

---

## SECURITIES OVER ESOTERIC PROPERTY

### Security over intellectual property

MICHAEL PATTISON

Arthur Robinson & Hedderwicks, Solicitors, Melbourne

#### INTRODUCTION

This paper is intended to introduce the issues arising out of the use by companies of intellectual property as a security. The paper commences with an outline of the principal types of intellectual property in Australia: copyright, trade marks, patent rights, industrial designs and confidential information. Australian law recognises two other categories of intellectual property right: rights in integrated circuits (known as EL rights) and plant breeder's rights.<sup>1</sup> These last two rights are not as significant as the other, more established, intellectual property rights and will not be discussed in this paper. However, they do not raise any unique issues and the principles discussed in this paper should be applicable to those rights without difficulty.

The ultimate aim of having a security is to be able to realise the security for an amount of money which is at least equal to the borrower's indebtedness. The second section of this paper accordingly contains some comments on the common methods of valuing intellectual property and an outline of issues arising on realising the value of intellectual property. Either of these subjects would justify one, or several, papers in their own right and the comments in this section only outline the relevant issues.<sup>2</sup> The third section discusses the types of security which can be taken over intellectual property generally, followed by specific comments on their applicability to each of the principal types of intellectual property. This discussion includes comments on the statutory provisions which might bear on the suitability of each type of intellectual property as a security.

The final section of the paper deals with priorities between competing securities. That section discusses the position applying to priorities generally and then the particular problems raised by the interaction between the charge registration provisions of the *Corporations Law* and the intellectual property legislation.

This paper is restricted to intellectual property under Australian law. The protection of intellectual property is national in origin and different countries accord different types of intellectual property quite different degrees of protection. It is also possible for particular intellectual property to be

---

<sup>1</sup> EL rights protect the ubiquitous "chips" that are the fundamental building block for modern computers. They are protected by the *Circuit Layouts Act 1989*. Plant breeder rights protect new breeds of plants. They are protected under the *Plant Breeder's Rights Act 1994*.

<sup>2</sup> For a more comprehensive discussion, see "Intellectual Property - An Accounting, Valuation and Taxation Perspective", Ernst & Young, October 1993.

protected in one country but not in another: despite popular belief, there is no such thing as a world wide patent. At the most there will individual patents in every country of the world protecting the same invention, although in practice it is rare to find such universal coverage. Where a lender is proposing to take security over intellectual property it should consider whether the property might also be of value outside Australia. If it could then the lender should consider obtaining separate security over the overseas intellectual property.

## OUTLINE OF INTELLECTUAL PROPERTY

### Copyright

Copyright is protected by statute, the *Copyright Act* 1968. Copyright grants the owner the exclusive right to do certain activities, principally to reproduce the protected subject matter. The *Copyright Act* establishes two general categories of subject matter protected by copyright:

- (i) "Works" - defined as original literary, dramatic, musical and artistic works; and
- (ii) Subject matter "other than works" - defined as sound recordings, cinematograph films, television broadcasts, sound broadcasts and published editions of works.

The duration of the copyright depends on the subject matter. With respect to literary, dramatic, musical or artistic works, copyright will generally<sup>3</sup> subsist for 50 years after the end of the calendar year in which the author of the work dies. Sound recordings, cinematograph films and television broadcasts are protected for 50 years from the expiry of the year of first publication or broadcast. Copyright in published editions essentially protects published works from being photocopied. It is particularly relevant where the copyright in the underlying work (for example, a musical score) has lapsed. The published edition copyright protects new editions of the work for 25 years from the expiry of the year in which the edition was first published.

In most countries of the world (including Australia), copyright protection is now automatic. There is no need to register the subject matter in order for copyright to subsist. Indeed, in Australia and most countries<sup>4</sup> there is no register on which copyright can be registered. Nor is there any need for the work to bear any particular notice in order for copyright to subsist.<sup>5</sup> The lack of registration requirement or option has advantages and disadvantages. The key advantage is that copyright in a work cannot be inadvertently waived through failure to register. The key disadvantage is that there is no central source for determining the owner of copyright in a work. This has consequences in terms of copyright's usefulness as a security, as discussed below.

The general rule is that copyright in a work is owned by the person who made that work or, if that person was employed by another, by his or her employer. This rule is particularly relevant where works are created by contractors. Unless the contract of engagement states otherwise, the person who paid for the work's development will have only a licence to the work (the terms of which will usually have to be implied from the contract of engagement) or, in rare circumstances, an equitable interest in the copyright.<sup>6</sup> The copyright itself will be owned by the contractor.

The position on ownership of copyright in subject-matter other than works is different and probably accords more with commercial expectations. Copyright in sound recordings and cinematograph

<sup>3</sup> Separate rules apply for photographs and for unpublished works.

<sup>4</sup> A notable exception is the United States, which does allow for registration although it is no longer compulsory.

<sup>5</sup> Such as the copyright notice which adorns the first page of most books and texts. However, the inclusion of such a notice might increase the range of remedies available to a person whose work has been infringed and may also allow the work to be protected by copyright in those few countries which are members of the UCC Copyright Convention but not of the Berne Convention.

<sup>6</sup> *John Richardson Computers Ltd v Flanders* (1993) 20 FSR 497.

films is owned by the "maker" of the recording or the film. The "maker" is defined<sup>7</sup> to be the person who owned the record at the time it was made or the person who made the arrangements necessary for the making of the film. In both cases the intent is for the record company/film producer to be the owner of copyright. With respect to broadcasts and published editions, the Act provides that the broadcast/published edition is owned by the broadcaster or publisher, respectively.

The classes of works protected by copyright are extremely wide. Anything which can be described as being an original "literary, dramatic, musical or artistic work" is likely to be protected by copyright. Although the scope of dramatic and musical works is reasonably clear, the categories of literary and artistic works are of extremely wide breadth. Within artistic works will be comprised such functional items as printed circuit diagrams, flow charts, architectural drawings, machinery drawings and maps. Anything which is, or can be, represented by way of text is likely to be characterised as a literary work. There have been decisions in Australia protecting as literary works subject matter such as computer programs, manuals describing the operation of an industrial process or the conduct of an industrial plant and recipes.

## Trade marks

Trade marks are the signs used by businesses to denote that goods or services come from a common origin. Using the example of a company which knows quite a lot about trade marks, a trade mark can consist of a word or words ("McDonalds"), a particular insignia (the golden arches), real or fictional characters (Ronald McDonald, the Hamburgler etc), the visual appearance of a product or the place where the product is dispensed (the colouring and design adopted in all McDonald stores, worldwide) and even in a piece of music (lacking an example from McDonalds, I refer to the second movement from Tchaikovsky's fifth symphony to promote Winfield cigarettes).

Trade marks can be either registered or unregistered. If registered, a trade mark will be protected by the *Trade Marks Act*. The current *Trade Marks Act* is the *Trade Marks Act* 1955. However, Federal Parliament is in the process of passing the *Trade Marks Act* 1995 ("the new Act") which will come into effect on 1 January 1996.<sup>8</sup> The new Act will expand the concept of a trade mark in a number of ways (for example, allowing a scent to be a trade mark!) and changes several features of Australian trade mark law to accord with Australia's obligations under the World Trade Organisation Agreement. In this paper I will refer principally to the new *Trade Marks Act*.

The new Act states expressly that registered trade marks constitute personal property<sup>9</sup> which may be assigned.<sup>10</sup> However, trade marks are a particularly fragile form of property. Unless carefully tended, a trade mark registration is liable to be removed from the register. One ground for removal is non-use - a person can apply to have a trade mark removed from the register on the ground that it has not been used for a continuous period of three years. The Act also provides other grounds for ordering the cancellation of the registration of a trade mark, including that the original registration was defective or that, even if the original registration was effective, due to circumstances since then the trade mark should not remain registered. This would occur where, through some neglect or failure to take action on the part of the proprietor of the trade mark, someone other than the proprietor has been using (without permission) the same or a similar trade mark, with the result that members of the public now associate the trade mark with that other user.

---

<sup>7</sup> Section 22.

<sup>8</sup> At the date of writing, the Bill has had its first reading speech and the second reading has been adjourned to the Winter sitting of the Senate. All references in this paper are to the Bill as first introduced into Parliament. Federal Parliament passed in 1994 a *Trade Marks Act* which was to come into force on 1 January 1996. That Act was widely criticised and will be repealed by the new Act before coming into force.

<sup>9</sup> Sub-section 21(1).

<sup>10</sup> Part 10.

The fragility of property in trade marks suggests a practical limitation on their worth as a security. Although the security holder can require the trade mark owner to take all steps necessary to maintain the validity of the registration, the reality is that the security holder is unlikely to monitor the proprietor's compliance with these steps and to ensure that the registration does in fact remain valid. If the trade mark in question is central to the owner's business then the security holder might be prepared to rely on the owner's self interest to ensure that all necessary steps are taken to maintain the validity of the trade mark. However, anyone taking security over a registered trade mark should take into account the risk that the registration (and hence the security) could subsequently become invalid.

An unregistered trade mark does not receive any protection from the *Trade Marks Act* but is protected by a number of other Acts and laws. Chief amongst these are the prohibition in the *Trade Practices Act 1974* against a corporation engaging in misleading or deceptive conduct and the common law tort of passing off. These actions will permit a trader to take action against another where that other has copied some indicia of the first trader's trading style in such a way as to confuse or mislead the relevant public.<sup>11</sup>

A trade mark can in theory be protected indefinitely. In the case of a registered trade mark the trade mark will be protected for as long as its registration remains valid and the registration fees are paid. In the case of an unregistered trade mark the trade mark will be protected for as long as the relevant mark has a valuable reputation.

It has long been accepted that unregistered trade marks cannot be assigned independently of an assignment of the business pursuant to which the mark acquired its attractive power.<sup>12</sup> This means that unregistered trade marks are not a suitable subject matter for an independent security - the security will be ineffective unless it has also been taken over the whole business. In consequence this paper will only deal with securities over registered trade marks.

## Patents

Patents protect inventions. In essence, an invention will be patentable if it is new, not obvious and produces a commercially useful effect. The subject matter of patents can be conveniently characterised as either being new and useful substances (such as pharmaceuticals) or processes (such as a method of manufacturing a particular pharmaceutical). In Australia, and most other countries, patents have a term of 20 years from the date of application.

The grant of a patent does not guarantee that the patent is valid. It only shows that the Patents Office was satisfied, on the material available to it, that the invention satisfied the criteria for patentability. Once granted, the patent is susceptible to being revoked on the application of third parties on the grounds that the patent does not comply with one of the requirements for patentability.

Even if valid, not all patents confer equal protection. The critical part of a patent is the "claims" of the patent. These define the scope of the patentee's monopoly. In general, the broader the claims, the easier it will be for the patentee to establish infringement of its patent, but the more susceptible the patent will be to challenge. In the course of the patent application process, the Patents Office will often require the applicant to narrow the claims in the patent application. There will come a point where the claims are narrowed to such an extent that the effect of the invention can be duplicated without coming within the claims of the patent (a process known as "working around" the patent). In that event, the patent would be, for all practical purposes, worthless as not conferring any real monopoly.

---

<sup>11</sup> *Erven v J Townend & Sons* [1979] AC 731.

<sup>12</sup> *The Leather Cloth Company v The American Leather Cloth Company* (1865) 11 ER 1435, 1440.

## Confidential information

The equitable action for breach of confidence seeks to preserve the confidentiality of information which has been communicated in confidence. The action is a creature of the common law and, in Australia, there is no statutory basis for the action. Where the action applies, it provides a very powerful right against unauthorised users of confidential information. The action protects all sorts of valuable information, whether of a personal<sup>13</sup> or a commercial<sup>14</sup> nature. The action is available where confidential information has been communicated in circumstances of confidence and there is a breach or threatened breach of the confidence. As the action is equitable, the full range of equitable remedies are available for breach of confidence including, most powerfully, the imposition of a constructive trust over the proceeds of the breach.<sup>15</sup>

Generally speaking, Australian law does not distinguish between confidential information, trade secrets and confidential know-how. Trade secrets and confidential know-how are both protected as being a type of confidential information.

There was previously some doubt in the authorities<sup>16</sup> as to whether confidential information was protected as a species of property. That doubt has now been removed, for Australia at least, by the High Court's unequivocal and unanimous holding that the "basis for protecting confidential information does not lie in some proprietary right. It lies in the notion of an obligation of confidence arising from the circumstances in or through which the information was communicated and obtained".<sup>17</sup>

The characterisation of confidential information in this way has consequences for its suitability as a security in its own right. It is fundamental to the concept of a charge that there be property which is the subject of the charge. As confidential information does not constitute property, it cannot be used as the subject of a charge type security.<sup>18</sup> Strictly speaking, confidential information is also not assignable: even if the security giver discloses full details of the secret to the security holder, the secret will still be known by the security giver. This suggests that confidential information will also not be a suitable subject for a mortgage type security.

Although confidential information does not constitute a separate right over which a security can be taken, there may be indirect ways of using confidential information as a security. There is authority for the view that confidential information forms part of a business's goodwill.<sup>19</sup> Section 262(1)(e) of the *Corporations Law* expressly recognises that charges can be taken over goodwill. This suggests that security over confidential information could be obtained by taking security over the goodwill of the business using the relevant confidential information. A less satisfactory security could also be obtained by taking security over the way the secret has been recorded (effectively

---

<sup>13</sup> *Duchess of Argyll v Duke of Argyll* [1967] Ch 302.

<sup>14</sup> *Saltman Engineering v Campbell* (1948) 65 RPC 203.

<sup>15</sup> *Lac Minerals Ltd v International Corona Resources* (1989) 16 IPR 27.

<sup>16</sup> Ricketson, *The Law of Intellectual Property*, The Law Book Company, 1984, Chapter 45.

<sup>17</sup> *Moorgate Tobacco Co Limited v Philip Morris Limited & Anor* (1984) AIPC 90-141. However, confidential information might be considered to be property in the context of the definitions used in particular statutes. For example, confidential information has been held to constitute property for the purposes of placitum 51(xxxi) of the *Commonwealth Constitution: Smith Kline & French Laboratories (Australia) Ltd & Ors v Secretary, Department of Community Services and Health* (1990) 17 IPR 545, 594.

<sup>18</sup> It might be thought that security could be taken over a chose in action instead. However, unlike the other intellectual property rights, confidential information does not itself constitute a chose in action: Starke, *Assignments of Choses in Action in Australia*, Butterworths 1972 at page 2. It is not until the information has been disclosed in circumstances of confidence and there is at least a threat of unauthorised disclosure that a chose in action will arise. Although I am not aware of any authority on point, it seems unlikely that such a chose in action could be used as a security. It is perhaps similar to the chose in action arising on the occurrence of a tort, which would not normally be assignable due to the prohibition against champerty (Starke at 62) or otherwise be able to be used as a security.

<sup>19</sup> *Re Keene* [1922] 2 Ch 475.

using copyright as the property) or the physical material on which it was recorded (a chattel security). I say less satisfactory because confidential information is distinct from the way it is recorded or the medium on which it is recorded. These latter types of security will not confer any right to prevent others from using the confidential information. They will only allow the holder to stop the reproduction of the way the information is recorded or to stop others getting access to the copy of the information held by the information holder.

### **Industrial designs**

The *Designs Act* 1906 allows the visual appearance of articles to be protected. Although similar to patent protection, the *Designs Act* does not require the article itself to be new or original but only that the visual appearance of the article be new or original.

Designs are only protected if they are registered under the *Designs Act*. Registration is for a maximum period of 16 years. Once registered, a design receives monopoly protection throughout Australia.

### **Licence agreements**

Intellectual property is often licensed and the licences can themselves be very valuable. The *Corporations Law* expressly recognises that charges can be taken over licences to patents, trade marks, copyright and registered designs.<sup>20</sup> It is beyond the scope of this paper to do justice to all the issues which must be considered when taking security over intellectual property licences. However, the following comments outline some of the principal issues.

The owners of intellectual property are often very sensitive about the people they allow to use their intellectual property. In consequence, intellectual property licences will often expressly prohibit the rights granted under the licence being used as a security. Even where they do not prohibit the rights being used as a security, the terms of the licence grant may have the effect of preventing any one other than the licensee from using the intellectual property. Finally, it is usual for licence agreements to allow the licence to be terminated upon any event of financial difficulty occurring to the licensee (such as its passing into receivership, commencing to be wound up etc). Since it is precisely on the occurrence of those events that the lender is most likely to want to exercise its security, the termination of the licence at that time will make the security futile.

These difficulties suggest that many intellectual property licences will usually not be, at least in their original form, a suitable subject for security. The practical answer may be that security should only be taken over an intellectual property licence if the security holder has the licensor's agreement to the security being taken. Of course, it might not always be commercially possible for that agreement to be obtained at the time the security is given.

## **VALUING INTELLECTUAL PROPERTY**

In my experience, the three principal methods suggested for valuing intellectual property in Australia at present are:

- (a) the comparative value method;
- (b) the historical cost method; and
- (c) the discounted cash flow method.

---

<sup>20</sup> Section 262(1)(e).

The comparative value method seeks to determine the value of the intellectual property by reference to the amount for which similar property has traded in the recent past. However, unlike some traditional property types (such as listed shares or land), there is no open market for intellectual property against which to obtain a significant set of comparisons. This is partly due to the fact that technology transfer agreements are usually confidential to the parties making them and also to the fact that sales of technology do not occur with anything like the same frequency with which other commodities are sold.

The historical cost method is probably the worst method for valuing intellectual property. This method seeks to value the intellectual property by reference to the amount spent in developing it. However, there is no reason in principle (and no empirical evidence to suggest) that the value of particular intellectual property will bear any relationship to the amount of money spent in developing it. The pharmaceutical industry, in particular, is legion with projects that have initially looked promising and which had to be abandoned at the eleventh hour when a rare side effect of a particular drug was discovered. Using the historical cost method, the intellectual property generated during that project would seem to be worth many millions of dollars. Due to abandonment of the project, the property might in fact be worthless.

The most popular method of valuing intellectual property in Australia at present seems to be the discounted cash flow method. However, this method is not without its problems. The method relies on a forecast being made of the revenue which will be obtained from the exploitation of the intellectual property. Where the relevant technology has already been proven in the market then it might be possible to make such a forecast, based on an analysis of previous earnings, with reasonable confidence. However, even in those circumstances, care must be taken to ensure that the historical revenue is in fact attributable to the intellectual property itself rather than to other factors, such as the borrower's superior marketing ability or quality of the borrower's manufacturing processes. Allowance must also be made for the risk that competing technologies may enter the market and result in the technology being outmoded and the forecast consequently becoming unreliable.

Where the intellectual property has not been proven in the market then the discounted cash flow method is even less satisfactory. At this stage there is no guarantee that the intellectual property will in fact ever produce anything of value. All sorts of problems can befall the technology before it is commercialised: the market can move on, competing technologies can emerge, insuperable prior intellectual property claims can appear and problems might emerge with the technology in the process of converting it from promising laboratory results to real world exploitation. These factors all suggest that a substantial risk component should be built into any discounted cash flow valuation. The reality is that any unproven technology, no matter how promising, has at least a chance of being ultimately worthless.

Even if the relevant intellectual property should be valuable, the lender needs to ask whether it, or a purchaser from it, will be able to realise the value in the property as a practical matter. It is in the nature of much intellectual property that many elements are needed in order to realise its value. The technology might be of such complexity that it can only be exercised effectively and efficiently by people who have worked with it for years. If the technology is of that type then there may be no practical way to enforce the security, as the people who are needed in order to work the technology might decline to accompany the technology on its transfer to the lender or a purchaser from the lender. The software industry, in particular, is notorious for the mobility of its workforce and the short-lived nature of companies in the industry. Before lending on security of rights over software, the lender needs to ensure that the software is able to be exploited even if the developer's staff are not available to assist in its future development, exploitation and maintenance.

An additional consideration is that the secured intellectual property might derive much of its value from other intellectual property, or be unable to be exercised without access to other intellectual property. In the case of copyright, patent and designs, the relevant intellectual property might be based on earlier works or technology by the same developer or require a licence from a third party in order to be used. This will normally only become apparent as a result of a thorough investigation

into the circumstances of the relevant intellectual property's creation and use. If rights to other intellectual property are needed to exploit the secured intellectual property then those rights should also be secured at the time the original security is obtained.

In the case of trade marks, the lender needs to consider whether the trade mark will be, in itself, of value. A trade mark's value is obtained solely through being used in the market place and acquiring a good reputation. The relevant trade mark might, for example, owe its attractive power (and hence value) to particular manufacturing processes or formulae with which it has been used in the past and which have led to the trade mark having its valuable reputation. If that be the case then a lender should ensure that it also has security over whatever made the trade mark valuable in the first place.

## SECURITY OVER INTELLECTUAL PROPERTY

### General

Copyright, registered trade marks, patents and designs are choses in action, that is, rights which must be enforced by legal action rather than by possession.<sup>21</sup> In consequence, intellectual property is in general able to be secured by the same mechanisms which secure other choses in action. This excludes forms of security based on possession (notably pledges)<sup>22</sup> but allows the other principal forms of security, being the mortgage and the charge. Given this audience, I do not propose to discuss these forms of security in detail but just to outline their main characteristics and then to discuss their application to the principal types of intellectual property.

A mortgage of personal property operates as an assignment of the property to the security holder coupled with an equity of redemption entitling the mortgagor to have the property assigned back upon the secured obligation being discharged. In most cases the mortgagor of intellectual property will need to continue using (and possibly granting licences to) the intellectual property in the conduct of its business. There will accordingly usually be an express or implied licence from the mortgagee back to the mortgagor to allow the mortgagor's business to continue. An equitable mortgage leaves the mortgagor as legal owner of the secured property but provides for the property to be assigned at law to the mortgagee upon there being an event of default. The legal mortgage is normally preferred as it provides better protection against subsequent unauthorised dealings by the mortgagor.

Legal and equitable mortgages over intellectual property are effected in the same way as they are over other types of property. If a legal mortgage is desired then the intellectual property is assigned to the mortgagee by instrument in writing. An equitable mortgage can arise by the mortgagor agreeing to assign legal ownership of the intellectual property to the mortgagee in the future or by a mortgage being entered into which does not comply with the formal requirements of the relevant intellectual property legislation. As with other forms of property, a prudent equitable mortgagee will ensure it has possession of all documents needed to perfect its title before providing the financial accommodation. Hence the mortgagee should get possession of the

<sup>21</sup> In *Colonial Bank v Whinney* (1885) 30 Ch D 261, 285 Fry LJ stated that "all personal things are either in possession or in action". In that case Fry LJ held that company shares constituted a chose in action for the purpose of the *Bankruptcy Act* 1883. In this finding he was in disagreement with the other two members of the Court of Appeal. However, his dictum has been followed since then and appears to represent the current state of the law: Sykes and Walker, *The Law of Securities*, The Law Book Company, 1993 at page 759. In the case of registered design rights, section 25C(2) *Designs Act* expressly recognises that designs are choses in action.

<sup>22</sup> Professor Palmer has suggested (*Securities over Personality*, The Federation Press, 1994 at page 138) that "it is not inconceivable that future authority will recognise a pledge of intangibles". Although an intriguing suggestion, the references cited by Professor Palmer do not provide strong support for the view that pledges can be taken over an intangible right. It is suggested that there will need to be very substantial development indeed before the law does recognise such a pledge.



registration certificate of the patent, trade mark or design and have the mortgagor execute an undated assignment of the property.

Charges can be either fixed or floating. A floating charge is used where the subject matter of the charge is, of its nature, being turned over and replaced in the ordinary course of the chargor's business. A fixed charge is used where the subject matter of the charge will in general<sup>23</sup> remain owned by the chargor for the duration of the security. In the context of intellectual property, the chargor will usually remain the owner of the intellectual property. It would be rare for a business to consist of the disposition of units of intellectual property to third parties on a regular, ongoing basis. This suggests that intellectual property would normally be secured by a fixed, rather than a floating, charge. Care must be taken in drafting the charge to ensure that future accretions to the intellectual property will be covered within the fixed charge.

## Security over copyright

Copyright is personal property<sup>24</sup> and can accordingly be the subject matter of a charge on the same basis as any other personal property.<sup>25</sup> Copyright may also be assigned by instrument in writing signed by or on behalf of the assignor<sup>26</sup> and can hence be the subject of a mortgage.

The Act specifically allows the assignment of copyright which is not in existence at the time of the assignment but which will only arise in the future.<sup>27</sup> This means that a charge or legal mortgage can be obtained over copyright which will not arise until the future and that the security will become effective immediately upon the copyright arising. With other types of property a mortgage or other dealing with respect to future property will be effective only in equity.<sup>28</sup>

To this point copyright poses no particular problems. The practical difficulty with using copyright as a security is to ensure that the security is granted by the owner of the copyright and that the owner is capable of granting the security interest. This difficulty arises from the following factors:

- The rules relating to ownership of copyright in works are quite technical and, where works are created by contractors, can operate contrary to commercial expectations. This may result in a person not being the owner of rights which it, quite reasonably, considers that it does own.
- There is no statutory register of copyright and hence no record to prove that a security is granted by the person who in fact owns the copyright. Even if the security is granted by a person who was once the owner of the rights, there is no way of determining whether that person has subsequently transferred ownership or granted a security to a third person. If ownership has been transferred then, of course, the subsequently arising security will be ineffective against the prior assignee, even if without notice and if valuable consideration has been given.<sup>29</sup> If only a security has been granted over the copyright then the priority of the two securities will have to be resolved in accordance with the usual principles.

---

<sup>23</sup> On recent authority, a limited degree of substitution may be tolerated: *Cimex Tissues*, 1994, unreported.

<sup>24</sup> Sub-section 196(1) *Copyright Act*.

<sup>25</sup> *Barker v Stickney* [1919] 1 KB 121, 128.

<sup>26</sup> Section 197(3) *Copyright Act*.

<sup>27</sup> Section 197(1) *Copyright Act*. See the discussion on this section in Ricketson, *The Law of Intellectual Property*, paragraphs 13.95 and 13.96.

<sup>28</sup> *Holroyd v Marshall* (1862) 11 ER 999, 1007.

<sup>29</sup> The priority rules protecting bona fide purchasers for value without notice do not apply as the earlier assignment would have been of the legal interest in the copyright, rather than only the equitable interest in that right.

- A licence granted in respect of copyright binds every successor in title to the interest of the licensor.<sup>30</sup> This is, of course, contrary to the position that would apply with most types of property. With most types of property, if the owner grants a licence to a third party and subsequently deals with the property in a manner inconsistent with the licence then the assignee is not bound by the licence.<sup>31</sup> The licensee is left with only an action for breach of contract against the grantor. With copyright, a security holder could find that its security has been devalued due to a licence granted by the copyright owner prior to the security being granted, again, even though the security holder may have given valuable consideration for its security and may not have had notice of the prior licence. Indeed on the wording of the section a security holder could even be bound by a licence granted by the copyright owner **after** the security was granted.

A grant of an exclusive licence will be particularly deadly. An exclusive licence operates to prevent anyone, including the grantor, from exercising the relevant copyright.<sup>32</sup> A person who takes a security interest over a copyright which is subject to an exclusive licence might find that the security is valueless, as all the rights to exercise the copyright have been exclusively licensed to someone else. On enforcement of the security, the security holder will have nothing more than bare ownership of the copyright.

In normal commercial dealings with copyright these problems are resolved by obtaining a warranty from the grantor that it is and at all material times will be the owner of the right (dealing with the first and second problems) and that it has not dealt with the right in any manner which is inconsistent with the relevant grant (dealings with the third problem). These warranties must be obtained by anyone obtaining security over a copyright. However, in all probability, a breach of the warranty is only likely to be detected upon the security holder seeking to enforce its security, at which time the grantor may be insolvent and so make the action for breach of warranty futile.

There is no totally satisfactory way of avoiding the above problems. Protection against future unauthorised licences or dealings may be obtained by ensuring the security takes effect by way of a legal mortgage with a licence back. This will leave the security holder as the owner of the relevant rights and any subsequent unauthorised dealings with those rights by the mortgagor (former owner) will be ineffective. A security holder who has only a charge over the copyright takes the risk of the copyright being devalued by a subsequent dealing with the copyright.

Although the assignment with a licence back might be preferred from the point of view of defeating subsequent transactions, it is also not without problems. If the mortgagor's business involves granting licences over the intellectual property to third parties then potential licensees are likely to want to know that they are dealing with the owner of that right, rather than with someone who has only a licence from the security holder. In those circumstances the grant of this type of security could hinder the conduct of the mortgagor's business, and so might be unacceptable for commercial reasons.

A further problem with the mortgage/licence back security is the risk of the security holder being liable for the mortgagor's copyright infringements. Among the exclusive rights conferred on the owner of a copyright is the right to authorise someone to do one of the acts comprised within the copyright. If the work which is the subject of the security infringes a third party's copyright then the licence back by the security holder may be regarded as the security holder's authorisation of the

---

<sup>30</sup> Sub-section 197(4) *Copyright Act*.

<sup>31</sup> Unless, possibly, the subsequent grantee is aware of the licence at the time of grant and even then the grantee would only be bound if the licence imposed a charge over the licensed subject matter instead of merely imposing a personal covenant on the licensor: *Barker v Stickway* [1919] 1 KB 121, a case concerning copyright before the introduction of section 197(4) or any equivalent. Compare with the position applying to the registered intellectual property rights, where registration of a licence will allow the licensee to enforce the licence against subsequent assignees.

<sup>32</sup> It is hence to be distinguished from a sole licence, which prevents the grantor from granting any further licences but allows the grantor to continue exercising the relevant right itself.

infringement. This could make the security holder liable (together with the mortgagor) for the infringement of the third party's rights. Thus, the preferred method of taking security over copyright from the point of view of being protected against subsequent unauthorised dealings with those rights has practical difficulties which makes it unattractive in a particular case.

There is even less that can be done to protect the security holder against unknown prior dealings with the copyright. Practical steps which the proposing security holder can take are to investigate the security giver's business as closely as possible and look for any indication that there have been relevant prior dealings with the copyright. Searches of the register of a company at the ASC may help by showing that there has been an earlier prior security interest. If the relevant business operates internationally then a search could be made of the registers of those countries in which it is possible to register copyright and security interests over copyright, such as the United States. However, these searches can only provide proof that there has been a prior dealing with the copyright; the absence of any evidence of a prior dealing does not provide any assurance that there has not been such a dealing.

As there is no way to be certain that the grantor of the security has not previously dealt with the copyright (whether by way of an assignment, exclusive licence or otherwise) in such a way as to devalue substantially its worth as a security, the value of copyright as a security is subject to the risk that the grantor has previously dealt with it in this way.

## Security over patents and designs

Patent and design rights have a number of features in common and may be conveniently discussed together. Both patent rights and registered design rights constitute personal property which are capable of assignment.<sup>33</sup>

Both Acts explicitly recognise that mortgages, licences and other interests may be granted<sup>34</sup> over the patent/design and require those interests to be registered.<sup>35</sup> The wording of both Acts show that what is registered is an existing interest in a patent/design.<sup>36</sup> Hence the Acts establish a scheme for registration of interests in patents/designs, rather than a Torrens type scheme whereby those interests arise from registration. Failure to register an interest in a patent/design does not, in itself, make the interest ineffective. There seems no reason why someone could not have, say, a valid charge over a patent notwithstanding failure to register the charge on the Patents Register. The right of licensees to register their interest in a patent confers on them a form of statutory protection of their interest. If the owner assigns the patent/design while the licence is in force then the assignee will be bound by the licence.

Section 189 *Patents Act* provides:

---

<sup>33</sup> Sub-section 13(2) *Patents Act* and sub-section 25C(1) *Designs Act*.

<sup>34</sup> Sub-section 103(1) *Patents Act* and section 38A *Designs Act*.

<sup>35</sup> Section 187 *Patents Act*, section 38A *Designs Act*.

<sup>36</sup> The obligation in section 187 *Patents Act* is to register "prescribed particulars" relating to patents. Regulation 19.1(1)(a) *Patents Regulations* states that an entitlement "as a mortgagee, licensee or otherwise to an interest in a patent" is registrable. Hence what is registered is the entitlement. Regulation 19.1(2) states that a request for registration of particulars under 19.1(1)(c) must be accompanied by proof "of the entitlement of the person making the request". This implies that the entitlement is in existence at the time of making the request and does not arise by virtue of being entered on the Register. In addition, section 196 allows the court to direct that unregistered documents be admitted into evidence "in proof of the title of a patent or to an interest in a patent", suggesting that the unregistered instrument would have been effective as a matter of substantive law to transfer title in the patent or to create an interest in the patent, subject to the procedural hurdle of getting the instrument into evidence. Section 38A *Designs Act* requires a person who is "entitled as mortgagee, licensee or otherwise" to apply to register "his title", suggesting that the title is already in existence.

- (1) A patentee may, subject only to any rights appearing in the Register to be vested in another person, deal with the patent as the absolute owner of it and give good discharges for any consideration for any such dealing.
- (2) This section does not protect a person who deals with a patentee otherwise than as a purchaser in good faith for value and without notice of any fraud on the part of the patentee.
- (3) Equities in relation to a patent may be enforced against the patentee except to the prejudice of a purchaser in good faith for value.

"Patentee" is defined to mean the person "for the time being entered in the Register" as the proprietor of a patent.

Where sub-section 189(1) applies it hence has the effect that, subject only to rights appearing in the Register, the person registered as the patentee may deal with the patent as its absolute owner. If a prior assignment or interest has not been entered on the register then the patentee is still able to pass good title in, or grant a valid interest over, the patent at the expense of the prior unregistered dealing. This seems to be an intentional exception to the normal *nemo dat qui non habet* principle. If that subsequent dealing then becomes registered before the prior dealing, it will prevail over the prior dealing. The section does not specifically address the situation of registration being subsequently sought for the prior dealing: presumably the prior unregistered dealing would be postponed to the subsequent registered dealing as a result of its failing to comply with the requirement in section 187 to register interests.

Sub-section 189(1) only protects a "purchaser". There is no authority on whether this means purchaser in the strict sense of the word (ie, someone who pays for the legal and beneficial interest in property) or whether it includes someone who acquires a lesser interest in a patent, such as a security holder or a licensee. A similar phrase has been taken, in the context of bankruptcy legislation, to have a broad meaning.<sup>37</sup> In addition, the phrase occurs in the *Patents Act* in the context of a section resolving priorities between competing interests in patents. This suggests that "purchaser" should be given a broad meaning and apply to anyone who acquires an interest in a patent for valuable consideration.

It is not clear whether notice of an earlier, inconsistent dealing would be sufficient for the subsequent security holder to be taken not to have dealt in good faith for the purposes of sub-section 189(2). One interpretation is that notice of earlier inconsistent interests would be sufficient to take a security holder outside the protection of sub-section 189(1). However, if that were correct then there would be no need for the words "without notice of fraud on the part of the patentee": if a person is taken to have been dealing in bad faith due to notice of an earlier inconsistent dealing then they would *a fortiori* be dealing in bad faith if they had notice of the patentee's fraud. I would accordingly suggest that bad faith in sub-section 189(2) requires more than mere notice of a prior inconsistent dealing. This interpretation is also consistent with the assumed policy in sub-section 189(1) of dealings being subject only to interests noted on the register.

Sub-section 189(3) allows equities in relation to a patent to be enforced against the patentee except to the prejudice of a purchaser in good faith for value. The absence of the words "without notice of any fraud on the part of the patentee" is interesting, but probably of no real importance. If the purchaser does have notice of the patentee's fraud then it is difficult to see how the purchaser could be acquiring in "good faith". Sub-section 189(3) is not restricted to equities which have been registered. It would seem that all types of equities in patents may be enforced, presumably on the same basis as they are enforced over any other type of personal property. An important limitation in sub-section 187(3) is the implication that equities may only be enforced against the patentee.

<sup>37</sup> See, for example, *Barton v Official Receiver* (1986) 66 ALR 355 where the High Court seems to have accepted that a borrower of money could be a purchaser for valuable consideration if the borrower had given something of real and substantial value for the loan.

This could lead to unsatisfactory results where it is necessary to enforce an equity against someone other than the patentee. For example, a person might have taken an interest in a patent knowing of a prior unregistered interest. If the subsequent interest is then registered then it will be difficult for the holder of the prior interest to have the subsequent interest removed since the equities are only enforceable against the patentee.<sup>38</sup> This suggests the importance of an interest in a patent being registered on the Patents Register as soon as possible after creation.

It is fundamental to a system which accords priority to interests based on whether they are registered that the register be open for inspection. Here the practice of the Australian Intellectual Property Office is less than perfect. The Patents Register is customarily searched by on-line access, either from the AIPO sub-branch in each capital city or from terminals located at the searcher's offices. Contrary to what is commonly believed, these searches will not disclose a security interest registered over a patent.<sup>39</sup> Although the AIPO plans to change its procedures so that registered security interests will be disclosed on the status report, there are no current plans for this to occur. At present the only practical way of ensuring that a patent is not subject to a prior security is to make a specific enquiry with the AIPO with respect to that patent. Another, less practical, way is to examine each copy of the Official Journal of Patents since the date the patent was lodged to determine if any security interests have been registered.<sup>40</sup>

The provisions in the *Designs Act* relating to dealings with designs are less comprehensive than those in the *Patents Act*. As stated above, persons who are entitled to an interest in the registered design are required to apply to have the interest noted on the register. As with the *Patents Act*, it is clear that the interest in the design exists independently of its being registered. There hence seems no reason why a person could not have an unregistered legal interest in a design, either by way of an assignment or a security.

The provisions of the *Designs Act* relevant to the grant of a security are in section 25C. That section provides:

- (1) The rights of an owner with respect to a registered design are personal property and are capable of assignment and transmission by operation of law.
- (2) Subject to this Act, the laws applicable to ownership and devolution of personal property apply in relation to the monopoly in a registered design as they apply in relation to other choses in action.
- (3) An assignment referred to in sub-section (1) shall be in writing signed by or on behalf of the owner.

The application of the provisions is not straightforward. "Owner" is defined to be the person "registered as the owner", suggesting that a dealing with the person registered as the owner would be effective, even if that person had already disposed of the design to another. Contrary to this, the provision requiring assignments to be registered<sup>41</sup> clearly contemplates that a person can be the owner of the design before being entered in the Register as such.

---

<sup>38</sup> This situation occurred in *New Ixion Tyre and Cycle Company v Spilsbury* [1898] 2 Ch 484. The registered proprietor had agreed to assign the patent but, before the assignment was registered, granted a licence to someone who knew of the unregistered assignment and who promptly registered the licence. The corresponding provision of the UK *Patents, Designs and Trade Marks Act 1883* did not limit the enforcement of equities against the patentee and the assignee was allowed to take the patent free from the licence. It is clear from the judgement (page 488) that the assignee would have been subject to the licence if the equity could only be enforced against the patentee.

<sup>39</sup> Telephone conversation with the Patadmin User Manager, Australian Intellectual Property Organisation on 17 February 1995.

<sup>40</sup> Ibid.

<sup>41</sup> Section 38.

The definition of "owner" in section 4(1) commences with the words "unless the contrary intention appears" and the references in section 25C to the "laws applicable to ownership of personal property" applying to designs could be seen as showing a contrary intention in section 25C. On that basis the section should be interpreted as though references to "owner" in the section refer to the person who owns the rights in the design, whether or not that person is the registered proprietor of the design. In the absence of any provision (such as in the *Patents Act*) which is clearly intended to allow people to deal with the registered proprietor of a design and to receive good discharges for those dealings, I consider the *Designs Act* should be construed so that the normal proprietary principles apply. In consequence, there is the risk that dealings with a design will be subject to prior, unregistered dealings.

This suggests that the person proposing to take security over a design will need to undertake the same investigations and be subject to the same uncertainties as the person taking a security over a copyright. This risk also suggests that the *Designs Act* should be amended so that a person dealing with the registered proprietor of a design may do so with confidence and subject only to any interests shown on the register.<sup>42</sup>

As stated above, interests in designs are required to be registered. However, the Act does not state any consequence of non-registration. Nor is there any provision in the Act stating that subsequent dealings are subject only to any registered interests (as there is in the *Patents Act*). The advantage of registering an interest is presumably that the registration will constitute notice of the interest in the design. That notice would be relevant in determining priorities between conflicting interests on the same basis that notice applies in relation to resolving priority disputes in relation to other choses in action.

### Security over registered trade marks

The current *Trade Marks Act* provides for registration of particulars of a registered trade mark, assignments or transmissions and registered users. The current Act does not permit other interests, such as security interests and trusts<sup>43</sup> to be registered. A registrable security could only be obtained under the current Act if structured as a legal mortgage. That would be achieved by way of an assignment to the mortgagee together with a licence back to the mortgagor to continue using the mark. Although that form of security would seem to be technically registrable, there are other difficulties under the current Act with taking such a security.<sup>44</sup> In the absence of the security holder's interests being able to be recorded in some way on the register, the security holder takes the risk that the security will be defeated by a subsequent assignment of the trade mark. Happily, the position will be improved under the new *Trade Marks Act* which, as stated above, is due to come into force on 1 January 1996.

The new Act provides expressly that a registered trade mark is personal property<sup>45</sup> and that a person claiming to have an interest in, or a right in respect of, a registered trade mark, can have the particulars of the right or interest recorded in the Register.<sup>46</sup> The registration procedure is voluntary and can be used both for registered trade marks and also for trade mark applications. The new Act does not ascribe a particular effect to the recordal of a right or interest on the register

<sup>42</sup> The person who had the prior dealing with the registered proprietor cannot be confident of success since the *Designs Act* specifically defines the "owner" of a design as being the person who is registered as the owner of the registered design (sub-section 4(i)). Since the section allowing designs to be assigned (25C(i)) is defined to be with respect to "an owner", the person who has the subsequent dealing could argue that the first dealing is ineffective until such time as it is registered.

<sup>43</sup> Trusts are expressly excluded from registration by section 15 of the current Act.

<sup>44</sup> In particular, the anti-trafficking provision in sub-section 74(4) which prevents the Registrar registering a person as a registered user of a trade mark if it appears to him that the registration would tend to "facilitate trafficking in the trade mark". There is no equivalent provision to sub-section 74(4) in the new Act.

<sup>45</sup> Sub-section 21(1).

<sup>46</sup> Section 114(1).

and expressly provides that the fact that an interest or right has been recorded in this way is not "proof of or evidence" that the relevant person has that right or interest.<sup>47</sup> Unlike the current Act, the new Act allows trade marks to be freely assigned,<sup>48</sup> subject only to the overriding requirement that a registration may always be removed if it is wrongly remaining on the register.

Section 22 of the new *Trade Marks Act* seems intended to provide some protection for a person who deals with the registered owner of a trade mark in good faith. That section provides:

- (1) The registered owner of a trade mark may, subject only to any rights vested in another person, deal with the trade mark as its absolute owner and give in good faith discharges for any consideration for that dealing.
- (2) This section does not protect a person who deals with a registered owner otherwise than:
  - (a) as a purchaser in good faith for value; and
  - (b) without notice of any fraud on the part of the owner.
- (3) Equities in respect of a trade mark may be enforced against the registered owner in the same way as equities in respect of any other personal property.

Although similar to the equivalent provisions in the *Patents Act*, these provisions are fundamentally defective. The equivalent to sub-section 22(1) in the *Patents Act* is subject only to rights appearing in the Patents Register. The absence of that qualification (which does appear in the current *Trade Marks Act*)<sup>49</sup> in the new *Trade Marks Act* means that the subsequent dealing will be subject to both registered and unregistered interests. The subsequent security holder could argue that failure to record the prior interest constitutes blameworthy conduct sufficient to postpone the earlier interest to the subsequent interest.<sup>50</sup> However, as recordal of interests is clearly voluntary under the new Act, the subsequent holder could not be confident of success with that argument. The result is to deprive people dealing with the registered proprietor of a trade mark from most of the protection which section 22 seems intended to confer.

As with the *Patents Act*, equities are only enforceable against the registered owner of the trade mark.

In summary, the provisions in the new *Trade Marks Act* allowing security interests to be recorded on the register will be welcomed. However, the absence of provisions which allow a person to deal with the registered owner in confidence, subject only to the interests which have been noted on the register, mean that registered trade marks continue to be less valuable for security purposes than they could be.

---

<sup>47</sup> Section 116.

<sup>48</sup> Part 10.

<sup>49</sup> Sub-section 57(1).

<sup>50</sup> On the principles discussed in Sykes and Walker, *The Law of Securities* at pages 396-407.

## PRIORITIES BETWEEN SECURITIES

### Priorities in general

The worth of any type of security will depend in part on whether that security has priority over any other security over that property. As intellectual property is a form of personal property, the usual rules for resolving conflicts between priorities over personal property will apply.<sup>51</sup> Given this audience, I do not propose to dwell on these rules at any length and summarise them as follows:

1. In the case of a conflict between a prior legal interest and a subsequent legal or equitable interest, the earlier legal interest will prevail. However, in certain circumstances the prior dealing may be postponed to the subsequent dealing as a result of the legal proprietor's blameworthy conduct.
2. In the case of a conflict between a prior equitable interest and a later legal interest, the equitable interest will prevail unless the legal interest is claimed by a person who is a bona fide purchaser for value without notice of the earlier equitable interest.
3. In the case of conflict between two equitable interests, the earlier interest will prevail unless the holder has been guilty of some blameworthy conduct which postpones it to the later interest.

I have referred in the preceding section to any particular provisions of the intellectual property legislation which might affect the application of these general rules.

An issue arising out of the second rule is whether registration of an interest under the intellectual property legislation will constitute constructive notice of the interest. The general rule is that the doctrine of constructive notice does not apply to personalty.<sup>52</sup> Tempting as it is to stop at this point, the rule that constructive notice does not apply to personalty has never been expressly applied to intellectual property. The doctrine of constructive notice has traditionally applied where a relevant interest would have been revealed by "such inquiries and investigations as would have been made in the circumstances by reasonable person, acting prudently in his own interests".<sup>53</sup> Registered trade marks, patents and designs all arise through registration on a Commonwealth register. Anyone dealing with those rights would need to inspect that register to determine, at the least, that the right does exist and is registered in the name of the person purporting to deal with it. Since a person needs to inspect the register for those purposes, it seems reasonable that they should also be fixed with knowledge of anything else appearing on the register.<sup>54</sup>

### Priorities under the *Corporations Law*

In respect of most types of securities granted by corporations, Part 3.5 of the *Corporations Law* replaces the general law priority rules with rules which are based on time of registration on the Register of Companies Charges and notice of prior charges. The application of Part 3.5 to intellectual property is by no means straightforward. Until we have some judicial guidance on the issues the following conclusions are necessarily speculative.

---

<sup>51</sup> Sykes and Walker, *The Law of Securities* at page 879.

<sup>52</sup> Sykes and Walker, *The Law of Securities* at page 802.

<sup>53</sup> *Bailey v Barnes* [1894] 1 Ch 25.

<sup>54</sup> This argument will be particularly strong once the on-line searches disclose security interests in the intellectual property.



The following provisions of the *Corporations Law* are relevant.

- The definition of "charge" in sub-section 9(1) includes a mortgage.
- The definition of "property" in sub-section 9(1) includes personal property and things in action. Hence, on normal principles, the definition is broad enough to include all forms of intellectual property except confidential information and unregistered trade marks.
- Paragraph 262(1)(e) provides that the provisions of Part 3.5 ("Charges") relating to the giving of notice, registration and priorities, apply in relation to charges over patents, trade marks, copyright, registered designs and licences to each of them.
- Sub-section 279(5) states that sections 280-282 (dealing with priorities of charges) "do not apply so as to affect the operation of" the *Copyright Act*, *Designs Act*, *Patents Act*, or the *Trade Marks Act*.

A preliminary point is the lack of any reference to confidential information, plant breeder's rights or EL rights. Although, for reasons discussed above, confidential information might not form an appropriate basis for security for other reasons, the omission of plant breeder's rights and EL rights is more serious. These rights are presumably only omitted due to their relatively recent origin. It would seem appropriate for their omission from the above provisions to be rectified.

Based on paragraph 262(1)(e) there seems no doubt the provisions of the *Corporations Law* dealing with charges are intended to apply to intellectual property. The effect of sub-section 279(5) is less easy to determine.

There was no equivalent to sub-section 279(5) in the *Companies Codes* of the States. Its first appearance was as section 204(5) of the *Companies Act* 1981 of the Australian Capital Territory. The section might have been felt necessary in that Act to prevent any inconsistency arising between two Commonwealth Acts. The provision in the ACT *Companies Act* was then repeated in the *Corporations Act* 1989 (Cth). When the *Corporations Act* was adopted by each State as the *Corporations Law*, the sub-section was also adopted as the law of those States.

If sub-section 279(5) had not been present then there would be the risk of any inconsistency between the *Corporations Law* and the intellectual property legislation being resolved differently depending on the place in which the chargor was incorporated. In respect of companies incorporated in a state, the inconsistency between the *Corporations Law* as a law of a state<sup>55</sup> and the Commonwealth intellectual property legislation would be resolved in accordance with section 109 of the Constitution.<sup>56</sup> Where a company was incorporated in the ACT the inconsistency would be between two pieces of Commonwealth legislation: this could result in the inconsistency being resolved in favour of the legislation which was passed most recently or in favour of the more specific legislation. In either event there is no assurance that the inconsistency would be resolved in the same way as it would with respect to companies incorporated in a State.

A broad interpretation of sub-section 279(5) would be that the priority principles in the *Corporations Law* are not intended to apply to intellectual property at all. However, if that had been intended then the provision could be expected to be expressed in terms of the priority provision not applying in relation to the intellectual property, as is done, for example, in relation to charges which are not subject to the registration requirement.<sup>57</sup> The broad interpretation is also inconsistent with

---

<sup>55</sup> Under section 7 of the *Corporations (Queensland) Act*, the *Corporations Law* takes effect as an Act of the Queensland Parliament. The same provision occurs in each of the other enabling Acts.

<sup>56</sup> Broadly speaking, section 109 provides for Commonwealth legislation to have priority over State legislation to the extent of any inconsistency between the two pieces of legislation.

<sup>57</sup> Sub-section 262(2).

the statement in paragraph 262(1)(e) that the provisions of Part 3.5 relating to priorities of charges apply in relation to charges on intellectual property.

An alternative, and it is submitted better, interpretation is obtained by concentrating on the word "operation" in sub-section 279(5). That word suggests that the priority provisions of the *Corporations Law* are not intended to change the result which would follow from applying the provisions of the relevant intellectual property legislation.<sup>58</sup> However, where the intellectual property legislation does not contain provisions which prescribe how conflicting priorities should be resolved then these priorities are to be resolved in accordance with the *Corporations Law* principles, rather than the general law principles.

The *Patents Act* and the new *Trade Marks Act* both contain provisions which resolve priorities between competing securities in certain circumstances; the *Copyright Act* and *Designs Act* do not contain such provisions. Hence priorities between competing interests in a copyright and design owned by a corporation will be resolved in accordance with the *Corporations Law* principles; priorities in a patent or trade mark will be resolved in accordance with the intellectual property legislation if its terms apply to the particular conflict and in accordance with the *Corporations Law* principles otherwise.

The application of the above might be conveniently illustrated by an example involving securities over a patent (where the intellectual property legislation does prescribe the priorities) and a design (where it does not). Assume X owns a patent and a design and grants a charge over them first to A and then to B. B does not have actual notice of A's charge. The following combinations result.

- (i) **A registers under intellectual property legislation and *Corporations Law*.** B's interest takes subsequent to A's (paragraph 280(1) *Corporations Law*).
- (ii) **A registers under intellectual property legislation but not under *Corporations Law*.** B will take subsequent to A's interest in the patent (sub-section 189(1) *Patents Act*) and, if registration under the *Designs Act* does (as was argued above) constitute notice of interests in designs then, B will also take subject to A's interest in the design (paragraph 280(1)(b) *Corporations Law*).

The *Corporations Law* deems charges which have not been registered on the Register of Companies Charges to be void in certain circumstances.<sup>59</sup> In consequence it would not be prudent for A to rely on registration under the intellectual property legislation alone. To ensure the security will remain valid in the event of X's becoming insolvent, A must also register the charge under the *Corporations Law*.

- (iii) **A registers under *Corporations Law* but not under intellectual property legislation.** If B registers its charge under the *Patents Act* then it will have priority over A's charge (sub-section 189(1) *Patents Act*). Sub-section 189(1) suggests B might even have priority if it does not register its charge, with the result that, for unregistered charges over patents, a last in time rule prevails! With respect to the design, A's interest has priority (paragraph 280(1) *Corporations Law*).

Registration of a charge under the *Corporations Law* may have an indirect effect on the resolution of the priorities by constituting notice for the purpose of the *Patents Act*. As discussed above, the relevant provision of the *Patents Act*<sup>60</sup> only apply to protect a purchaser in good faith for value and "without notice of any fraud on the part of the

<sup>58</sup> Indeed, to the extent that the *Corporations Law* applies as a law of a state, the State law would not be competent to change that result.

<sup>59</sup> Section 266 - charges which are void against a liquidator or an administrator. This section is not amongst those which sub-section 279(5) states do not apply so as to affect the operation of the intellectual property legislation.

<sup>60</sup> Section 189.

patentee". If the person creating the security interest in the patent has actual notice of a prior dealing, whether through its registration on the Register of Companies Charges or otherwise, then that person may not qualify as a purchaser in "good faith" and so would not have the benefit of those provisions. However, if the subsequent security was created without actual notice of the earlier interest then its holder could still be regarded as a purchaser in good faith for value. Even if registration on the Register of Companies Charges constituted constructive notice of the prior charge for the purpose of applying the general law priority rules,<sup>61</sup> it is unlikely to also constitute constructive notice of any fraud on the part of the patentee. Registration on the Register of Companies Charges would accordingly not constitute constructive notice to deprive a "purchaser" in good faith of the protection afforded by the *Patents Act*.

- (iv) **A does not register at all.** If B also does not register at all then A's interest has priority (paragraph 280(1)(b) *Corporations Law*). However, if B registers under the *Patents Act* then it will have priority over A's charge (sub-section 189(1) *Patents Act*). To protect itself against subsequent charges over the design, B should also register under the *Designs Act*.

## Priorities - summary

In summary:

- (a) The *Patents Act* contains provisions which affect the application of the general law priority principles. As a result of those provisions it is essential that security interests in patents be registered under the *Patents Act*. Failure to do so will make the security unenforceable against a subsequent security holder, even if the security was registered on the Register of Company Charges.
- (a) The new *Trade Marks Act* also contains provisions affecting the operation of the general law priority principles. Those provisions accord priority to the first created interest, irrespective of registration and, possibly, even notice. Due to the risk of a security being defeated by a prior unregistered interest, great caution is needed before using registered trade marks as a security.
- (b) The provisions which affect priority in the *Patents Act* and the *Trade Marks Act* only apply if the holder is a purchaser in good faith for value without notice of fraud on the owner's part. If the security holder cannot be so characterised then the general law priority principles will apply.
- (c) Security interests in designs are required to be registered under the *Designs Act*. There is no register on which to register interests in copyright. With respect to each of these types of intellectual property, the general law principles for determining priorities apply. With respect to designs, it would be prudent to register the charge on the intellectual property register. That registration increases the likelihood of subsequent dealings arising with actual notice of the charge. It may also constitute constructive notice of the charge.

---

<sup>61</sup> At common law a person was taken to have notice of the particulars of a charge registered under the relevant Companies Act: *Wilson v Kelland* [1910] 2 Ch 306. Although sub-section 165(1) abolishes the doctrine of constructive notice for other documents, sub-section 165(2) preserves the doctrine in relation to documents lodged on the Register of Company Charges. The question is accordingly open whether registration under the *Corporations Law* would be taken to constitute constructive notice of interests in intellectual property. The only authority to have considered a similar issue, the *Australian Central Credit Union* decision ((1991) ASC 56-037), suggests that registration under the *Companies Code* would be taken to constitute constructive notice of an interest in a chattel. However, that decision was based upon the assumed intention of a State Parliament in passing the *Companies Code* and then an Act allowing registration of interests in motor vehicles. It is not particularly relevant to whether registration under a State register would constitute constructive notice for the purposes of interests in property arising under Commonwealth legislation.

- (d) If the relevant intellectual property legislation contains provisions affecting the priority of interests in the property then those provisions apply to resolve the priorities. Where those provisions do not apply, or if the legislation does not contain such provisions, then the *Corporations Law* priority principles apply to resolving priorities between conflicting security interests in intellectual property owned by corporations. Registration under the *Corporations Law* is required to avoid a charge over intellectual property being declared void against a liquidator of the company.
- (f) As the position is unclear in a number of respects, the prudent security holder will, of course, register its interests under both the intellectual property legislation and the *Corporations Law*. Only such dual registration maximises the prospects of the security interest being effective in all circumstances.

## CONCLUSION

The Australian Industrial Property Organisation publishes each week an "Official Journal of Patents". All interests filed with the AIPO on patents are published in the Journal. To determine the current Australian practice on registration of charges over patents, I organised a search of each edition of the Official Journal in 1994. In that twelve month period, only 2 charges over patents were registered on the Patents Register. One of the chargors was an American limited partnership (which was not registered as a foreign company in Australia) and so there was no provision for that charge also to be registered on the Register of Companies Charges. The other chargor was an Australian corporation and a search of the Register of Companies Charges showed that the charge had not been registered on that register.<sup>62</sup>

A possible reason for the lack of charge registrations is that it is still uncommon for Australian companies to obtain financial accommodation using patents as the substantial security. If that is the case then, since patents are a form of intellectual property which is particularly amenable to use as a security, it seems likely that the other forms of intellectual property are also not used as the substantial security. This may indicate a general lack of interest in the Australian business community in the potential value of intellectual property as security.

A second possible reason for the lack of registrations is that lenders and their advisers are not in general aware of the need to register charges over patents on the Patents Register. As discussed above, failure to register on the Patents Register is likely to result in the security granted over the patents of the borrower being ineffective to the extent that those patents are subject to charges in favour of third parties.

The following summary of the suitability of each of the intellectual property regimes as a security may be helpful:

- (a) **copyright** - due to difficulties with establishing ownership of copyright and capacity to deal, copyright is not a good candidate for security.
- (b) **confidential information and unregistered trade marks** - on the current law these cannot form the basis for a separate security. Security over confidential information or unregistered trade marks must be obtained indirectly, preferably by a security over the goodwill of the business.
- (c) **registered trade marks** - these do not form a suitable subject for security under the present Act. Under the new Act, the provision to have interests noted on the register will make a security over a registered trade mark more effective. However, from a priorities point of view, there is the risk that the security will be subject to an earlier unregistered interest.

<sup>62</sup> The chargors were Hyndbrook Pty Ltd and Fluid Management Ltd Partnership. The charges were notified in the Official Journal in Volume 8, No 9 and Volume 8, No 41, respectively.

- (d) **patents** - the best candidate for an intellectual property security at present. The provisions in the Act protecting a person dealing with the registered proprietor of the patent, together with the provisions allowing securities to be registered over a patent, make patents a suitable subject for security.
- (e) **designs** - although an effective security can in principle be taken over registered designs, designs are usually of less value commercially than the other forms of intellectual property and so designs are unlikely to be a suitable security as a practical matter. Securities over designs will also be affected by concerns over the owner's capacity to deal.

One conclusion is that lenders should be alert to the possibility of registering their security interests on the specific intellectual property registers. A second conclusion is that intending security holders should ensure they conduct proper searches of the available registers. It is likely that searches are already conducted of the Register of Company Charges. Searches should also be conducted of the Patents, Designs and Trade Mark registers. When conducting those searches care should be taken to ensure that the search will in fact reveal any relevant interest. As discussed above, on-line searches of the Patents Register will not at present reveal security interests over patents.