APPENDIX 25 – PENDING FEDERAL REFORMS

A comprehensive discussion of pending federal reform proposals as of February 1, 2000 is contained in PRELIMINARY REPORT # 1: AN OVERVIEW OF THE CURRENT LEGAL STRUCTURES GOVERNING THE PERFECTION AND PRIORITY OF SECURITY INTERESTS IN INTELLECTUAL PROPERTY AND AN ANALYSIS OF PROPOSED REFORMS at section IV, pages 166-188.

APPENDIX 26 - THE EFFECT OF BANKRUPTCY UPON A FIRM USING PATENTS AND TRADEMARKS AS COLLATERAL

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INTRODUCTION

The Bankruptcy Code sets forth an orderly process for the distribution of a debtor-in- bankruptcy's assets. This process has the effect of altering many of the procedural and substantive rights and obligations of the debtor, as well as of the debtor's creditors. Parties asserting a property interest in assets of a debtor in bankruptcy, however, must rely on non-bankruptcy law to determine the nature and extent of their property interests. The most commonly asserted interest by creditors involved in a bankruptcy are security interests.

Security interests are consensual liens that arise at the inception of a credit transaction. While security interests are enforceable between parties to the credit transaction and as against third parties at the moment of their creation, secured parties must "perfect" their interests for their interests to

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survive a bankruptcy filing. The importance of the concept of perfection of security interests in bankruptcy cannot be overstated. An unperfected security interest can be avoided by the debtor's trustee in bankruptcy for the benefit of the bankruptcy estate. "Perfection for purposes of the Bankruptcy Code means priority against the ordinary creditor with a judicial lien (the lien creditor).

The body of non-bankruptcy law most often implicated when personal property is used as collateral is the state law captured in Article 9 of the Uniform Commercial Code (U.C.C.). Article 9 went through a major revision in 1998. Both the "old" and "revised" versions of the Article outline the rules for perfecting security interests in personal property collateral, and define the priority rights held by secured parties. Primary among the priority rights defined in Article 9 is the rule that a security interest that is perfected by a proper state notice filing has priority over the creditor with a competing lien (the lien creditor). The priority rule for lien creditors is just one of many rules in Article 9 designed to provide clear and certain rights to all parties in competition with security interests in all forms of personal property. Intangible personal property falls within the broad jurisdictional scope of Article 9.

The scope of Article 9, however, is not absolute. To the extent that Article 9 is preempted by another body of federal law, the preempting law governs the issue of how to establish a "perfected" security interest. Both the Patent Act and the Lanham Act include recording and transfer provisions. Both of these provisions protect subsequent purchasers against unrecorded assignments. It does not appear from the face of either statute, however, that the ordinary lien creditor qualifies as a protected purchaser. The preemptive force of these statutes remains uncertain, however, because some courts have defined the concept of protected transferee very broadly when dealing with federal recording provisions.

This uncertainty takes on greater urgency when the debtor, as owner of the intellectual property, files for bankruptcy protection.[1] Bankruptcy provides an acid test for the efficacy of non-bankruptcy law perfection of security interests; unperfected security interests are subject to avoidance in bankruptcy. The following sections outline the central effects of bankruptcy upon a firm using patents and trademarks as collateral.

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[1] See http://www.thestandard.com/article/display(listing, in what is called the "Dot-com Flop Tracker" internet companies that have failed).

PERFECTION OF SECURITY INTERESTS IN PATENTS AND TRADEMARKS

A. Perfection Put to the Section 544(a) Avoiding Powers Test

Non-bankruptcy legal regimes outline the methods for the transfer of interests in patents and trademarks – namely the Patent Act[2] and the Lanham Act.[3] Both of these federal statutes provides a method of documenting and recording interests in intellectual property by the specific property number assigned by the appropriate federal regulatory agency. A structural element common to these statutes is their linkage of the concepts of transfer and title.

Financiers seeking to take a security interest in most types of personal property look to Article 9, which dissociates the concept of title and security interest transfers and provides an efficient and streamlined method of attachment and perfection of security interests. Article 9 states, subject to certain specified exceptions, that it governs "any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts. . . ."[4] As comprehensive in scope as Article 9 is, it also recognizes its potential for displacement, in deference to the federal intellectual property regimes.[5] Both the Patent Act and the Lanham Act address the issue of transfer of an interest in intellectual property, but do not specifically mention, in the language of Article 9, the issues of creation, attachment, perfection and priority of security interests. Moreover, Article 9 simply provides that *if* another body of law governs these matters, *then* Article 9 steps-back or is preempted. Section 9-104(a) of old Article 9, known as the "step-back" provision reads:

This Article does not apply to a security interest subject to

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2 Section 261 of the Patent Act states, "An assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office within three months from its date or prior to the date of subsequent purchase or mortgage." 35 U.S.C. § 261 (1994).

3 Section 1060 of the Lanham Act reads in part: An assignment shall be void as against any subsequent purchaser for a valuable consideration without notice, unless it is recorded in the Patent and Trademark Office within three months after the date thereof or prior to such subsequent purchase. 15 U.S.C. § 1060 (1994).

4 U.C.C. § 9-102 (1996).

5 U.C.C. § 9-104(a) (1996).

> any statute of the United States to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property.[6]

Moreover, old section 9-302(3)(a) states that an Article 9 filing "is not necessary or effective to perfect a security interest in property subject to "a statute . . . of the United States which provides for a national or international registration . . . or which specifies a place of filing different from that specified in this Article."[7] The Official Comment to section 9-302(3)(a) states:

> Subsection (3) exempts from the filing provisions of this Article transactions as to which an adequate system of filing, state or federal, has been set up outside this Article and subsection (4) makes clear that when such a system exists perfection of a relevant security interest can be had only through compliance with that system (i.e., filing under this Article is not a permissible alternative).[8]

Revised Article 9 also provides for the preemption of its provisions by federal statute in sections 9-109(c)(1) and 9-311(a)(1).[9] It should be noted that the new filing preemption language in section 9-311(a)(1) does not direct perfection or filing questions towards a statute of the United States unless that statute contains a priority rule for lien creditors.

It is not apparent, however, from the text of either "old" or "revised" Article 9 nor from the law addressing the title and transfer of interests in patents and trademarks, exactly which legal regime governs the attachment, perfection and determination of priority of security interests in patents and trademarks. This is of concern because the issue of perfection of security interests in patents and trademarks is at the heart of many of the fundamental issues that arise in a debtor-with-intellectual-property's bankruptcy.

When a debtor files for bankruptcy, its trustee becomes interested in determining whether any non-bankruptcy claimed rights (such as

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6 Id.

7 U.C.C. § 9-302(3)(a) (1996).

8 U.C.C. § 9-302(3)(a) (1996) cmt.

9 U.C.C. [Revised] § 9-311(a)(1).

perfected security interests) are vulnerable to defeat.[10] The trustee has the power, under § 544(a) of the bankruptcy code, to upset the interests of an unperfected creditor, thereby limiting the creditor's ability to receive the full measure of what they are owed in the debtor's bankruptcy.[11] As the cases discussed below illustrate, perfection of security interests for § 544(a) purposes is the most common context for the questions about perfection. The issue of perfection of security interests also arises in the context of the trustee's avoidance powers pursuant to section 547 (preferences) and section 548 (fraudulent conveyances). Preferences and fraudulent conveyances in the context of transfers of interests of patents and trademarks will be discussed in Part III.

(i) Perfection of Security Interests in Patents

The Patent Act states that the "assignment, grant or conveyance" of an interest in a patent "shall be void against any subsequent purchaser or mortgagee" unless the assignment, grant or conveyance is recorded in the PTO within three months from its date, or prior to the date of such purchase or mortgage.[12] While this provision is designed to address the issue of the steps necessary to be taken to effectuate a transfer of interest in a patent, it is not clear the extent to which this provision preempts Article 9 when the transferred interest at issue is security interest.

The court in *In re Transportation Design and Technology, Inc.*,[13] addressed the question of whether the section 261 of the Patent Act preempts Article 9 with respect to transfers of security interests in patents. The court stated that the language in the Patent Act providing for the recordation of an assignment speaks to the issue of a transfer of title and

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10 The trustee . . . may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by -

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property in which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists; 11 U.S.C. § 544(a)(1)(1997).

11 Under Section 541(a)(3), interests recovered under § 550 become property of the estate. Section 541(a)(3) reads: (a) . . . [The] estate is comprised of all of the following property, wherever located and by whomever held: (3) Any interest in property that the trustee recovers under section . . . 550. . . of this title. 11 U.S.C. § 541(a)(3) (1997).

12 35 U.S.C. § 261 (1994).

13 In re Transportation Design and Technology, Inc., 48 B.R. 635 (Bankr. S.D. Cal. 1985).

does not include within its meaning the transfer of a security interest. The *Transportation Design* court concluded that only an Article Nine filing protects the secured party with an interest in a recorded patent against the bankruptcy trustee. The court did note in dicta, however, that recording under section 261 of the Patent Act is necessary to protect the secured party against subsequent assignees of the patent, including a secured party that characterized its security interest as a "conditional assignment."

Following the lead of *Transportation Design*, the Bankruptcy Appellate Panel in *In re Cybernetics Services, Inc*., held that only an Article 9 filing was sufficient to perfect a security interest in a patent. In this case, the debtor owned a patent for a video signal collection device. Creditor had a security interest in all of debtor's assets, including "general intangibles" and filed a financing statement to perfect its security interest in the Article 9 filing office. No financing statement filed or recordation of a transfer of interest was made in the Patent office. Upon debtor's bankruptcy, creditor moved for relief from the automatic stay in order to enforce its security interest in the patent. The trustee opposed this motion and argued that the creditor's security interest in the patents was unperfected and therefore avoidable because the transfer of interest was not recorded in the Patent office.

The BAP determined that to establish priority against involuntarily lienholders, including the trustee in bankruptcy, the creditor must perfect its interest pursuant to the terms of Article 9. A recording with the Patent and Trademark Office is insufficient to provide constructive notice of a transfer of a security interest. The court continued by observing that in defining transfer of ownership, in contrast to the Copyright Act, the Patent Act does not use words such as "mortgage" and "hypothecation" in addition to the term "assignment."[14] Accordingly, the Patent Act does not preempt Article

[14] Section 101 of the Copyright Act reads: A "transfer of copyright ownership" is an assignment, mortgage, exclusive licenses, or any other conveyance, alienation or hypothecation of a copyright or of any of the exclusive rights comprised in a copyright, whether or not it is limited in time or place of effect, but not including a nonexclusive license. Section 205 (c) & (d) read: (c) Recordation as Constructive Notice. – Recordation of a document in the Copyright Office gives all persons constructive notice of the facts stated in the recorded document, but only if–(1) the document, or material attached to it, specifically identifies the work to which it pertains so that, after the document is indexed by the Register of Copyrights, it would be revealed by a reasonable search under the title or registration number of the work; and (2) registration has been made for the work. (d) Priority Between Conflicting Transfers. – As between two conflicting transfers, the one executed first prevails if it is recorded, in the manner required to give constructive notice under subsection (c), within one month after its execution in the United States or within two months after its execution outside the United States, or at any time before recordation in such manner of the later transfer. Otherwise the later transfer prevails if recorded first in such manner, and if

9 to the same extent that the Copyright Act does. The Patent Act however, does provide priority rules for subsequent mortgages and purchasers, and thus no such transfer is effective against such parties in the absence of a recordation of the transfer in the PTO.

The case of *City Bank and Trust Co. v. Otto Fabric, Inc*[15] offers an illustration of the adverse consequences that can befall creditors who are confused by the language of the Patent Act and its relationship to Article 9 and the Bankruptcy Code. In *Otto Fabric*, Creditor recorded a transfer of an interest in debtors patents in the Patent Office within 90 days of debtor's bankruptcy. It had also previously filed an Article 9 financing statement, outside of the 90 day period. The bankruptcy trustee argued that the security interest ought to be avoided as a preference since a recordation of creditor's interest was made during the preference period. The bankruptcy court held, in reliance on the comments to section 9-302 stating that "the federal patent assignment statute occupies the field of filing." The bankruptcy court concluded that the recordation of the security interest in the Patent Office perfected secured creditor's interest, and because such perfection was within 90 days of bankruptcy, the transfer was an avoidable preference.[16] The bankruptcy court also observed that a "single and absolute system of securing a creditor's interest in patents as collateral" was preferable, and this conclusion was supported by case law.[16] "Requiring both federal and U.C.C. filing to perfect a creditor's interest in a patent would be contrary" to the purpose of Article 9, which is to provide "a rational and convenient filing system for security interests."[17]

The District Court disagreed with the bankruptcy court's findings and conclusions citing several independent grounds.[18] First, the court

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taken in good faith, for valuable consideration or on the basis of a binding promise to pay royalties, and without notice of the earlier transfer. 17 U.S.C. § § 101, 205 (c) & (d) (1994).

15 City Bank and Trust, Co. v. Otto Fabric, 83 B.R. 780, 781-82 (D. Kan. 1988).

16 In re Otto Fabric, Inc., 55 B.R. 654 (Bankr. D. Kan. 1985).

17 The Bankruptcy Court cited in support of its conclusion that a patent may be assigned as collateral for a loan Waterman v. Mackenzie, 138 U.S. 252, 260 (1891); Magnuson Industries, Inc. v. Co-Rect Products, Inc., 676 F.2d 703 (8th Cir. 1981); Railex Corporation v. Joseph Guss & Sons, Inc., 40 F.R.D. 119 (D. D.C. 1966). It further observed that two circuits have noted that the patent assignment statute "does not require recording to support the validity of an assignment, except as to subsequent purchasers or mortgagees without notice, and by implication recognizes the validity as to all others." *Citing*, Why Corporation v. Super Ironer Corporation, 128 F.2d 539, 541 (6th Cir. 1942); John Tuman & Sons, Inc. v. Basse, 113 F2d 928 (2nd Cir. 1940).

18 *In re Otto Fabric, Inc*., 55 B.R. 654 (Bankr. D. Kan. 1985).

19 *City Bank and Trust v. Otto Fabric*, 83 B.R. 780.

observed that the "federal statute does not expressly state that one must file an assignment with the Patent and Trademark Office to perfect a security interest. . . .If Congress intended to preempt the field of filing, it could have said so."[19] Second, the language of Section 261 of the Patent Act says that recordation in the Patent Office is necessary to protect against the interests of a "subsequent purchaser or mortgagee" and makes no mention of lien creditors. Thus, the court continued, the federal statute leaves open "a state filing to protect one's security interest in a patent against a lien creditor."[20] Finally, the court concluded, "to require a federal filing and thus a collateral assignment to perfect a security interest in a patent seems inconsistent with the modern notion that a grant of a security interest need not include the conveyance of title or ownership rights."[21]

(ii) Perfection of Security Interests in Trademarks

Similar to the Patent Act, the Lanham Act provides for the recordation of assignments of trademarks, together with trademark holders' goodwill. The Lanham Act, however, does not define the term "assignment" and as is the case under the Patent Act, it fails to expressly provide a system for perfecting security interests in trademarks. Because of the absence of such a specific provision, courts have held that Article 9 of the U.C.C. is the body of law governing the issue of how one perfects a security interest in a trademark -- while acknowledging that this subject "involves a trap for the unwary."[22]

The court in *In re Together Development Corp.*, in examining this issue, looked at the historical antecedents to the term "security interest" in order to determine whether an "assignment" would generally be thought of as a security interest. The court observed that, in 1946, the year the Lanham Act was passed, most security interests were referred to as "chattel mortgages" or "conditional sales." Prior to the enactment of Article 9 in the early 1960's, most non-possessory pledges of interests in personal property were called "mortgages" or "hypothecations." An assignment was deemed to be a transfer of a different nature.

The court continued by examining the reference in the Lanham Act

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20 *Id.*

21 *Id.*

22 *Id.*

23 *In re Together Development Corporation*, 227 B.R. 439, 440-441 (Bankr. D. Mass. 1998).

to phrase "successor to the business," concluding that Congress must have had in mind "an outright assignment in the context of the sale of an entire business of which the trademark is a part." Moreover, the court noted the express reference in the Copyright Act to the transfer of "mortgages" and concluded that the Lanham Act's language concerning the transfer of interests fails to provided a method of perfecting security interests in trademarks.[23] Thus, the court concluded, Article 9 governs the issue of perfection of security interests in trademarks.

This position is consistent with the progeny of cases that have consistently held that the Patent Act does not preempt Article 9 and that the Article filing office is the proper place to perfect a security interest in trademarks. In *Roman Cleanser v. National Acceptance Co.*,[24] the court held that a security interest in a trademark is properly perfected by filing under Article 9, and such a transfer of interest is not equivalent to an assignment, which must be recorded in the Patent and Trademark Office. In In re *199Z*, Inc., the creditor recorded its interest in the PTO, as well as filed an improper financing statement under Article 9.[25] The court, in finding secured creditor's interest to be unperfected, held that the Lanham Act does not preempt Article 9 because it does not expressly include provisions for recording security interests within its scope.[26]

B. Characterization of Intellectual Property when used as Collateral

Another concern central to the issue of the proper steps for perfection of security interests is how to characterize specific types of intellectual property for commercial law purposes. To illustrate, it is not necessarily clear how to properly characterize computer software. A prospective lender seeking to take a security interest in such software must first determine whether this software is copyrightable, patentable or protected as a trade secret, or characterized pursuant to Article 9, as "intangibles," or "ordinary goods."[27] If a copyright has been registered

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24 *Id.* at 441.

25 *Roman Cleanser v. National Acceptance Co*., 802 F.2d 207 (6th Cir. 1986).

26 *In re 199z, Inc*., 137 B.R. 778 (Bankr. C.D. Cal. 1992).

27 *See id.*

28 Moreover, if software is embodied in goods that are normally used in more than one jurisdiction, the software, if deemed to be an Article 9 asset, may be deemed to be "mobile goods." If the intellectual property embodied in the software is deemed to be general intangibles, the secured party must file a financing statement in the state where

describing, with specificity, the software, then the place to register and thus perfect a security interest may be the Copyright Office. If however, a business method patent has been registered with the Patent and Trademark office, it may be deemed to be a general intangible, with the perfection location dictated by Article 9.[28]

The extent to which the software is determined to be copyrightable or patentable in the first instance, as well as how one perfects a security interest in an unregistered copyright, or in after acquired copyrights remains unclear. The number of unanswered questions that are raised by this one commercial scenario make the collateralization of many potentially patentable materials an uncertain venture and accordingly, creditors particularly vulnerable in bankruptcy.

AVOIDANCE OF SECURITY INTERESTS AS PREFERENCES AND FRAUDULENT CONVEYANCES

A. Preferential Transfers in Bankruptcy

Another important bankruptcy context for the confusion over perfection is found in the area of preference law. The Bankruptcy Code allows for the avoidance of certain preferential transfers made upon the eve of bankruptcy. Section 547 of the Bankruptcy Code requires a two-step inquiry to determine whether a given transfer qualifies for preferential avoidance. Section 547(b)[29] sets forth seven elements that must be

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the debtor is located. Cases have held that software products are to be as "ordinary goods," thus requiring a state law filing in the place where the "last event occurs on which is based the assertion that the security interest is perfected or unperfected." It should be noted that Revised Article 9 overrules the "software as ordinary goods" case law and defines software as a general intangible. Financing statements with respect to general intangibles are to filed in the place the debtor is located, which in the case of an organized entity, is in its place of organization. *See* Revised U.C.C. § § 9-102(a)(42) & (75), 9-307(b) & (e) (1999).

29 See U.C.C. § 9-103(3)(1997). Under revised Article 9 the place to file with respect to all collateral is debtor's "location," which is defined for corporate debtors as its state of organization. See Revised U.C.C. §§ 9-301, 307 (2000).

30 11 U.S.C. § 547(b) reads: [T] trustee may avoid the transfer of an interest of the debtor in property B

(1) to or for the benefit of creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

established to prove an avoidable preference. These elements include (i) a transfer,[30] (ii) of an interest in the debtor's property,[31] (iii) to or for the benefit of a creditor,[32] (iv) for or on account of an antecedent debt,[33] (v) made while the debtor was insolvent,[34] (vi) made on or within 90 days of

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(3) made while the debtor was insolvent;

(4) made B

(A) on or within 90 days before the date of the filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if B

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provide.

31 Section 101(54) of the Bankruptcy Code broadly defines transfer to include: . . . every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption. 11 U.S.C. § 101(54) (1997).

Accordingly, the perfection of security interests, title transfers, and payments to creditors all fall within the definition of "transfer" under the Bankruptcy Code..

32 In order to be subject to preference avoidance, the transfer must be of property the debtor.

33 Section 101(10)(A)of the Bankruptcy Code defines "creditor" as "an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." 11 U.S.C. § 101(10)(A) (1997). "Claim" is broadly defined as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." 11 U.S.C. § 101(5)(B) (1997). Because one of the stated justifications for preference avoidance is to ensure equitable treatment among similarly situated creditors, it follows that the transferee have the status of a creditor with a claim to debtor's bankruptcy estate.

34 The Bankruptcy Code does not specifically define the term "antecedent debt." Cases have determined that for a debt to be antecedent pursuant to § 547, the transfer must come after the date of the incurrence of the debt.

35 The classic definition of an insolvent debtor is one whose liabilities exceeds it assets. Section § 101(32) of the Bankruptcy Code defines "insolvent" as a "financial condition such that the sum of the entity's debts is greater than all of such entity's property, at fair valuation. . .". 11 U.S.C. § 101(32) (1997). The insolvency test is applied on the date the transfer is made. If a debtor is solvent at the time of the transfer in question, and later becomes insolvent and is insolvent at the time of bankruptcy, the insolvency test is not met, and the transfer is not vulnerable to preferential avoidance. The timing rules of Section 547(e) come into play in determining a debtor's solvency at the time of transfer, because the date a transfer is made may be determined with reference to the §547(e)(2)(B) grace period. Section 547(f) sets forth a presumption of

bankruptcy[35] (vii) that enables such creditor to receive more than they would receive under a chapter 7 distribution.[36] If the trustee proves all seven elements,[37] the trustee has established its prima facie case for a preference, and the transferee then has the burden of proving that one of the Section 547(c) exceptions applies.[38] Section 547(c) describes eight different

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insolvency during the 90 days preceding the bankruptcy filing. 11 U.S.C. § 547(f) (1999). This provision's legislative history explains the impetus behind the enactment of the presumption of insolvency during the 90 days prior to bankruptcy:

> Given the state of most debtor's books and records, such a task is nearly impossible. Given the financial condition of nearly all debtors in the three months before bankruptcy, the task is also generally not worth the effort. Rarely is a debtor solvent during the three months before bankruptcy. Thus, the preference section requires the trustee prove a fact that nearly always exists yet never can be proven with certainty. . .
> H.R. Rep. No. 595, 95th Cong., 1st Sess. 178 (1977).

The burden is placed on the creditor to rebut this presumption, which likely will involve an examination of debtor's books and records and a valuation of its assets. In the case of a challenge to a transfer made to or for the benefit of an insider beyond the 90 days prior to bankruptcy, the trustee is not granted the benefit of a presumption, and must prove insolvency with reference to the debtor's records.

36 Any transfer challenged as a preferencemust be made, if to a non-insider, within 90 days prior to debtor's bankruptcy filing. Transfers are potentially avoidable if made within one year of bankruptcy if the transferee is an "insider." "Insider" is defined under the Bankruptcy Code to include, a relative of the debtor or of a general partner of the debtor, a partnership in which the debtor is a general partner, a general partner of the debtor, or a corporation of which the debtor is a director, officer, or person in control. If the debtor is a corporation, an insider is deemed to be a director of the debtor, an officer of the debtor, a person in control of the debtor, a partnership in which the debtor is a general partner, a general partner of the debtor, and a relative of a general partner, director, officer, or person in control of the debtor. *See* 11 U.S.C. § 101(31) (1997).

37 The final focus of the preference analysis is "upon whether the creditor would have received less than a 100% payout in a Chapter 7 liquidation." *See* Smith v. Creative Financial Management, Inc. (*In re* Virginia-Carolina Financial Corp.), 954 F. 2d 193, 193 (4th Cir. 1992). This test requires a comparison between the value of what the creditor received as a result of the transfer, and what the creditor would have received in a hypothetical chapter 7 liquidation, absent the transfer. This is measured "not by what the situation would have been if the debtor's assets had been liquidated and distributed among his creditors at the time the alleged preferential payment was made, but by the actual effect of the payment as determined by when bankruptcy results." *See id*, *citing* Palmer Clay Products v. Brown, 297 U.S. 227, 229 (1936). If the value of what was actually received is greater than the amount the creditor would have received in a liquidation, the hypothetical liquidation test is satisfied.

38 In the case of a chapter 11, a debtor in possession. ". . . a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties. . . of a trustee serving in a case under this chapter." *See* 11 U.S.C. § 1107 (1997).

39 Not all transfers made while the debtor is insolvent are deemed under the bankruptcy

circumstances in which an otherwise avoidable preferential transfer is granted a safe harbor from avoidance. These circumstances include (i) a contemporaneous exchange for new value,[39] (ii) a transfer in the ordinary course of business,[40] (iii) a transfer in connection with an enabling loan,[41] (iv) a transfer followed by a subsequent advance of new value,[42] (v) transfer made in connection with a floating lien,[43] (vi) statutory lien transfers,[44] (vii) transfers to satisfy domestic relations debts,[45] and (viii) transfer made in small consumer transactions.[46] While each of the seven section 547(b) elements must be present in order to find a preference, the transfer need only qualify under one of the section 547(c) safe harbors to be saved from avoidance.

To aid the trustee in its pursuit of avoidance, Section 547(f) sets forth a presumption of insolvency during the 90 days preceding the bankruptcy filing; a presumption that may only be overcome by the transferee's proof of sufficient evidence of solvency.[47] Subsection 547(e) outlines the governing rules that define when a transfer is deemed to be made.[48]

The time of the transfer relative to the time the debt was incurred

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code to be preferential. Some transfers are deemed beneficial, notwithstanding the bankruptcy process. *See* 11 U.S.C. § 547(c)(1) - (8) (1997) Section 547(g) reads: "For purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section." *See* 11 U.S.C. § 547(g) (1997).

40 *See* 11 U.S.C.§ 547(c)(1) (1997).

41 *See* 11 U.S.C.§ 547(c)(2) (1997).

42 *See* 11 U.S.C.§ 547(c)(3) (1997).

43 *See* 11 U.S.C.§ 547(c)(4) (1997).

44. *See* 11 U.S.C.§ 547(c)(5) (1997).

45 *See* 11 U.S.C.§ 547(c)(6) (1997).

46 *See* 11 U.S.C.§ 547(c)(7) (1997).

47 *See* 11 U.S.C.§ 547(c)(8) (1997).

48 This presumption only aids the trustee in cases where the transfer is made during the 90 days before a bankruptcy filing. For transfers made to insiders more than 90 days (but less than one year) before bankruptcy, the burden is the on trustee to prove insolvency, in the absence of a presumption. *See* 11 U.S.C. § 547(f) (1997).

49 *See* 11 U.S.C. § 547(e) (1997). In addition, § 547(a) provides the definition of "inventory", "new value" and "receivable." *See* 11 U.S.C. §§§ 547(a)(1), (a)(2) & (a)(3) (1997).

is of critical importance to a preference analysis. When filing or recordation is necessary to "perfect" the transferee's interest, Section 547(e)(2)(B) is implicated. Because of the requirement that the transfer must be on account of an antecedent debt, the focus of the timing analysis is on whether there is a "gap" between the incurrence of the debt and the time of the transfer. The "antecedent debt" test is satisfied if the debt is incurred before, or antecedent to the date the transfer.[49]

Section 547(e)(2)(B) sets forth a ten day grace period within which transfers of interests may be perfected. With respect to security interests, this grace period begins on the date of attachment.[50] If the transfer is perfected within the grace period, the date of the attachment will be deemed to be the date of the transfer.[51] If, however, the transferee perfects its interest beyond ten days from the date of attachment, the transfer is deemed to take place on the date of perfection.[52] If due to confusion and uncertainty as to how to perfect a security interest in patents or trademarks, the perfection is delayed beyond ten days from the date of the security interest attachment, the transfer is deemed to be a transfer "on account of an antecedent debt." If this happens within 90 days of a bankruptcy filing, the transfer is a preference subject to avoidance under § 547(b).[53]

The case of *City Bank and Trust Co. v. Otto Fabric* (discussed above) provides a telling illustration of the trouble a creditor with an interest in patents or trademarks may find itself in when its debtor files for bankruptcy – even if it properly perfected its interest outside of the 90 day preference period. While ultimately reversed by the District Court, the bankruptcy court initially found that the recordation of a transfer of an interest in a patent in the Patent Office within the 90 day preference period

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[50] The justifications for the preference rules support the necessity of the requirement of transfers made on account of antecedent debt. If a debt is incurred contemporaneously with a transfer, there is no depletion of value from the estate as a result of such transfer. If creditors contribute value commensurate with their receipt of transfers of value, other creditors are not subject to harm.

[51] . . . A transfer is made . . .(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time,. . .11 U.S.C. § 547(e)(2)(A) (1997).

[52] If the section 547(e)(2)(A) grace period has not expired at the time bankruptcy is filed, the transferee may perfect its interest within the three month grace period without violating the automatic stay. *See* 11 U.S.C. § 362(b)(3) (1997).

[53] *See* 11 U.S.C. § 547(e)(2)(A) (1997).

[54] Notwithstanding the satisfaction of each of the section 547(b) elements of a preference, the transfer could still be saved if it falls within one of the "safe harbor" exceptions of section 547(c). *See* 11 U.S.C. § 547(c) (1997).

was a preferential transfer. It appears in this case that the secured creditor was unsure as to the proper place to file to perfect its security interest, and thought the prudent course was to take a "belt and suspenders" approach. While not ultimately fatal to its interest in the collateral, it took two written opinions to reach the ultimate conclusion that the proper place to perfect a security interest in a patent is the Article 9 filing office.

B. Transfers of License Interests as Preferences

As noted above, to qualify as a preference, a transfer must be on account of an antecedent debt. The date a debt is deemed to have been incurred turns on a non-bankruptcy law determination. When intellectual property is transferred as collateral or loan repayment or to otherwise secure an obligation, the debt is deemed to arise once the obligation becomes enforceable.[54] Debts incurred in connection with absolute assignments of intellectual property are deemed to arise at the time title or control is transferred. When intellectual interests are licensed, However, the time the debt is incurred is less straightforward.

If one looks at an intellectual property license as analogous to a real estate lease, the debt would be deemed to have been incurred contemporaneously with each periodic payment transfer. Accordingly, each transfer of a license interest would be on account of a contemporaneous debt.

An alternative view of a license for the use or exploitation of a patent or trademark, however, has the potential to raise some troubling preference issues. If the language of the license, or the context, suggests a one-time transfer of rights in exchange for periodic payments, then the debt would be deemed to have been incurred at the time the license agreement was entered into. Thus, each license payment would be considered a transfer on account of an antecedent debt. If a debtor files for bankruptcy during the term of the license agreement, any payments made (on account of an antecedent transfer of rights) within 90 days of bankruptcy are subject to avoidance as preferences.

C. Avoidance of Fraudulent Conveyances

Fraudulent conveyances are transfers prior to bankruptcy, made with either actual fraud, or with what is known as constructive fraud. When

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55 City Bank v. Otto Fabric, 83 B.R. 780, 781-82 (D. Kan. 1988).

a debtor is in bankruptcy, the Bankruptcy Code gives the trustee the power to avoid transfers qualifying as fraudulent under two independent provisions. Section 544(b) allows the trustee to avoid any transfer "by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable."[55] What this means is that any transfer that could be avoided by a creditor under state fraudulent conveyance act can be avoided by the trustee in bankruptcy.[56] This provision allows the trustee to avoid transfers made within the state-law "look-back" period -- which can be as long as four years. Section 548 of the Bankruptcy gives the trustee powers to avoid fraudulent transfers without requiring that there be an unsecured creditor with an avoidable claim in bankruptcy.[57] The section 548 "look-back" period is one year.

Section 548 fraudulent conveyance law may be implicated when patents and trademarks are used as collateral for reasons similar to those discussed with respect to preferences. For there to be a fraudulent transfer, there must be a transfer of an interest -- and the transfer of a security interests qualify under this provision. If the security interest transfer is perfected within the "look-back" period, the transfer, if meeting the criteria for avoidance under section 548 or under state fraudulent conveyance law, is subject to avoidance. If due to confusion and uncertainty as to how to perfect a security interest in patents or trademarks, the perfection is delayed and spills into the look-back period, the transfer is vulnerable to defeat by the trustee as a fraudulent conveyance.

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56 11 U.S.C. § 544(b) (1997).

57 To use section 544(b), there must be a creditor with an allowable claim in debtor's bankruptcy that could have avoided the transfer under state law.

58 Section 548(a)(1) reads: The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of filing of the petition, if the debtor voluntarily or involuntarily–(A) made such transfer or incurred such obligation with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or (B) (i) received less than a reasonably equivalent in value in exchange for such transfer or obligation and (ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation; (II) was engaged in business or a transaction, o9r was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured. 11 U.S.C. § 548(a) (1997).