trade-mark is not likely to become invalid if it is transferred as part of the assignment of the assets of an enterprise, 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 precondition 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.[19] 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.[20] 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.[21] 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.

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 securitization of royalty payments collateralized by IPRs). In the case of a patent, for instance, the obligation to make royalty payments may end if the patent is later found to be invalid. Moreover, unlike the predetermined monthly royalty payment associated with an immovable or tangible movable, intellectual property royalties are frequently based on actual sales, which can vary widely and unexpectedly; for instance, a musical group may become unpopular or a widely used patent may be superseded by a superior one.

Finally, in cases where the value of particular IPRs to licensed end-users depends on their continued access to expert advice and service from the owner/debtor, the collateral value of the income stream owed by licensed end-users is uncertain. Once the defaulting debtor is no longer in business and 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.[22]

2.2 Possible Responses to Valuation Challenges

2.2.1 Introduction

There is considerable variation in the degree to which valuation challenges diminish the attractiveness of IPRs as collateral for secured lenders. 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 example of David Bowie's aggregate copyrights in his music mentioned by Knopf [23] 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 an IPR as collateral simply by reason of the creator's established reputation in relation to past IPRs of the same genre. Nevertheless, relative to more traditional types of collateral, IPRs suffer from inherent valuation challenges that impede IPR-secured lending. Can these challenges be offset?

Research solicited by the Law Commission suggests that the valuation challenges created by the "idiosyncratic" nature of IPRs will diminish as lenders become more familiar with the intellectual property world and begin to acquire specialized experience and expertise. This is a process that will unfold naturally without the need, in our view, for formal government intervention, as IPRs continue to account for a growing proportion of the assets of debtor enterprises.[24] Empirical research indicates that general institutional lenders are increasingly prepared to extend IPR-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 venture capitalist's expert and specialized judgment.[25] As IPRs become more commonly used as collateral, valuation techniques will improve thus allowing more widespread use of IPRs as security.

2.2.2 Substantive Intellectual Property Law Reform?

Several of the inherent valuation challenges identified above are not attributable to a lack of IPR valuation expertise. Rather they stem from substantive or procedural features of the current Canadian legal framework governing IPRs and related rights. While changing these features could reduce uncertainties in collateral valuation, this advantage must be evaluated against the possible costs of undermining important principles of intellectual property law.

For instance, making registration of copyrights a precondition 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 prerequisite to the right to copyright protection. As another example, we noted earlier that lobbying by businesses to facilitate commercial transactions involving trade-marks eventually led to legislative amendments to permit assignments "in gross."[26] However, the practical impact of this reform has been largely negated by judicial decisions holding that a trade-mark assigned independently of the business with which it is associated is likely to be found invalid. Such jurisprudence reduces the commercial and collateral value of trade-marks. However, it is fully compatible with the fundamental policy intention behind trade-marks, which is to reliably identify the source of the wares.

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 available to the public."[27] 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-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 to improve the quality of issued patents. However, such an approach would probably not be cost-effective, since this more stringent examination process would apply even to patents destined never to be used as collateral or never to be challenged.

2.3 Summary

Because of their inherent legal nature and characteristics, IPRs pose unique valuation risks for secured creditors compared with other types of movable and immovable property. First, most IPRs have a statutorily limited legal life. Next, and even more important, because they are by nature concerned with innovation, all IPRs are susceptible to being rendered obsolete by further innovation and therefore have a potentially limited economic life. Moreover, because the value of an IPR is often linked to a specific application in a specific company, its liquidation value may be significantly lower than its use value. IPRs are also subject to legal challenge, 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 unacceptably compromising fundamental policies of intellectual property law.[28] The greatest potential for reducing the valuation risk associated with IPRs lies in improving valuation techniques. Those techniques will become more reliable as assessors gain practical experience in evaluating IPRs. Thus, eliminating other barriers to the use of IPRs as collateral will also indirectly reduce valuation risks.

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1 *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 . . ."

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

3 *Ibid.,* s. 46.

4 *Copyright Act,* s. 6.

5 *Ibid.,* s. 14.

6 See Part 2.1.5 below.

7 Townend at 431. See also Lipton at 262 "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 312 "The average life of a patent is about 5 years."

8 Mann at 139.

9 "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 308–9.

10 See, for example, Mann at 155.

11 Smith at 316; see also McFetridge at 273.

12 "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 263.

13 "The divestment team has to create a "legend" as to why this division's prospects were hampered by the corporate grip (e.g., the accounting system was inappropriate, corporate overhead charges were excessive, the supervising executives were better at squeezing blood out of a stone than nurturing growth). The only basis for selling the patents is to attest to the buyers about the incompetence of the prior managers." Rutenberg at 334.

14 McFetridge at 273.

15 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.).

16 *Trade-marks Act,* s. 18(1)(b).

17 *Trade-marks Act,* s. 48(1).

18 See *Heintzman v. 751056 Ontario Ltd.* (1990) 34 C.P.R. (3d) 1(F.C.T.D.) for an example of this.

19 More common attacks on the validity of the copyright include lack of originality and expiration of the term of protection.

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

21 *Copyright Act,* s. 14.1.

22 See Mann at 141.

23 Knopf at 8.

24 "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 432.

25 See generally Mann.

26 See Part 2.1.5 above.

27 Townend at 434.

28 This is not to say that that there are no changes to intellectual property law that would help reduce valuation uncertainty without adverse substantive effects on the integrity of intellectual property policy. For example, Parliament might re-examine the rule that copyright ownership reverts to the author's heirs 25 years after the author's death despite a previous assignment and might also make it clear that a subsequent assignee and secured creditors are entitled to invoke a waiver of authorial moral rights. However, such reforms would likely have only a relatively minor impact on valuation uncertainty.

3 Uncertainties in the Current Federal Registration and Priority Framework

3.1 Sources of Uncertainty

3.1.1 Uncertain Reliability of Federal Intellectual Property Registries as Records of Ownership

A prospective secured creditor's first step should be to identify the existence, nature and extent of the would-be 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 would-be debtor's legal title.

Under three of the federal intellectual property acts – the *Trademarks Act*, the *Industrial Design Act* and the *Integrated Circuit Topography Act* – registration of an assignment in the federal title is merely permissive. Although the assignment may be registered, registration is not made a prerequisite 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 that the would-be debtor (despite being the apparent owner of record) had not previously disposed of the IPR under an unregistered assignment.[1]

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.

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.[2] 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 took place.

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.[3] 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 Intellectual Property Statutes to Secured Transactions

Despite extensive analysis of the potential impact of the registration provisions of federal statutes on the priority of security taken in federal IPRs, no firm conclusions can be drawn.[4] On the contrary, there is a general, indeed universal, consensus that virtually any question relating to priority cannot be determined with certainty.

First, it has not been determined whether secured transactions even fall within the scope of the federal 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?[5] If so, is their application limited to assignments created by a formal transfer of title, or do they apply to all transactions that charge or hypothecate IPRs, even where formal title is retained by the debtor? [6] The answers to both questions remain speculative.

The prevailing uncertainty on the basic question of the applicability of the federal intellectual property 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 uncertainty. For instance, the Registrar of Trade-marks will make an annotation on the record indicating that the Registrar has received a security agreement purporting to affect the trade-mark in question, but this practice has no legislative base. The absence of rules makes it virtually impossible to determine priority as 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.[7]

Moreover, even if it were made clear that the registration provisions of the federal Intellectual property statutes apply to security interests, this would not eliminate the existing uncertainty. As we have just seen,[8] the statutes as currently 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 effect is almost entirely speculative.[9]

3.1.3 Operational Deficiencies

In addition to this profound legal uncertainty, current registry practices are not sensitive to the information needs of either prospective secured creditors or prospective assignees of federal IPRs. The patent, copyright and trade-marks databases are currently accessible online, but the online source is not adequate for due diligence searching in respect of either financing or purchasing. None of the online databases are guaranteed to disclose all relevant information, and such information as is disclosed may be several weeks out of date.[10] Security agreement information does not appear at all in the online patent database.[11] As Knopf notes, "[s]uch uncertainty does not exist and would not be considered acceptable in other Canadian registration regimes, such as those for real estate or PPSA [personal property security act] filings."[12]

3.2 Reducing Uncertainty

The law relating to the priority of security interests in federal IPRs is uncertain. Should something be done about it? Research has tended to focus on the sources of current legal uncertainty. No attempt has been made to quantify the impact of this uncertainty on the cost of lending.

An accurate assessment may not be feasible, given the difficulty of separating the additional costs created by the legal risk associated with an inadequate secured transactions legal framework from those attributable to the unique valuation difficulties posed by IPRs.[13] Nevertheless, it is at least possible to identify the general nature of the additional costs created by the current legal uncertainty.

Dual registration is the most obvious source of additional costs. If the IPR collateral is important enough 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 than in that of other movable assets. This imposes both an increased initial risk assessment and an ongoing monitoring burden on secured creditors for which debtors ultimately pay in the form of less accessible and costlier secured credit.[14]

For example, the prevailing uncertainty about 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 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 and demand by borrowers and lenders for IPR-secured financing grows.[15] 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 the incremental resolution of uncertainties will itself create additional costs as the lending community is forced to continually adjust its risk assessment rules and practices in light of the latest judicial ruling on the issues.

Immediate legislative reform would likely accelerate the demand for IPR-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 commonplace as the taking of security over houses in the residential property market.[16]

3.3 Summary

The law relating to security interests in IPRs is fraught with uncertainty. Before considering security interests themselves, any secured creditor, or more broadly, any potential assignee, must ascertain the debtor's title to the asset being offered as collateral. Although title registries exist at the federal level for all federal IPRs, these are not reliable for purposes of title investigation. Under three of the federal intellectual property 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; examination of the title register does not provide authoritative information regarding title. Under the remaining 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 that registers first.

Even so, details of existing law mean that the registry 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. Moreover, the courts have held that priority established by mere registration is subject to the exceptions to first-in-time priority embodied in certain principles of provincial property law, thus further undermining the value of the registry as a source of title information.

When security interests are added into the mix, the uncertainty increases dramatically. Virtually all aspects of priority contain uncertainty. First, it is not clear which secured transactions fall within the scope of the federal registration provisions. Are all secured transactions federally registrable, or only those that are formally cast as assignments? It may be that none are registrable. Even if registration of a security interest does not establish priority of its own effect, annotation of such a registration may serve as notice or constructive notice and so establish priority indirectly.

In addition to this legal uncertainty, current registry practices are not sensitive to the information needs of either prospective secured creditors or prospective assignees of federal IPRs. The patent, copyright and trade-marks databases are currently accessible online, but these online resources were designed for other purposes, such as searching prior patents. They are not adequate for financing- or purchasing-related due diligence searches since they may be incomplete or out of date.

This uncertainty increases direct costs because lenders are routinely advised to register under both federal intellectual property law and provincial secured transactions law and to observe the formal requirements of both systems. Yet even this practice does not eliminate priority uncertainty of federal registration. And the interaction and potential conflict between federal statutes and provincial secured transactions laws undermine the confidence of secured creditors in the quality of IPR collateral relative to other movable assets. This increases both the initial risk and the ongoing monitoring burden for secured creditors, inconveniences for which debtors ultimately pay in the form of less accessible and costlier secured credit.

For many years, lawyers with expertise in intellectual property law have recognized that there is uncertainty in secured transactions involving intellectual property. In 1998, after the matter was studied by the National Intellectual Property Section, the Canadian Bar Association urged the Government of Canada to enact a national scheme for the registration of security interests in personal property.

Although the benefits of a reformed legal framework for IPR-secured financing are difficult to quantify, the current uncertainties are so well documented and so pervasive that the cost savings are bound to justify the investment. The case for reform is especially pressing in view of the expected increase in demand for IPR-secured financing that will accompany improved access and reduced costs.

Recommendation 1

Parliament should improve the legal framework governing federal intellectual property rights to reduce the legal uncertainty associated with taking such rights as collateral.

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1 Wood (2002) at 671.

2 See Wood (2002) at 671. 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.

3 See the controversial Federal Court decision to this effect in *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 122–3 and Wood (2002) at 684–5.

4 In addition to the papers prepared for the Leveraging Knowledge Assets Conference/Roundtable by Wood; Spring-Zimmerman *et al.*; Knopf; Adams and Takach; and Duggan. See also Cuming and Wood; Wood (2000); Mercier and Haigh; and Gold.

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

6 Wood (2002) at 679–80; Spring-Zimmerman *et al.* at 120.

7 Spring-Zimmerman *et al.* at 120; Knopf at 57.

8 See Section 3.1.1. above.

9 Wood (2002) at 683–6.

10 Knopf at 49.

11 *Ibid.*

12 *Ibid.*

13 McFetridge notes at 272 that "[t]he loss to the economy due to the use of less efficient forms of finance would be difficult to measure in practice."

14 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 271.

15 "[I]t would appear that demand for improvement of the legal framework will increase if the economy worsens and asset-based financing makes a resurgence." Knopf at 86.

16 Townend at 450.

4 Reform of the Ownership Disclosure Function of the Federal Intellectual Property 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 intellectual property registries is a reliable indicator of current legal ownership. How, then, might federal law and practice be reformed to make the intellectual property registries more reliable records of a would-be debtor's legal title. More fundamentally, are reliable title registries for federal IPRs needed at all? If true title registries for federal IPRs are unfeasible 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. Although this would not help prospective secured creditors verify a would-be debtor's title to a particular federal IPR, it would at least eliminate the current uncertainty about the effect of registering or failing to register one's title.

4.2 Are Conclusive Legal Title Registries Needed for Federal IPRs?

There is no question of altogether abolishing the federal intellectual property registries. With the exception of copyright,[1] registration is a prerequisite to the very coming into existence of the IPR. Until registration, the IPR does not exist. Registration also provides certain benefits to holders of copyrights. 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,[2] the registered copyright owner is relieved of the need to provide the off-record 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,[3] 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[4] 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.[5]

So the question is not whether the federal intellectual property registries should be preserved, but rather whether the priority effect of registering an assignment should be strengthened so as to make registration of an assignment conclusive evidence of legal title against competing unregistered assignees.

The argument in favour of reforming the federal intellectual property 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 title, but also for the purposes of assignment and licensing transactions.

Of course, the same arguments would justify the establishment of a title registry for any item of property, not just IPRs. Yet title registries have *not* been put in place for most categories of movable property. For the most part, the cost is not worth the benefit. Either 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. The question, rather, 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 in three important ways. 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 obliterated through their transformation into cash and their absorption into 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 can be subdivided among different owners, either through partial assignments or through the grant of territorially confined exclusive licences. Finally, like land, IPRs last long enough that successive transfers of ownership (and a correspondingly lengthy chain of title) are a real likelihood. In short, as with immovables, establishing a title registry for IPRs can be justified on the grounds of commercial efficiency.

Parliament has already endorsed the idea of a true title register for patents, copyrights and plant breeders' rights; the registries established under the *Patent Act*, the *Copyright Act* and the *Plant Breeders' Rights Act* all give some level of third-party effect to registration of an assignment. However, their failure to provide a comprehensive regime leaves significant uncertainties. 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 that would justify different treatment from copyright. Both provide protection for subject matter very similar to that protected by copyright,[6] and the case for a true title registry is, if anything, even stronger for industrial designs and integrated circuit topographies because, unlike copyright, these types of IPRs only come into existence by virtue of their registration.

The situation with trade-marks is somewhat different. Unlike the other categories of IPRs, trade-marks have no resale or 'subdivision' market 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.[7] 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 respond in a timely manner, the registration may be expunged.[8] A transferee who does not register the transfer and thereby provide an address for service[9] therefore runs the risk of expungement without notice. This means that requiring the transferee to register to preserve its title would place little additional burden on the transferee. Moreover, unlike the current situation 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.[10] This suggests that there is a sufficient assignment market for trade-marks to justify the advantages of extending third-party legal effect to registered title and registered assignments of title.

We therefore recommend adopting the ownership-disclosure function of all six federal intellectual property registries with the features described below. 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 intellectual property 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. The rest of this report proceeds on this assumption.

Recommendation 2

All of the federal intellectual property statutes should create true title registries so that registration of a transfer of a registered federal intellectual property right will be conclusive evidence of legal title against any unregistered transfer.

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 way to ensure the reliability of a registry.[11] 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 has only a negative priority impact, not a positive one.[12] 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.[13] Elimination of the actual knowledge doctrine is in line with contemporary legal policy for both land and movables registries.[14] 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.[15] 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.[16]

An exception to the strict first-to-register rule of priority should prevent a transferee from taking advantage of it if the transferee has acted fraudulently or in bad faith. However, the mere fact that the transferee knows of a prior unregistered transfer should not of itself constitute fraud or bad faith. There must be some additional element of misleading conduct or deceit before the exception can be invoked. Land titles systems and personal property registry systems that use a strict first-to-register rule of priority also recognize a fraud exception, and there is no reason in principle why a similar rule cannot be employed in the context of IPRs.

Recommendation 3

The federal intellectual property registries should be governed by a strict first-to-register rule of priority in which knowledge of a prior unregistered interest is irrelevant, except in the case of fraud or bad faith.

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 that 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.

It is appropriate that the registries allow for all types of transfers of IPRs, including licences or assignments.

Recommendation 4

The federal intellectual property registration regimes should permit the registration of all transfers, grants of interests or interests in applications for grants in federal intellectual property, irrespective of whether those grants of interests are by assignment or licence.

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 intellectual property registries are significantly reformed to permit cheap and efficient remote access. Though considerable progress has been made in making federal IPR database information available online, these efforts have been aimed primarily at substantive searching, such as for 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, online searching, including full chain-of-title searching (that is, grantor/grantee searching) for all IPRs.

Recommendation 5

The federal intellectual property registration systems should be overhauled to ensure that they support reliable, current, online searching of the full chain of title of all federal intellectual property rights.

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1 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 the moment it is expressed in material form. Unlike both Canada and the United States, many countries have, therefore, not elected to provide a public registration system for copyrights. See, for example, Patry at 394 ff.

2 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."

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

4 *Ibid.,* s. 7(3).

5 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 statutes that says the registered owner is 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 "[t]he certificate, in the absence of proof to the contrary, is sufficient evidence . . . of the person named as proprietor being proprietor."

6 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* but for s. 64 of the *Copyright Act*.

7 See Part 2.1.5 above.

8 *Trade-marks Act,* s. 44.

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

10 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."

11 See, for example, CCQ art. 2945, 2946.

12 See Part 3.1.1 above.

13 *Ibid*.

14 See, for example, CCQ art. 2963: "Notice given or knowledge acquired of a right that has not been published never compensates for absence of publication."

15 A discussion of the disadvantages of this still-current doctrine 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.

16 A source of uncertainty may arise in principle with respect to unregistered copyrights. Because registration is not a prerequisite to the existence of copyright, an assignee of an unregistered copyright faces the risk that the copyright was the subject of a 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 7.4.2.

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 intellectual property 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.[1]

One possible solution to this latter problem would involve a choice of law approach as opposed to a substantive law reform strategy.[2] 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.[3] For Quebec debtors, the relevant provisions of the *Civil Code of Québec* (CCQ) would apply; for debtors located in the other provinces and territories, reference would be made to the relevant PPSA. 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; for example, French law would govern French debtors. In the interests of precision, and because the potential application of non-Canadian secured transactions law to security granted in Canadian IPRs by foreign debtors creates its own set of uncertainties and risks,[4] we prefer to call this reform option the choice of law approach.

This part of the report analyzes how the choice of law approach would be implemented, outlines its advantages and disadvantages, and discusses 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 results 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.[5] However, minute variations can still result in different substantive laws being 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 than 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 located.[6] If the debtor has its registered office in Montréal 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, secured creditors would need to register in both provinces. This not only increases cost and inconvenience, but it also increases substantive risk. 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 be in place first. 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 are likely to be resolved. The cost of the uncertainty is not just the risk of being subordinated but also 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 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 intellectual property registries and the provincial secured transactions regimes, is needed to adequately resolve such disputes. And, to ensure both 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, for example, 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 rule delineating debtor location for the purposes of security interests 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. What's more, 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 (including both intellectual property and other property), the choice of law approach requires dual searching to discover prior transfers of IPRs whenever a security interest is taken in assets that include IPRs. We agree with Professor Wood's observation that "the elimination of dual searches is a quixotic enterprise in this particular field" and that it is of marginal benefit.[7]

The second perceived advantage of the choice of law approach to law reform is that it requires minimal expenditures compared with the federal approach discussed in Part 6. This perception may not be accurate. As noted in Part 3 of this report, significant substantive reform of existing federal intellectual property 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, while 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 resources on both substantive and structural reform 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 Canada; in such cases, the content of the applicable secured transactions law will be outside the control of both the federal and provincial 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.[8] 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 through 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 one that would preserve the benefits associated with the title registry reforms 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 intellectual property registry and in the secured transactions registry of the province or territory where the debtor is located.

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.[9] Consider the following hypothetical situation:

> *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 intellectual property 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 disposition of the collateral without authority. But protecting the secured creditor shifts the inquiry burden to later assignees in the position of B2. As the chain of title grows longer, the inquiry burden on assignees becomes 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, assignees will need to determine the names and locations 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 will face precisely the same onerous search burden. To protect 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

The considerable variation among provinces and territories regarding the applicable legal rules for determining the correct name of a debtor for registration and searching purposes further complicates the coordination challenge. It 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. Prospective assignees and secured creditors 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.

Moreover, there are at present no 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 intellectual property registries. Consequently, without further reform, searchers 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 intellectual property registries for the purposes of conducting provincial searches. This problem does not arise in respect of secured transactions generally since, in the absence of a title registry, a prospective assignee or secured creditor will only search by the name of its immediate transferee or debtor, 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 validly registered as a matter of provincial secured transactions 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, the federal government would have to implement formal name rules for entering ownership and assignment of ownership in the federal title registry. Second, federal and provincial name rules would have to be made uniform, as would rules between provinces. Both steps are required to ensure that all interests registered provincially 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 be the penalty 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 systems (i.e., 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 becomes available only in the event of conflict between two rival claimants. In general provincial secured transactions law this is acceptable since invalidity of the registration prejudices only the party that registered according to the incorrect name; but in the federal title system it also destroys 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 that granted the original 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 intellectual property registries conformed to the applicable federal rules even though the debtor (in his or her capacity as the initial IPR owner or assignee) would have been responsible for the federal registration. 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, not only that all the debtor's IPRs were registered in the federal title register, but also that the registrations conformed with the federal name rules.

What's more, such steps would only ensure that the debtor/owner in the chain of title was correctly registered according to the federal name rules. It would not in itself suffice to ensure that all security interests granted by prior owners were 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 name 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 agreed to and adopted by the 13 provinces and territories and the federal government. However, the likelihood of achieving this should not be overestimated given that even the PPSA jurisdictions have not yet managed to achieve such uniformity.

5.5 Possible Structural Solutions to the Coordination Challenges

Are there structural solutions to these problems? In the United States, a report by the Franklin Pierce Law Centre[10] (FPLC Report) commissioned by the United States Patent and Trade-mark Office 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. Although the databases would be separate, to the user it would look as though only a single registry was being searched.

Would the 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 IPR? 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 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 13 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 will 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.[11] 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 intellectual property 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.[12] 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.

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 Canada. But sometimes the owner/debtor will be located elsewhere. Consider, for example, the large number of Canadian patents issued to U.S. patentees.

We have seen that chain-of-title searching imposes significant obstacles to 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 a Canadian IPR, 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 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 search the state Article 9 register of the state in which the debtor/owner is located. The same would be true if the lender were dealing with a Canadian debtor who had taken an assignment of the patent from an original U.S. owner.

Worse, many countries outside 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 intellectual property registries. Rather, a special rule to accommodate foreign debtor/owners located in jurisdictions that lack a security registry would need to be crafted along the following lines:

> *Where the registered owner of a federal IPR is located outside 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 for making a security*

interest effective against third parties imposed by the secured transactions law of the jurisdiction where the owner was located.

However, the practical result of such a rule is that any encumbrance 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.[13] However, these registries are territorially confined, like the federal Canadian registries, to IPRs to be exploited within the borders of the particular country.[14] They are not designed to accommodate the registration of security in Canadian IPRs.

One possible solution would be to require that secured creditors taking security in Canadian IPRs from foreign debtor/owners and wishing to prevail against federally registered assignees of the same IPRs register in a provincial secured transactions registry. However, implementation of this solution is fraught with difficulties. There is no principled basis for choosing which of the provincial secured transactions regimes should apply to security granted by foreign debtor/owners; and this could lead 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 cost-effectiveness of this solution.[15]

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 considered just as territorially fixed as real estate. There is no universal concept of an IPR. Even though international conventions may impose minimum standards, an IPR is still a bundle of nationally determined rights that are applicable only in the jurisdiction where the property is exploited. It follows that, as with land, IPRs within each country are governed by the national law of that country.[16]

The territoriality principle that pervades intellectual property law, and its analogy to land, means that the location of the collateral, rather than 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 in most countries is typically integrated 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.[17] 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 reform efforts centred on Article 9 contemplate close coordination with the federal law on intellectual property ownership and its transfer.

It follows 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 will almost certainly be adjudicated in the country where they arise and the courts of that country will almost certainly apply their own substantive registration and priority rules to resolve it.

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

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 has outlined a choice of law approach to this problem, while Parts 6 and 7 examine 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.

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 determine 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 enough variation in the fine print of provincial statutes 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 intellectual property registry and in the secured transactions registry of the province or territory where the debtor is located.

One of the features of the choice of law approach is that it invokes more than one legal system: the law of the debtor's location applies to the registration and priority status of security rights, while determinations relating to ownership and assignment of the IPRs are subject to federal law. This has two main disadvantages, the first of which is the chain-of-title problem. 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 to determine whether those prior owners had granted prior security interests. Thus the existence of the federal title register makes it more complicated for a prospective creditor to ascertain priority of security interest in a federal IPR than in a more traditional form of personal property. Moreover, the lack of uniformity in debtor/owner name rules between provincial and federal registries means that valid security interests granted by prior owners may remain invisible, 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 (a process whereby a single online portal automatically queries 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 owners 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 still, many countries outside 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.

Recommendation 6

To resolve the priority claims of secured creditors to federal intellectual property rights, Parliament could enact a federal choice of law rule that designates the law of the debtor's location as the law applicable to registration and priority. Because this approach makes it more difficult to search a chain of title and creates problems where foreign debtors are involved, it should be regarded as a second-best solution and should be adopted only if Parliament thinks that it is unable to implement a federal substantive approach to the problem.

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1 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) raises 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 several additional priority considerations.

2 See generally the so-called provincial reform approach identified by Wood (2002). While these authors do not use the term choice of law, the provincial approach they discuss depends on a choice of law connecting factor. See generally Walsh.

3 See Part 1.1 above for precise citations.

4 As to which, see Part 5.6 below.

5 For Quebec, see CCQ art. 3105, para. 1 and 2. For the common law provinces and the three territories, see, for example, NB PPSA s. 7(2)(a), Ont PPSA s. 7(1)(a)(i). Although the CCQ and the PPSAs 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.

6 Compare CCQ art. 307, "The domicile of a legal person is at the place and address of its head office," with 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."

7 Wood (2002) at 694.

8 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, for example, NB PPSA s.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.

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

10 The FPLC Report is summarized in Ward and Murphy. It has not yet been formally accepted by the United States Patent and Trademark Office.

11 The FPLC Report is not as clear as might be desired on this point. The entirety 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, para. 64. Presumably owner name rules under the federal intellectual property acts would be amended to correspond to the state UCC rules, although the report does not address this point.

12 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 interest was registered against that particular asset.

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

14 The multilateral Madrid and Hague Systems are an exception. Under these systems, a trade-mark or industrial design owner in one of the member states can obtain protection for the mark or design in some or all of the member jurisdictions by filing a single international registration with the World Intellectual Property Organization (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.

15 On all the points made in this paragraph, see generally Walsh.

16 See, for example, 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 30–31, 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 30–31, 2001); Martin Wolff, *Private International Law*, 2d ed. (Clarendon Press, Oxford, 1950) at 547–8; James J. Fawcett and Paul Torremans, *Intellectual Property and Private International Law* (Clarendon Press, Oxford, 1998).

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

6 Federal Substantive Approach

6.1 Introduction

This part examines the possibility of amending the federal intellectual property statutes 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 in Part 4 for competing assignees would be extended to secured creditors).

As previously noted, we refer to this as the federal substantive approach, or simply the federal approach, in the interests of brevity. In fact, 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, including 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 pre-empted 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; the same is true 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 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 that was not so registered. It follows that a federally registered assignment or security right could never be subordinated to a security right that had been 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 associated with the choice of law solution outlined in Part 5. The search burden would be simplified, as prospective secured creditors and assignees that intended to register federally would need to search only the federal intellectual property 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 happened 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 into line with the widely accepted territorial approach to determining the third-party effects of property dealings in IPRs.[1]

Recommendation 7

Parliament should amend the intellectual property statutes to provide for the federal registration of security interests in the intellectual property registries.

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.[2]

6.2.2 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.[3] It is true that once registered federally, a factually identical trade-mark 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.[4] Although it would probably be desirable to establish 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 that have independently begun using the same mark that only one party has registered.

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 that 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.[5]

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 licensing 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?

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, these royalty payments 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 registry 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 licensed 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, although 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, legislation has provided for the registration according to assignor name of outright assignments of "accounts" or "claims" of the debtor against third parties.[6] Accordingly, it is possible, at least for Canadian owner/debtors, for 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 counterbalance the advantages of a unified treatment of all accounts, no matter what the source.

In conclusion, 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 and 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 the original IPR? The same considerations that dictated our conclusion that IPR-related proceeds such as royalty payments should not be subject to the federal regime as original collateral also dictate 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 registry other than the one that creates 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.[7] The experience in that jurisdiction has shown 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 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 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.[8]

Clearly, if the federal first-to-register priority regime is extended to secured transactions involving federal IPRs, the same substance-over-form test should be used to determine when the grant of security by a licensee-debtor will be subject to that regime.

Recommendation 8

The federal registry system for security interests in intellectual property should apply only to federal intellectual property rights. Security interests in royalty payments should be excluded from the scope of the federal system.

6.3 Priorities

6.3.1 Secured Creditor versus 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.

6.3.2 Secured Creditor versus 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 that is not registered federally is entirely ineffective? Or is a "mixed" federal system preferable, in which a provincially registered interest is effective except in competition with a federally registered 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 *Peregrine*[9] decision, Judge Kozinski favoured the opposite conclusion, holding that a security interest in copyright that 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. The same objective could be achieved even in a mixed system as long as federal registration, as outlined above, always superseded 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 that had only been registered or otherwise publicized in accordance with the law of the debtor's location could be safely ignored.

In the context of a reformed ownership registry regime, it is worth revisiting our Recommendation 3 that "the federal intellectual property registries should be governed by a strict first-to-register rule of priority in which knowledge of a prior unregistered interest is irrelevant."[10] It bears emphasizing here that the same policy must be adopted for security interests if the mixed federal approach is to work. The holder of a federally registered interest must have priority over a creditor whose interest is not registered federally (even if that interest was registered or otherwise publicized under the law of the 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 registries or personal property charge registries. If knowledge acquired in this way were to affect priority, the mixed federal approach would be fatally undermined.

6.3.3 Secured Creditor versus Debtor's Insolvency Administrator

In our view, there is similarly 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.

6.3.4 Secured Creditor versus 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.[11] A growing number of common law provinces have adopted a similar policy.[12] The rationale is a compelling one since this approach indirectly promotes the prompt satisfaction of judgment debt without the expense and burden of having to pursue active judgment enforcement measures. Once 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 among competing registered interests determined by their order of registration.[13] Of course, to maintain the integrity of the federal registry as the sole authoritative source of priority ranking, the judgment creditor, like any secured creditor, would have to have publicized its interest through federal registration to secure priority in competition with another federally registered 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.

Recommendation 9

To have priority over another security interest subsequently registered in a federal intellectual property registry, a security interest would have to be registered in the federal intellectual property registry system. However, registering a security interest in a federal intellectual property right in the provincial registry system would be effective to establish priority over any interest that was not registered federally, including the debtor's insolvency administrator.

6.4 Summary

The alternative to the choice of law approach is a federal approach under which the federal intellectual property 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 that was not so registered.

While we refer to this as a federal approach, 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. Further, only security interests in federal IPRs themselves would be subject to the federal regime; security interests in IPR-related rights, particularly 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 pre-empted only for the purposes of resolving a contest involving at least one federally registered claimant. Furthermore, although a provincially registered security interest in a federal IPR would be subordinated to any federally registered interest in that IPR, the provincially registered interest would, nevertheless, take precedence over any interest that was not registered federally, and over the debtor's insolvency administrator.

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1 See, for example, Austin, Walsh.

2 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.

3 Although s. 7 of the *Trade-marks Act* confers a set of federal rights on unregistered marks that is essentially identical to the one provided under provincial law, it is not intended that these rights be included within the federal registry system.

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

5 See Part 7.4.2.

6 See, for example, NB PPSA s. 3(2)(a) and CCQ art. 1642. But note that, unlike the PPSAs, the CCQ 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 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 CCQ'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.

7 A secured creditor's right to proceeds under art. 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.

8 This would have an added advantage of making it unnecessary to distinguish between an absolute assignment of the licence and a transfer by way of security.

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

10 See Part 4 above.

11 CCQ art. 2730.

12 See, for example, ss. 2.2–2.6 of the NB *Creditors' Relief Act* combined with s. 20(1) of the NB PPSA.

13 The priority effect of registration against other judgment creditors or unsecured creditors, however, should perhaps be decided by the law of the debtor's location. 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, for example, the various provincial creditors' relief statutes and the more recent Alberta *Civil Enforcement Act* and Newfoundland and Labrador *Judgement Enforcement Act*. 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.

7 Structural and Operational Reforms of the Federal Intellectual Property 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. The legal and design reforms needed to modernize the title aspects of federal intellectual property registries are discussed in Part 4 above. Below we look at how the federal system would need to be reformed to support the proposed federal approach to security interests in IPRs.

7.2 Notice-registration versus Document-filing

The simplest reform would be to make specific provision for the federal registration of security interests. This should be very minor if it is undertaken at the same time as the title-side reforms discussed in Part 4.

Part of the government's law reform decision involves making a choice between a notice-registration system and a document-filing system. A notice-registration system, unlike a document-filing registry, does not require the actual security documentation to be filed or even tendered to the registry.[1] 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 widespread acceptance of the superiority of notice-registration over document-filing in the 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 multilingual registries, the efficient computerization of the registry record and registry access, and more effectively protect the privacy 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. Changes in the terms of their security agreements need not be reflected in the registration record as 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.[2]

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.[3] There is no reason why notice-registration would be any less advantageous for security in intellectual property.[4]

Accordingly, we recommend that notice-registration be adopted in any federal registry system that might be established for security in federal IPRs.

Recommendation 10

The federal registry system for security interests in intellectual property should adopt a notice-registration system.

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 intellectual property 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 intellectual property 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 federal intellectual property registries might be maintained as ownership registries exclusively 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 intellectual property 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 that 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 be achieved equally well 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. To the user, the registry would appear to have only one database, no matter how the databases are configured.

In Part 5 above, we noted that one impediment to the effective implementation of gateway searching was the difficulty of achieving uniform debtor name rules among federal, provincial and territorial governments. Under the federal approach, coordination would not present the same difficulty, even if separate federal intellectual property registries were maintained, since all would fall within federal jurisdiction. There is no reason for different name criteria for the different federal registries and, if they were modernized, ensuring standardization would be a simple matter. Once this was accomplished, the problem would be solved and the issue of whether the federal intellectual property 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

Basic Solution

Difficulties arise in regard to after-acquired property because of the specific asset-based indexing and searching system currently used for the federal intellectual property registries. Leaving aside copyright, which is discussed below, the main obstacle to the unification of the federal registries that house current and after-acquired federal IPRs is the obsession with reliable asset-specific searching; to find all interests, including security rights, in a specific IPR using an asset-based search alone, all interests must be indexed and searchable according to an asset-specific identifier. But IPRs acquired by the debtor after the security agreement is entered into cannot possibly be referenced to the security interest. It is simply not possible to index the security interest by reference to an after-acquired IPR.

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 in the same generic category.

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, to know whether the security right was effective. But, as discussed 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. Again, the same inquiry would be necessary under a choice of law approach.

In other respects, the federal solution would greatly reduce the inquiry burden on third parties, compared with 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 since the problem of searching multiple provincial or territorial registries under the choice of law approach could be ameliorated using a gateway search technique.[5] The more important advantage of the federal model is that it would eliminate the problem of debtor name uniformity and the foreign debtor problem.

Recommendation 11

The federal registry system for security interests in intellectual property should provide a separate federal name-indexed registry for security interests and should permit a secured creditor to register an interest in after-acquired intellectual property rights.

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 the secured creditor could protect itself. The methods will vary according to whether the security in unregistered copyrights is excluded from the federal registry system applicable to security in copyrights.

If security in unregistered copyrights were excluded from the federal registry system, 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, if it wanted to fully protect its interest. Provincial registration would protect the secured creditor's priority against subsequent secured parties and subsequent transferees as long as the copyrights remained unregistered, but prompt federal registration would be necessary to preserve priority against a subsequent federally registered assignee or secured creditor once the copyrights were registered.

However, to protect its interests, the secured creditor would have to constantly monitor the federal copyright registry for new filings by the debtor 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 risk defeat if the debtor assigned the copyright, still unregistered, to a new owner who then registered federally and granted a security interest in the newly registered copyright.[6] 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. 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.[7]

Alternatively, security granted in unregistered copyrights might be included within the federal registry 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 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 noted above, the federal registry system for security in copyrights would be debtor-name indexed, 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 Summary

Some legal and structural reforms to the federal registry system are necessary or potentially desirable to accommodate the federal registration of security interests. Modernizing the title aspects of federal intellectual property registries, as outlined in Part 4, is an important first step. Implementing the federal approach to security interests in IPRs would require little more than a statutory provision enabling the federal registration of security interests. This reform should be technically very minor if carried out with the title-side reforms discussed in Part 4.

A registration could be implemented in one of two ways – through document-filing or notice-registration. In a document-filing system, the actual security documentation would be filed, whereas in a notice-registration system, only a notice need be registered, setting out the barest 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 interests. It would also be technically easier to implement than document-filing.

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 IPR. We do not make any recommendation as to which integration option should be implemented. As long as the registries are all available online 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, and the problem of non-uniform names would be avoided.

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1 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.

2 See for example, NB PPSA ss. 43(5) and (6).

3 See Siebrasse and Walsh, *Proposal for a New Brunswick Land Security Act.*

4 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.

5 Part 5.5 above (although note that the level of federal-provincial and inter-provincial cooperation needed is quite formidable).

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

7 Note that a similar problem arises in principle in respect of an 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, serves to protect the primacy of the federal register.

8 Implementation Strategy

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 have concluded that the valuation risk cannot be reduced by changing only the legal incidents and attributes of IPRs. However, governments can reduce the valuation risk by encouraging the development of expertise in the valuation of IPRs and the development of best practices in this domain. By sponsoring research and disseminating knowledge, governments can foster a climate that is more receptive to the use of IPRs as collateral.

Recommendation 12

Governments should encourage the development of expertise in the valuation of intellectual property rights and facilitate the development of best practices in this domain.

The Law Commission's research and consultation revealed that the expertise needed to facilitate the use of IPRs as collateral is dispersed among different specialists. Intellectual property lawyers are knowledgeable about IPRs, while commercial lawyers are knowledgeable about the creation of security interests. Many lawyers may not have access to well-drafted security documents that contain appropriate provisions for lending on the security of IPRs. Others may be unaware of the nature of the legal and structural changes that will have been introduced to facilitate the use of such property as collateral. As lenders increase their reliance on IPR-based collateral, lawyers will need to become conversant with the relevant aspects of *both* intellectual property law and commercial law. The Canadian Bar Association and the provincial law societies can help their members acquire the expertise they need by offering appropriate education programs and materials.

Recommendation 13

The Canadian Bar Association, the Intellectual Property Institute of Canada, law schools, business schools and law societies should support the development of educational materials and courses dealing with security interests in intellectual property and promote expertise in commercial and intellectual property law.

9 Conclusion

Action is needed to modernize the legal regime governing security interests in IPRs. The current framework is rife with uncertainty. Modernizing and rationalizing the rules governing security in IPRs will improve access to IPR-secured credit and lower its cost. It will also indirectly improve valuation capabilities since lender familiarity with IPR collateral will grow with increasing demand for IPR-based security.

There are two basic approaches to addressing the 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. Under the federal approach, the federal intellectual property 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 advantages that the choice of law approach is believed to offer 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, such as, 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 priority status under the choice of law approach, a potential secured creditor must first search the federal title registry to identify all owners in the historical chain of title. Next, the creditor must search the registry systems in the province or territory where each owner is or was located to determine whether that owner ever granted a prior security interest in the IPR. This means that different registries in several jurisdictions may need to be searched to determine the priority status. The challenge of successfully identifying all prior interests is exacerbated by interjurisdictional variations in debtor name rules. Without uniform debtor name rules, security interests validly granted by predecessors in title may be undiscoverable by a provincial search using the name in the federal title registry. This would result in irreducible uncertainty as to priority status, which would adversely affect the terms on which credit would be granted. Although a gateway approach to searching (i.e., a search in which a single query automatically addresses several registries) would facilitate the technical aspects of searching, it would not eliminate the need to conduct multiple searches. Nor would it resolve the uncertainty stemming from variation in debtor name rules. And if a foreign owner were identified in the chain of title, the problem would be exacerbated because security interests that 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, an interest validly granted in a country that does not maintain a general encumbrance registry would remain undiscoverable. This is another source of irreducible uncertainty.

Both of these problems are eliminated or dramatically reduced under the federal approach. At most, two registries would have to be searched: the federal title registry and the federal security interest registry. Debtor name variation and the accompanying uncertainty would be eliminated. The foreign debtor problem would also disappear since foreign creditors, like any creditor, would be required to register federally to establish their priority.

On the whole, we recommend the federal approach. The choice of law approach faces an irreducible obstacle – the possible presence of foreign debtors in the chain of title – an obstacle likely to loom larger with continued market integration. In summary, both approaches will likely entail a similar law reform effort. There is a pressing need to modernize commercial law to support innovation and the transition to a knowledge economy. The recommendations in this report aim to facilitate this transition in Canada.

List of Recommendations

Recommendation 1
Parliament should improve the legal framework governing federal intellectual property rights to reduce the legal uncertainty associated with taking such rights as collateral.

Recommendation 2
All of the federal intellectual property statutes should create true title registries so that registration of a transfer of a registered federal intellectual property right will be conclusive evidence of legal title against any unregistered transfer.

Recommendation 3
The federal intellectual property registries should be governed by a strict first-to-register rule of priority in which knowledge of a prior unregistered interest is irrelevant, except in the case of fraud or bad faith.

Recommendation 4
The federal intellectual property registration regimes should permit the registration of all transfers, grants of interests or interests in applications for grants in federal intellectual property, irrespective of whether those grants of interests are by assignment or licence.

Recommendation 5
The federal intellectual property registration systems should be overhauled to ensure that they support reliable, current, online searching of the full chain of title of all federal intellectual property rights.

Recommendation 6
To resolve the priority claims of secured creditors to federal intellectual property rights, Parliament could enact a federal choice of law rule that designates the law of the debtor's location as the law applicable to registration and priority. Because this approach makes it more difficult to search a chain of title and creates problems where foreign

debtors are involved, it should be regarded as a second-best solution and should be adopted only if Parliament thinks that it is unable to implement a federal substantive approach to the problem.

Recommendation 7

Parliament should amend the intellectual property statutes to provide for the federal registration of security interests in the intellectual property registries.

Recommendation 8

The federal registry system for security interests in intellectual property should apply only to federal intellectual property rights. Security interests in royalty payments should be excluded from the scope of the federal system.

Recommendation 9

To have priority over other interests subsequently registered in a federal intellectual property registry, a security interest would have to be registered in the federal intellectual property registry system. However, registering a security interest in a federal intellectual property right in the provincial registry system would be effective to establish priority over any interest that was not registered federally, including the debtor's insolvency administrator.

Recommendation 10

The federal registry system for security interests in intellectual property should adopt a notice-registration system.

Recommendation 11

The federal registry system for security interests in intellectual property should provide a separate federal name-indexed registry for security interests and should permit a secured creditor to register an interest in after-acquired intellectual property rights.

Recommendation 12

Governments should encourage the development of expertise in the valuation of intellectual property rights and facilitate the development of best practices in this domain.

Recommendation 13

The Canadian Bar Association, the Intellectual Property Institute of Canada, law schools, business schools and law societies should support the development of educational materials and courses dealing with security interests in intellectual property and promote expertise in commercial and intellectual property law.

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