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The Practical Lender

A bulletin devoted to highlighting the practical effects of law on the finance business. The ☞ denotes practical lender tips for the lender.

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SECURITY INTERESTS IN TRADEMARKS: TRAPS FOR THE UNWARY

To a secured lender, trademarks and service marks can be a valuable form of collateral. Lenders must take care, however, because improperly characterizing the collateral interest can be disastrous both for themselves and for their customers. In a recent decision from the Trademark Trial and Appeal Board of the U.S. Patent and Trademark Office, Chemical Bank and its customer, USA Detergents Inc., learned that using the wrong terminology can have a drastic effect on trademarks or service marks subject to "intent-to-use" applications for registration. By taking a collateral assignment of, rather than a security interest in, a trademark for which its customer had filed an application for registration on an intent-to-use basis, Chemical Bank inadvertently caused the cancellation of the subsequent registration for such trademark. This article summarizes the case and explains how to avoid this trap for the unwary.

Impact of the Lanham Act on Lenders

Recent court cases have indicated that an appropriate state filing under the Uniform Commercial Code should be sufficient to perfect a security interest in trademarks or service marks (this article will refer to these generally as "marks"), at least with regard to other creditors or any trustee in bankruptcy. However, cautious lenders continue to record their security interests in federally registered marks with the U.S. Patent and Trademark Office ("PTO") because they may obtain some advantages with regard to subsequent purchasers of the marks. Under the federal trademark statute, known as the Lanham Act, a party may apply to the PTO for registration of trademarks or service marks (i) already in use by the party or (ii) not yet being used by the party but for which the party has a bona fide

intent to use (the latter being known as an "intent-to-use" or "ITU" application). The Lanham Act further provides that registered marks, as well as marks for which an application to register has been filed, are assignable, provided that the goodwill of the business connected with the use of, and symbolized by, the marks is also assigned. However, no mark or application for registration may be assigned prior to use of the mark. With regard to ITU applications, this prohibition means the subject marks are not assignable prior to the filing of a statement of use with the PTO, except to certain successors to the applicant.

Borrowers may not assign trademarks or service marks which are the subject of ITU applications for federal registration unless they have first filed a statement of use with the PTO.

The Clorox Case

In connection with a financing transaction, USA Detergents and Chemical Bank entered into a Trademark and Tradename Security Assignment and License Agreement that purported to assign USA Detergents' ITU application for federal registration of "SUPER SCRUB" along with several other marks, both registered and applied-for. The agreement provided for a royalty-free license back to USA Detergents of all rights in the marks and for a reassignment to USA Detergents when it repaid the underlying loan. The intent of the agreement was to provide Chemical Bank with collateral and Chemical Bank never intended to use the marks in commerce or for any purpose other than collateral for the loan.

The Clorox Company, in *Clorox Co. v. Chemical Bank*, 40 U.S.P.Q.2d 1098 (TTAB 1996), petitioned the PTO to cancel the registration issued to Chemical Bank (as assignee and, therefore, owner of the mark) for the "SUPER SCRUB" mark. In addition to claiming that there existed a likelihood of confusion with its "SOFT SCRUB" mark and certain other claims, Clorox claimed that the registration was invalid because USA Detergents had assigned the ITU application to Chemical Bank in violation of the Lanham Act. Clorox argued (and the PTO Appeal Board subsequently agreed) that the assignment of the mark was premature because, at the time of the loan closing, USA Detergents had not begun use of the mark.

Assignment of a mere "intent to use" the mark was void, and that, in turn, voided the subsequent registration of the mark and allowed the competing Clorox trademark to gain priority.

In holding the registration invalid, the PTO looked to the relevant language in the Lanham Act and the intent of Congress in passing it. When adopting the anti-assignment language in 1989, Congress' expressed intent was to prevent "trafficking in trademarks" before they had fully ripened. Additionally, permitting assignment of applications before a mark is used would conflict with the principle that a mark may be validly assigned only with the business or goodwill attached to the use of the mark.

Although "trafficking in trademarks" was clearly not the intent of either Chemical Bank or USA Detergents, the assignment and subsequent registration were nonetheless voided. The PTO ignored Chemical Bank's argument that the true effect of the agreement was the granting of a security interest rather than an assignment of ownership. The PTO, in effect, elevated the form of the transaction over its true substance.

Conclusion

The decision in *Clorox* illustrates a significant trap for the unwary secured lender and, more importantly, for its customers. Fortunately, the trap is easily avoided. When the collateral includes trademarks and service marks for which ITU applications are pending, a lender must not take a collateral assignment of such marks. Given the potential for inadvertent loss of the borrower's rights in marks for which ITU applications are pending, lenders should require the borrower to identify all ITU applications and require its counsel to use only security agreements (rather than collateral assignments) for all trademark and service mark collateral.

Lenders should adopt standard practices that (i) require borrowers to identify all ITU applications for federal registration and (ii) require its counsel to use only security agreements for trademark and service mark collateral when ITU applications are involved.

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