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Possible future work on security rights in intellectual property

Note by the Secretariat*

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I. Introduction

1. At its thirty-ninth session, in 2006, the Commission on International Trade Law (UNCITRAL) approved in principle the substance of the recommendations of the draft UNCITRAL legislative guide on secured transactions (the “draft guide”).¹ At that session, the Commission noted that intellectual property (e.g. copyrights, patents or trademarks) was increasingly becoming an extremely important source of credit and should not be excluded from a modern secured transactions law. In that connection, it was stated that financing transactions with respect to equipment or inventory often included security rights in intellectual property as an essential and valuable component. It was also observed that significant financing transactions involving security rights in all the assets of a grantor would typically include intellectual property.²

2. In addition, the Commission noted that the recommendations of the draft guide generally applied to security rights in intellectual property to the extent they were not inconsistent with intellectual property law (see A/CN.9/631, recommendation 4, subpara. (b)). Moreover, the Commission noted that, as the recommendations had not been prepared with the special intellectual property law issues in mind, the draft guide generally recommended that enacting States might consider making any necessary adjustments to the recommendations to address those issues.³

3. Moreover, in order to provide guidance to States in that regard, the Commission requested the Secretariat to prepare, in cooperation with other organizations and in particular the World Intellectual Property Organization (WIPO), a note discussing future work by the Commission on security rights in intellectual property. The Commission also requested the Secretariat to organize a colloquium on security rights in intellectual property.⁴

4. The UNCITRAL Second International Colloquium on Secured Transactions: Security Interests in Intellectual Property Rights (hereinafter the “Colloquium on Security Interests in Intellectual Property Rights”) was held in Vienna on 18 and 19 January 2007. At the Colloquium, several issues were raised with respect to the treatment of security rights in intellectual property in the draft guide.⁵ It was widely felt that some of those issues could be addressed by clarifying the text of certain definitions and recommendations of the draft guide without changing policy decisions made by the Commission and Working Group VI (Security Interests), while other issues required more substantial work and adjustments to the asset-specific part of the draft guide.

5. At its twelfth session (New York, 12-16 February 2007), Working Group VI revised several recommendations and definitions to address those issues that could be addressed with minor adjustments and clarifications (see A/CN.9/620, paras. 111-120). At its eleventh and twelfth sessions, the Working Group considered

¹ *Official Records of the General Assembly, Sixty-first Session, Supplement No. 17 (A/61/17)*, paras. 13-78.

² *Ibid.*, para. 81.

³ *Ibid.*, para. 82.

⁴ *Ibid.*, para. 86.

⁵ The papers presented at the Colloquium are available on the UNCITRAL website (<http://www.uncitral.org/uncitral/en/commission/colloquia/2secint.html>).

and approved the recommendations of the draft guide, presented in two parts for each chapter, one part that highlighted the general recommendations or core principles for the benefit of all States, and another part that dealt with asset-specific principles and recommendations for the benefit of those States which might not need all the asset-specific recommendations (see A/CN.9/617 and A/CN.9/620).

6. The purpose of the present note is to address some of the issues that would require further work by the Commission and more significant adjustments to the asset-specific part of the draft guide, as a supplement to the draft guide for the benefit of those States which would need specific guidance with respect to security rights in intellectual property. The note is not intended to list all the issues in an exhaustive way or to discuss them in every detail. It briefly discusses some of the main issues that would need to be addressed with a view to reasonably establishing the desirability and feasibility of future work by the Commission.

7. The note first discusses briefly the importance of intellectual property as security for credit and the inadequacy of current laws (chap. II), and then summarizes the current treatment of security rights in intellectual property in the draft guide and suggests several adjustments that would need to be made to the asset-specific part of the draft guide (chap. III). The note concludes with the suggestions for future work on security rights in intellectual property (chap. IV).

II. Importance of intellectual property as security for credit and the inadequacy of current laws

8. With the advent of the information age and the rapid pace of technological development, intellectual property, such as patents, trademarks, copyrights, customer lists, know-how and trade secrets (for the definition of “intellectual property”, see A/CN.9/631/Add.1, Introduction, sect. B, Terminology and rules of interpretation), represents an increasingly significant component of the value of many businesses. Many of those businesses are engaged in developing, licensing, distributing and managing intellectual property and their principal assets consist of the intellectual property. In addition, other businesses, such as manufacturers, frequently utilize equipment that requires the use of patented technology for its operation and distributors often sell goods that derive a significant portion of their value from trademarks affixed to the goods or copyrighted material included in the packaging. All those businesses, including technology businesses that currently have resort only to investors as a source of capital, as well as more traditional companies that rely increasingly on the use of intellectual property in their businesses, would benefit from access to secured credit predicated upon the value of their intellectual property or their rights to use intellectual property of other persons.

9. Intellectual property is typically used as an encumbered asset in secured lending transactions in two primary ways. First, intellectual property frequently represents an intrinsic component of the value of other property owned by the grantor, such as goods that have been branded with a registered trademark or that incorporate copyrighted materials in their packaging. Such intellectual property may be owned by the grantor or licensed by the grantor from a third party pursuant to an exclusive or non-exclusive licence. In either case, the goods themselves may have little or no value to a lender as security unless applicable law would permit the

lender to enforce its security rights in the goods in an efficient and cost-effective manner without infringing the intellectual property rights.

10. Second, intellectual property often has sufficient independent value so that a grantor is able to use it as security for credit. Examples would be the portfolio of patents owned by a pharmaceutical company or the trademarked name and logo of a well-known chain of retail stores. This is especially true for the growing number of companies in the technology sector. For example, an owner/licensor of computer software might seek to obtain a loan secured by the anticipated streams of royalty payments from its various licences. In these circumstances, the amount of credit that a lender is willing to extend and the interest and other compensation that the lender will require, will depend in part on the lender's level of certainty that it will be able to look to the intellectual property and anticipated royalty payments under the various licences as a source for repayment of its loan.

11. In any case, clear and predictable laws are critical to enabling the lender to make this determination. As is the case with any asset that may be used as an encumbered asset for credit, law other than secured transactions law governs the exact nature or the extent of the asset. In the case of intellectual property, the asset is defined in the framework of national law and practice, as well as a number of international conventions that determine in the first instance what types of intellectual property may be encumbered and how. This framework is, in many cases, not coordinated with existing secured transactions laws, which are often based on principles applicable to tangible assets, such as inventory and equipment, or other types of intangible asset, such as receivables. In some jurisdictions, some aspects of security rights in certain types of intellectual property are governed by the intellectual property law (e.g. registration), while in other jurisdictions such rights are subject to a more complete coverage in the secured transactions law. The common result is that security rights in intellectual property are governed by both sets of laws, often with some uncertainty as to the relationship between the two regimes.

12. Accordingly, there is a need for a careful coordination between the laws governing secured transactions (and, in the case of the grantor's insolvency, insolvency laws) and those governing intellectual property generally.⁶ This requires understanding the principles that support intellectual property commerce and identifying the extent to which they may differ from those supporting commerce for tangible goods and receivables.⁷

⁶ For more information on the importance of intellectual property as security for credit and problems under current law, see "Intellectual property issues affecting a secured transactions regime", submitted by the Commercial Finance Association in connection with UNCITRAL's development of a guide on secured transactions (August, 2004), available at <http://www.uncitral.org/pdf/english/colloquia/2secint/Kohn.pdf>.

⁷ For an analysis of the issues by a group of intellectual property law experts, see "Report and analysis of the Ad Hoc Working Group on Intellectual Property Financing regarding the UNCITRAL draft legislative guide on secured transactions" (January, 2007), available at <http://www.uncitral.org/pdf/english/colloquia/2secint/Ad%20Hoc%20Working%20Group%20Report.pdf>.

III. Asset-specific adjustments to the draft guide with respect to security rights in intellectual property

A. Terminology

13. The term “intellectual property” is defined in the draft guide as including “copyrights, trademarks, patents, service marks, trade secrets and designs and any other asset that is considered to be intellectual property under the domestic law of the enacting State or an international agreement to which it is a party” (see A/CN.9/631/Add.1, Introduction, sect. B, Terminology and rules of interpretation). The commentary makes reference to agreements, such as the Convention Establishing the World Intellectual Property Organization and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).⁸

14. With respect to other terms, the draft guide relies on terminology normally used in secured transactions legislation. While this approach may be adequate in some respects, it may require adjustments in other respects, because intellectual property law has its own terminology, which may not be fully consistent with the current terminology used in the draft guide.

15. For example, the draft guide uses the term “assignment” solely with respect to receivables (see A/CN.9/631/Add.1, Introduction, sect. B, Terminology and rules of interpretation). However, “assignment” has a broader meaning in intellectual property practice, involving a transfer of ownership in intellectual property and not merely the transfer of a receivable. Similarly, the draft guide does not define a “licence” and only refers to a licence in an undifferentiated sense without addressing the differences between exclusive licences and non-exclusive ones. In the same vein, the draft guide uses the term “retention of title” only with respect to tangible property. It does not refer to licences, which by definition involve the retention of title in intellectual property by the licensor (see para. 37 below). Furthermore, the draft guide does not provide terminology to identify the varying interests of owners, co-owners, joint authors and other parties involved in the initial development of intellectual property.

16. In addition, following the approach taken in most legal systems and reflected in the United Nations Convention on the Assignment of Receivables in International Trade⁹ (hereinafter the “United Nations Assignment Convention”), the draft guide does not differentiate trade receivables from income streams under licence agreements relating to intellectual property. As this approach is disputed in some intellectual property circles, the issue may need to be discussed (see para. 35 below).

17. Moreover, the draft guide does not define tangible property embodying in part intellectual property (e.g. trademarks of goods or software embedded in goods) or security rights in such property, nor discusses at any length the relevant issues. On the one hand, if a security right in such property did not extend to intellectual property embodied therein, the security right may be deprived of any meaning

⁸ Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, annex IC (United Nations, *Treaty Series*, vol. 1867, No. 31874).

⁹ United Nations publication, Sales No. E.04.V.14.

(where, for example, the encumbered asset is inventory of digital cameras operated by software on a chip). On the other hand, such a result may be incompatible with the right of the owner of the intellectual property to control the distribution of copies and goods embodying intellectual property and may have to be limited in line with applicable principles of intellectual property law (see paras. 38 and 39 below).

B. Scope

18. The law recommended in the draft guide should provide that it applies to “all types of movable property and attachment, tangible or intangible, present or future, including inventory, equipment and other goods, contractual and non-contractual receivables, contractual non-monetary obligations, negotiable instruments, negotiable documents, rights to payment of funds credited to a bank account, proceeds under an independent undertaking and intellectual property rights” (see A/CN.9/631, recommendation 2, subpara. (a)).

19. However, the law should provide that “notwithstanding recommendation 2, subparagraph (a), it does not apply to ... intellectual property to the extent that the provisions of this law are inconsistent with national law or international agreements, to which the State is a party, relating to intellectual property” (see A/CN.9/631, recommendation 4, subpara. (b)).

20. The commentary explains that a State enacting secured transactions legislation in accordance with the draft guide should consider whether it might be appropriate to adjust certain of the recommendations as they apply to security rights in intellectual property. Examples of such recommendations include recommendation 204 on the law applicable to security rights in intangible property, recommendations 43 and 83 on registration in a specialized registry, and recommendations raising the issue of whether a security right in goods extends to any intellectual property involved in their use or operation (see A/CN.9/631/Add.1).

21. In addition, the commentary draws the attention of States to the need to examine their existing intellectual property laws and the State’s obligations under intellectual property treaties, conventions and other international agreements and, in the event that the recommendations of the draft guide are inconsistent with any such existing laws or obligations, the State’s secured transactions law should expressly confirm that those existing intellectual property laws and obligations govern such issues to the extent of the inconsistency. Moreover, the commentary clarifies that States may need to adjust certain recommendations of the draft guide to avoid inconsistencies with intellectual property laws and treaties (see A/CN.9/631/Add.1).

22. While the commentary encourages States to undertake an analysis of possible inconsistencies between intellectual property law and the draft guide, it does not provide specific guidance on where such inconsistencies may arise nor how recommendations in the draft guide should be adjusted to avoid them. Although the draft guide recommends that intellectual property law prevail over secured transactions law to the extent there are any inconsistencies between the two, there may be reluctance on the part of some States to apply any recommendations in the draft guide to intellectual property assets due to concerns about possible adverse domestic or international consequences from an erroneous application. This reluctance may in turn lead lenders to conclude that intellectual property assets are

not an appropriate subject for secured financing, which can have undesired consequences given the increasingly important role of intellectual property in modern economies.

23. Future work by the Commission would provide specific guidance to States as to any adjustments that would need to be made in the asset-specific part of the draft guide to address issues arising in secured transactions relating to intellectual property and thus facilitate such transactions.

C. Creation of a security right

1. General approach of the draft guide

24. Under the draft guide, a security right is created by agreement between the grantor and the secured creditor (see A/CN.9/631, recommendation 12). To be effective, a security agreement must reflect the intent of the parties to create a security right, identify the secured creditor and the grantor and describe the secured obligation and the encumbered assets (see A/CN.9/631, recommendation 13). If not accompanied by a transfer of possession of the encumbered asset, the agreement must be concluded in or evidenced by a writing that, in conjunction with the course of conduct between the parties, indicates the grantor's intent to grant a security right. Otherwise, it may even be oral (see A/CN.9/631, recommendation 14).

25. The assets encumbered under the security agreement may be described in a generic way, such as "all present and future assets" or "all present and future inventory" (see A/CN.9/631, recommendation 13). The security right may secure any type of obligation, present or future, determined or determinable, as well as conditional and fluctuating obligations (see A/CN.9/631, recommendation 15). It may cover any type of asset, including assets that, at the time the security agreement is concluded, may not yet exist or that the grantor may not yet own or have the power to encumber (see A/CN.9/631, recommendation 16). Unless otherwise agreed by the parties to the security agreement, the security right in the encumbered asset extends to its identifiable proceeds (see A/CN.9/631, recommendation 18).

26. If the encumbered asset is a receivable, an assignment of the receivable is effective as between the assignor and the assignee and as against the debtor of the receivable notwithstanding an agreement between the initial or any subsequent assignor and the debtor of the receivable or any subsequent assignee limiting in any way the assignor's right to assign its receivables (see A/CN.9/631, recommendation 22).

2. Possible asset-specific adjustments

27. The general provisions of the draft guide with respect to the creation of a security right may apply to security rights in intellectual property (see A/CN.9/631, recommendations 12-18). However, the application of certain provisions to security rights in intellectual property may need to be adjusted with asset-specific recommendations.

(a) Generic description of encumbered assets

28. For example, the concept of a generic description of the encumbered assets may need modification when applied to the registration of intellectual property in a specialized registry. A description that embraces “all rights” for a specific item of intellectual property may be “generic” for these purposes, such as “all rights in Patent B in Country X”. However, a description of multiple items of intellectual property may need some identifying description for each item, such as “all motion pictures owned by Studio A identified by title on the attached schedule”.

29. As discussed below (see para. 49), intellectual property registries index notices by the intellectual property, not the grantor. Thus, a notice that merely identified “all intellectual property owned by the grantor” would not contain a sufficient description. It would instead be necessary to identify each item of intellectual property by title or identification in the registered notice. For efficiency reasons, it might be appropriate to require the description of the encumbered assets in the security agreement to meet the same level of precision.

(b) Non-transferable obligations

30. Another example is the provision of the draft guide that, while a security right may secure any type of obligation (see A/CN.9/631, recommendation 15), the law recommended in the draft guide does not override statutory prohibitions to the transferability of specific types of asset, with the exception of prohibitions to the transferability of future receivables and the effectiveness of an assignment of receivables made despite an anti-assignment agreement (see A.CN.9/631, recommendation 17).

31. Further work would need to clarify that it is important to permit the party to whom the services in personal service contracts with authors or inventors are owed to create a security right in its rights to receive performance, as this will often be necessary to obtain financing. However, a blanket provision that allows such a party to create such a security right without consent of the party owing the performance of such services might be incompatible with existing laws. The impact of these matters on the ability of a party to create a security right in the right to receive performance under such personal service contracts may need further study.

(c) After-acquired assets

32. A further example is the provision of the draft guide that a security agreement may cover assets that may not exist at the time the security agreement is concluded (“after-acquired” or “future assets”); see A/CN.9/631, recommendation 16). On the one hand, there is commercial utility in allowing a security right to extend to intellectual property to be later created or acquired. For example, in some States it is possible to create a security right in a patent application before the patent is issued. Similarly, it is common practice to fund motion pictures or software to be produced. An effective secured financing law should support such practices. On the other hand, many States limit transfers of various future intellectual property. Some States limit the ability to make effective transfers of rights in new media or technological uses that are unknown at the time of the grant. It may be necessary to adjust the draft guide to accommodate those rules.

(d) The *nemo dat* principle

33. Another example is the requirement that the grantor must have rights in the encumbered asset (the principle that no one can give what he or she does not have - *nemo dat quod non habet* or *nemo plus juris transferre potest quam ipse habet*), which has particular importance with respect to security rights by licensees (see A/CN.9/631, recommendation 13). Future work would need to clarify the application of the *nemo dat* principle to intellectual property, namely that a creditor obtaining a security right in intellectual property or rights to use intellectual property does not obtain any rights more than the rights that the grantor has in that intellectual property. In particular, if the grantor were a licensee, it would need to be confirmed that the licensee could not give anything more than the right granted to the licensee from the licensor. One of the effects of this result is that future work would need to reinforce the lender's need to conduct appropriate due diligence to determine matters such as the extent of the licensee's rights, the duration of those rights and the territories in which those rights may be exercised.

(e) The principle of party autonomy

34. Another example of an issue that might require further work is the provision of the draft guide recognizing party autonomy (see A/CN.9/631, recommendation 8). Further work on security rights in intellectual property should clarify that intellectual property owners have the right to decide which third parties may use the intellectual property and the conditions for so doing. In particular, intellectual property owners should have the right to transfer their rights or to give to another person a licence to use them.

(f) Anti-assignment agreements

35. In this connection, future work has to confirm the right of the licensor under law other than the secured transactions law to limit by contract the right of the licensee to transfer the licence or give a sub-licence to a third party, as well as the right of the licensor to terminate the licence for breach of contract. As a result, it should be made clear that the relevant provision of the draft guide with respect to anti-assignment agreements relating to receivables (see A/CN.9/631, recommendation 25) does not apply to the rights of licensees under intellectual property licences. However, in line with current law in most legal systems and the United Nations Assignment Convention, it does apply with respect to receivables arising from intellectual property (e.g. licence royalties). In this regard, intellectual property experts argue that receivables arising from intellectual property should be treated as forming part of the intellectual property. In support of their argument, they refer to case law, international conventions permitting transfers and licences of intellectual property and restricting practices involving compulsory licences. They also refer to national laws, for example, imposing restrictions on the assignability of royalties payable to owners-licensors.

(g) Title to intellectual property

36. Another issue that should be addressed is who has title or the rights associated with title to intellectual property as an encumbered asset: the grantor or the secured creditor. For intellectual property, title determines important components of asset value, including the right to deal with governmental authorities for several purposes,

such as for patent prosecutions, to grant licences and to pursue infringers. It is therefore important to determine whether the grantor or the secured creditor holds title to the intellectual property during the financing, as this will be important to both parties in order to preserve the value of the encumbered asset. Under the principle of party autonomy, the law should allow the parties to decide the matter for themselves in the security agreement. Where the agreement is silent, it may be necessary for a secured transactions law to be coordinated with the relevant rules of intellectual property law to ensure that the secured creditor does not have title to intellectual property as an encumbered asset (as is the case with any other encumbered asset). A possible approach may be to provide that, unless otherwise agreed, the secured creditor has no right to approve various types of licence.

(h) Retention of title by the licensor in a licence agreement

37. Yet another example is the provision of the draft guide that treats certain title-retention transactions as functionally equivalent to secured transactions, allowing a buyer of goods to create a security right in the goods even before the buyer pays the price in full and acquires title in the goods. A licence agreement involves permission to use intellectual property under the conditions set out in the licence agreement and the retention of title in the intellectual property by the licensor. Future work should clarify that such a transaction is not functionally equivalent to a secured transaction and the licensee does not automatically have the right to transfer the licence or give a sub-licence to a third party (for further discussion of this issue, see chap. III, sect. J, on acquisition financing, paras. 78-80 below).

(i) Tangible property embodying intellectual property

38. A further issue that should be addressed relates to security rights in tangible property embodying intellectual property rights (e.g. pharmaceuticals and mechanical devices that reflect patented inventions; DVDs, paperback books and lithographs that embody copyrighted work; and labels, apparel and merchandise containing trademarks). While the security right in such tangible property would be worthless if it did not give rights of use of the embodied intellectual property, the security right in the tangible property is limited by the rights of the holder of rights in the embodied intellectual property. For example, a person that buys a copy of a DVD containing copyrighted music cannot then make and sell thousands of duplicates without permission of the intellectual property owner.

39. Under current practice, intellectual property law addresses this situation under the “exhaustion” doctrine. Under this rule, an authorized sale of a copy exhausts some rights, such as the right to control further sales of that particular copy. Thus, if the grantor has obtained ownership of the goods in a transaction that “exhausted” relevant intellectual property rights, a secured creditor could resell the goods at least within the authorized territory without infringement. However, the treatment of the exhaustion doctrine is a complex issue, especially in international transactions, and would need to be carefully examined (see also para. 72 below).

D. Third-party effectiveness of a security right

1. General approach of the draft guide

40. The main method for making a security right effective against third parties is registration of a notice with limited information in a general security rights registry (see A/CN.9/631, recommendation 33). Other methods for achieving third-party effectiveness of a security right include registration in a specialized registry (see A/CN.9/631, recommendation 43), transfer of possession and control (see A/CN.9/631, recommendation 38, 50 and 51).

2. Possible asset-specific adjustments

(a) Intellectual property that is registrable

41. Registration of a notice in the general security rights registry is relevant with respect to the third-party effectiveness of a security right in intellectual property. Similarly, registration of a security right in a specialized registry is relevant under the law of many jurisdictions (the draft guide simply recognizes it if it exists, but does not require it), at least with respect to certain types of intellectual property, such as patents and trademarks (and, in some States, copyrights). Other methods for achieving third-party effectiveness of a security right, such as transfer of possession or control, are not relevant for intellectual property (see A/CN.9/631, recommendations 38 and 50).

42. Coordination between the general security rights registry and any specialized registry, such as a patent or trademark registry, is an issue that would need to be addressed, in particular since:

(a) Intellectual property registries may be indexed by asset while the security rights registry is indexed by the name of the grantor of the security right;

(b) Intellectual property registries may involve document registration rather than notice registration and the legal effects may be the creation of a right (title, right to use or security right), rather than only the third-party effectiveness of a security right as is the case with the general security rights registry;

(c) Intellectual property registries may involve the registration of title, right to use and security right in an intellectual property asset rather than only to a security right as is the case with the general security rights registry;

(d) Registration of a security right in after-acquired property may not be possible in an intellectual property registry, while it is possible in the general security rights registry; and

(e) Multiple registrations in the various registries would increase cost and effort both for registrations and searches (under the draft guide, the secured creditor may choose to register in the general security rights registry or in the specialized registry (if registration of security rights is permitted), although registration in the specialized registry provides a higher priority ranking).

(b) Intellectual property that is not registrable

43. Future work would need to address the third-party effectiveness of security rights in intellectual property with respect to which there is no specialized registry (e.g. trade secrets or copyrights in many States). In this situation, a security right in such intellectual property may become effective against third parties automatically upon its creation or upon registration in the general security rights registry. Another approach, which conforms to the practice in a few States, would be to provide that intellectual property not subject to a registration system might not be used as security for credit at all. However, such an approach would not be consistent with the purpose of the draft guide to modernize the law so as to promote increased access to secured credit.

44. Yet another approach would be to provide that, where there is no registry for the specific intellectual property, a security right in intellectual property may become effective against third parties by registration of a notice in the general security rights registry. However, this approach (which is already possible under the general recommendations of the draft guide) would require that the issues identified above (see para. 42) be addressed through new asset-specific recommendations. In particular, the fact that the general security rights registry would not reflect the chain of title in intellectual property as an encumbered asset and secured creditors would have to check the chain of title in the encumbered asset outside the general security rights registry should be carefully considered (of course, this is the case with any other movable property with the exception of receivables with respect to which even outright transfers are registrable). Otherwise, if the grantor transferred title to the intellectual property and subsequently created a security right, the secured creditor would run the risk of not obtaining an effective security right.

E. Registry system**1. General approach of the draft guide**

45. The draft guide recommends a general security rights registry (see A/CN.9/631, recommendations 55-73). In general, the purpose of the registry system in the draft guide is to provide a method for making a security right effective in existing or future assets, to establish an efficient point of reference for priority rules based on the time of registration and to provide an objective source of information for third parties dealing with a grantor's assets as to whether the assets may be encumbered by a security right.

46. Under this approach, registration is accomplished by registering a notice as opposed to the security agreement or other document (see A/CN.9/631, recommendation 55, subpara. (b)). The notice need only provide the following information:

(a) An identification of the grantor and the secured creditor and their addresses;

(b) A description that reasonably identifies the encumbered assets, with a generic description being sufficient;

(c) The duration of the effectiveness of the registration; and

(d) If the enacting State so decides, a statement of the maximum amount secured (see A/CN.9/631, recommendation 58).

47. The draft guide provides precise rules for identifying the grantor, whether an individual or a legal person. This is because notices are indexed and can be retrieved by searchers according to the name of the grantor or according to some other reliable identifier of the grantor (see A/CN.9/631, recommendations 55, subpara. (h), and 59-61). The draft guide contains other rules to simplify operation and use of the registry.

2. Possible asset-specific adjustments

(a) Coordination of registries

48. As discussed above, many States maintain registries for recording transfers, including security rights, with respect to intellectual property. These registries exist in most States for patents and trademarks. Some States have similar registries for copyrights, but the practice is not universal. The registry proposed in the draft guide is a notice-based registry. The idea is that the registry only gives notice of a security right and a reasonable identification of the collateral, usually by generic category. Such a system works well for tangible and certain intangible assets (e.g. receivables).

49. Intellectual property registries, however, primarily use recording act structures or “document registration” systems. In those systems, it is necessary to record the entire instrument of transfer, or, in some cases, a detailed memorandum of transfer. The reason for this is that in many cases the transfer may only involve limited rights in the intellectual property. As such, it is essential for the instrument of transfer to identify the precise right being transferred in order to give effective notice to searchers and to allow efficient utilization of assets. In addition, the intellectual property systems index registrations by the specific item of intellectual property, not by grantor. This is because the central focus is on the intellectual property itself, which may have multiple co-inventors or co-authors and may be subject to multiple changes in ownership as transfers are made.

50. Coordination between the general security rights registry and any specialized intellectual property registry is an issue that would need to be addressed, as mentioned above (see para. 42). In addition, the issue would need to be examined as to whether the general security rights registry proposed in the draft guide should be used for security rights in intellectual property at all, especially in cases where a specialized intellectual property registry is otherwise available.

(b) After-acquired assets

51. An essential feature of the general security rights registry recommended in the draft guide is that it can apply to “after-acquired” property of the grantor. This means that the security right can cover assets to be later acquired by the grantor (see A/CN.9/631, recommendation 16). The notice may also cover assets identified by generic description (see A/CN.9/631, recommendation 64). Thus, if the security right covers all existing or later acquired inventory the notice may so identify such inventory. Since priority is determined by date of registration, the lender may maintain its priority position in later acquired inventory. This greatly facilitates revolving credit facilities, since a lender extending new credit under such a facility

knows that it can maintain its priority position in new assets that are included in the borrowing base.

52. Existing intellectual property registries, however, do not readily accommodate after-acquired property. Since transfers of or security rights in intellectual property are indexed against each specific item of intellectual property, they can only be effectively recorded after the intellectual property is first registered in the registry. This means that a blanket recording in a specialized registry with respect to “after-acquired” intellectual property would not be effective, but instead a new recording is required each time a new item of intellectual property is acquired.

53. At the Colloquium on Security Interests in Intellectual Property Rights, intellectual property professionals indicated that they had undertaken some considerable work on this issue under the auspices of WIPO. The Commission may profitably examine that work in addressing this matter.

(c) Dual registration

54. The draft guide permits registration with respect to a security right in intellectual property through registration in either the general security rights registry or a specialized intellectual property registry, or in both of them. The utility of each of these approaches should be the subject of further study in light of the benefits that can be obtained as against the costs involved for multiple filing and searching.

F. Priority of a security right

1. General approach of the draft guide

55. The priority of a security right is based on the time of registration (i.e. before creation) or the time a security right was made effective against third parties (i.e. after creation; see A/CN.9/631, recommendation 78). However, a security right that was made effective against third parties by registration in a specialized registry (that provides for registration of security rights) is superior to a security right that was made effective against third parties by registration of a notice in the general security rights registry (see A/CN.9/631, recommendation 83). Similarly, a security right made effective by transfer of possession or control is superior to a security right made effective by registration of a notice in the general security rights registry (see A/CN.9/631, recommendations 99 and 101). Finally, with limited exceptions, transferees of encumbered assets take the assets subject to any security right that was effective against third parties at the time of the transfer (see A/CN.9/631, recommendations 85-88).

2. Possible asset-specific adjustments

(a) Identification of competing claimants

56. Where the encumbered asset is intellectual property, future work should discuss the types of competing claimant (for the definition of “competing claimant”, see A/CN.9/631/Add.1, Introduction, sect. B, Terminology and rules of interpretation). Competing claimants may differ depending on whether a transfer of intellectual property, an exclusive or non-exclusive licence or a security right in intellectual property is involved.

57. In the case of a transfer or an exclusive licence of intellectual property that is not subject to registration, the main competing claimants are transferees and the basic rule is that the first transfer in time prevails. With respect to intellectual property that may be registered, the main rule is that the first transferee to register in the intellectual property registry has priority. In some jurisdictions, a later-in-time transferee that obtained its right in good faith (i.e. without notice of the prior transfer) may have priority. In the case of a non-exclusive licence, the primary competing claimants would be the licensor, competing title claimants and the creditors of the non-exclusive licensee. This is because the creditors of the non-exclusive licensee may not have the right to stop competing claimants from using the intellectual property and need the cooperation of the licensor.

(b) Relevance of knowledge of prior transfers or security rights

58. The rule providing that knowledge of the existence of a right on the part of a competing claimant is irrelevant for determining priority may need to be reconsidered with respect to security rights in intellectual property (see A/CN.9/631, recommendation 75). As mentioned, many intellectual property registries provide that a later conflicting transfer may only gain priority if it is recorded first and taken without knowledge of a prior conflicting transfer. This rule applies both to security rights and to title transfers recorded in the registry. Inconsistencies could result if the knowledge requirement for security rights was treated differently than title transfers. This matter requires further study.

(c) Priority of a right registered in an intellectual property registry

59. The rule that registration in a specialized registry (including an intellectual property registry) provides a right with higher priority status than a right registered in the general security rights registry is also appropriate with respect to security rights in intellectual property (see A/CN.9/631, recommendation 83). In this regard, it is worth reviewing how the operation of intellectual property registries differs from that for the general security rights register proposed in the draft guide (see para. 42 above).

(d) Priority of a right that is not registrable in an intellectual property registry

60. Another issue is the priority rule with respect to security rights in intellectual property with respect to which there is no specialized intellectual property registry. One approach may be to provide that, in such cases, priority for security rights is determined by the order of registration in the general security rights registry recommended in the draft guide. However, as discussed above, transfers of title in intellectual property are not registrable in the general security rights registry. Thus, unless such title transfers are registrable in the general security rights registry, as between a prior title transfer and a registered security right, the prior title transfer would evidently prevail. This means a creditor would still need to search outside the registry to find prior title transfers, as is the case with movable property in general.

(e) Rights of transferees of encumbered intellectual property

61. The rules of the draft guide are sufficient for the situation where the security right is created and made effective against third parties and thereafter title to the intellectual property is transferred. The basic rule would be that the transferee takes

the intellectual property subject to the security right (see A/CN.9/631, recommendation 85). The first exception to the rule would be applicable in the case where the asset sold or licensed is intellectual property. The buyer or licensee would take the intellectual property free of the security right if the secured creditor authorizes the grantor to sell or license the encumbered intellectual property (see A/CN.9/631, recommendation 86). However, there is some doubt in intellectual property circles as to whether the second exception should also apply, that is whether a non-exclusive licensee in the ordinary course of business (that complies with the terms of the licence and appropriate instructions to pay any secured creditor of the licensor that has a security right in any royalties owed by the licensee to the licensor) should take free of a security right created by the licensor (see A/CN.9/631, recommendation 87, subpara. (c); see also paras. 62 and 63 below).

(f) Rights of licensees of encumbered intellectual property

62. Intellectual property is routinely licensed. The retained rights of a licensor, such as the right to receive royalties, and the rights of a licensee can both be used as an encumbered asset for credit. In each case, it is necessary to consider the relevant priority rules where the competing claimants are the lenders of the licensor and the licensee, or the licensor and the lenders of the licensee. Generally, there should not be a competition between the lender of the licensor and the lender of the licensee because each would have a different encumbered asset. The lender of the licensor would normally have a security right in royalties owed by the licensee to the licensor, while the lender of the licensee would have a security right in royalties owed by a sub-licensee to the licensee. In any case, the lender of the licensee would not have rights any greater than the licensee itself, so that if the licensee defaulted under the licence, the licensor could terminate the licence, if the licence so provided.

63. With regard to the first case, the licensor's lender would need to know that in case of enforcement the licensee would continue to render performance and pay royalties to the lender, while a licensee would need to know that so long as it continued performance its licence would not be terminated. As to the second case, the licensor would need to know that it had mechanisms to gain priority over the licensee's lender and other creditors with respect to royalties payable under the licence. In addressing those issues, it would be appropriate to preserve party autonomy so that the parties could adjust their respective rights and obligations by individual agreement. The provisions of the draft guide regarding party autonomy, in particular with respect to priority, are relevant in that regard and may need to be adjusted or supplemented by appropriate commentary (see A/CN.9/631, recommendations 8 and 77).

(g) Rights of "ordinary course" non-exclusive licensees

64. One question of particular importance is whether a non-exclusive licensee "in the ordinary course of business" of the licensor should take free of any security rights created by the licensor (i.e. whether recommendation 87, subpara. (c), should apply in the context of security rights in intellectual property). The concept of an "ordinary course" transaction comes from the practices in tangible property. No customer would buy goods from a dealer if the customer thought that a lender could

repossess the goods because the dealer did not pay its loan. Thus, to facilitate commercial practices, the draft guide allows an “ordinary course” buyer to take free of the prior security right. However, under the draft guide, the security right continues in proceeds from the sale (see A/CN.9/631, recommendations 18, 40 and 41). Thus, the lender loses a security right in the goods to an ordinary course buyer, but in exchange obtains a security right in proceeds from their sale or disposition.

65. It is argued that this “ordinary course of business” concept is inappropriate for intellectual property. Under the *nemo dat* principle, a licensee of intellectual property only takes the actual right transferred subject to all prior transfers, including security rights. Thus, according to this view, application of an “ordinary course of business” exception would be incompatible with this principle and the ability of owners-licensors to control use of their intellectual property. Moreover, if a sub-licensee can “take free” of a prior security right, it could limit the ability of lenders to police improvident sub-licences (to determine whether they were in fact made in the ordinary course of business of the licensee). This is a matter that needs further study.

G. Rights and obligations of third-party obligors

1. General approach of the draft guide

66. The draft guide discusses the rights and obligations of debtors other than the debtor granting a security right in an asset to secure the payment or other performance of an obligation. Such third-party debtors (obligors is the term used in the draft guide to distinguish from the debtor-grantor) include the debtor of an assigned receivable, the person obligated under a negotiable instrument, the guarantor/issuer, confirmer, or nominated person where the encumbered asset is in the form of proceeds under an independent undertaking (for the definition of “proceeds under an independent undertaking”, see A/CN.9/631/Add.1, Introduction, sect. B, Terminology and rules of interpretation), the depositary bank where the encumbered asset is the right to payment of funds credited to a bank account (for the definition of “right to payment of funds credited to a bank account”, see A/CN.9/631/Add.1, Introduction, sect. B, Terminology and rules of interpretation) and the issuer of a negotiable document.

2. Possible asset-specific adjustments

67. Any future work on security rights in intellectual property would need to include a discussion of the rights and obligations of third parties such as the licensor in a situation where the licensee has created a security right in its licence. In the same way that a depositary bank is protected in cases where the encumbered asset is the right to payment of funds credited to a bank account, the rights of a licensor may need to be protected. For example, a licensor may help facilitate the financing of a licensee’s interest by agreeing with the lender to enforce various licence clauses in case the licensee defaults on the loan, such as withholding performance or terminating the licence. In these situations, licensors need to be able to preserve the integrity of their intellectual property and contractual relationships.

H. Enforcement of a security right

1. General approach of the draft guide

68. Under the draft guide, after default the secured creditor is entitled (see A/CN.9/631, recommendation 134):

- (a) To obtain possession of a tangible encumbered asset;
- (b) To sell or otherwise dispose of, lease or license an encumbered asset;
- (c) To propose to the grantor that the secured creditor accept an encumbered asset in total or partial satisfaction of the secured obligation;
- (d) To collect on or otherwise enforce a security right in an encumbered asset that is a receivable, negotiable instrument, right to payment of funds credited to a bank account or proceeds under an independent undertaking;
- (e) To enforce rights under a negotiable document;
- (f) To enforce its security right in an attachment to immovable property; and
- (g) To exercise any other right provided in the security agreement (except to the extent inconsistent with the provisions of the law recommended in the draft guide) or any other law.

69. In exercising its rights, the secured creditor has to act in good faith and in a commercially reasonable manner (see A/CN.9/631, recommendation 128). In particular with respect to extrajudicial enforcement, the secured creditor must abide by this standard of conduct and exercise its remedies subject to certain notifications and additional safeguards (see A/CN.9/631, recommendations 141-144).

2. Possible asset-specific adjustments

70. The enforcement of a security right in intellectual property raises special issues that would need to be addressed. For example, the right of the secured creditor to take possession of the encumbered asset is not relevant if the encumbered asset is intellectual property (see A/CN.9/631, recommendations 142 and 143). The question arises here (as with all types of intellectual property) as to whether an equivalent right of the secured creditor to take control should be introduced and how this would fit with the particular type of intellectual property involved.

71. Another question that would need to be discussed relates to the right of the secured creditor to dispose of, license, accept or collect licence fees with respect to intellectual property, in particular in cases where the intellectual property is inseparable from another asset (e.g. trademarked goods or goods with embedded software; see paras. 38 and 39 above) or in situations where the intellectual property has been licensed and the rights of the licensor must be taken into account. A further question relates to responsibilities of a secured creditor that becomes the owner of a trademark or other intellectual property right to renew and maintain the trademark in good order, or to police its use against infringement.

72. A further question arises with respect to encumbered assets that consist of goods that embody intellectual property. The main issue is the extent to which a security right that only applies to the goods allows the secured creditor to deal in or

otherwise dispose of the goods consistent with the intellectual property right, taking into account any doctrine of intellectual property law that would permit a transfer of the goods with the intellectual property embodied in the goods (see paras. 38 and 39 above).

73. All those issues would need to be addressed also for situations where the encumbered asset is not intellectual property but the rights of a licensee arising from a licence to use intellectual property. In such a situation, the rights of the secured creditor may be constrained. For example, if the licensee-grantor has created a lower-ranking security right in the same licence, usually enforcement of a higher-ranking security right would eliminate a lower-ranking security right (see A/CN.9/631, recommendations 158 and 159). However, where the encumbered asset is merely a licence, the secured creditor only succeeds to the licensee's rights. A mere licensee cannot enforce the intellectual property right against another mere licensee or secured creditor with a lower-ranking security right. Only the licensor (or appropriate right-holder) can do that (in some jurisdictions, exclusive licensees may join the licensor as a party to the proceedings). Thus, a secured creditor enforcing its security right against a licensee may have limited rights against other parties. This issue deserves further study, especially in reference to a determination of the "competing claimants" to a security right in intellectual property licences.

I. Insolvency

1. General approach of the draft guide

74. In the case of insolvency of the grantor, the effectiveness of a security right is preserved subject to any avoidance actions and stays (see A/CN.9/631, recommendations of the *UNCITRAL Legislative Guide on Insolvency Law*¹⁰ (hereinafter the "*UNCITRAL Insolvency Guide*"), chap. XI, recommendations (35), (39) and (46)). The priority of a security right is also preserved subject to any preferential claims (see A/CN.9/631, recommendations 178-180). Post-commencement finance does not take priority over pre-commencement security rights, but the insolvency court may authorize the post-commencement creation of security rights with priority over pre-commencement security rights in certain situations (see A/CN.9/631, recommendations of the *UNCITRAL Insolvency Guide* (66) and (67)). Secured creditors are entitled to participate in insolvency proceedings and to vote on a reorganization plan, which may be binding on secured creditors even without their approval if certain conditions are met (see A/CN.9/631, recommendations of the *UNCITRAL Insolvency Guide* (126), (151) and (152)).

2. Possible asset-specific adjustments

75. The provisions of the draft guide with respect to the general application of insolvency law, in particular with respect to stays and similar limitations, would apply to security rights in intellectual property (see A/CN.9/631, recommendations of the *UNCITRAL Insolvency Guide* (35), (39), (46) and (49)).

76. However, certain special issues would need to be addressed. One example is the effect of the rejection of a licence in cases in which the insolvent debtor is the

¹⁰ United Nations publication, Sales No. E.05.V.10.

licensor. In such a situation, a licensee may have invested considerable sums in further developing or commercializing the intellectual property, so that rejection of the licence may entail significant financial loss. On the other hand, insolvent licensors need some protection against a continuing obligation to support overly burdensome licences (for the treatment of contracts in the *UNCITRAL Insolvency Guide*, see part two, chap. II, sect. E).

77. Another example is the treatment of intellectual property as a third-party-owned asset in cases in which the insolvent debtor is the licensee. In this situation, there is a question as to whether the licensee's interest under the licence should become part of the insolvency estate where other law, such as intellectual property law, restricts the assignment of such a licence without the licensor's consent. In cases where the interest of a licensee does become part of the insolvency estate, issues arise regarding the obligation of the insolvency estate to perform ongoing obligations, such as payment of royalties, and the ability of the insolvency representative to dispose of the licence consistent with its terms. It should also be noted that there is considerable difference in the treatment of these issues in the insolvency laws of different countries, which will necessitate a careful study in order to achieve a harmonized approach.

J. Acquisition financing

1. General approach of the draft guide

78. The draft guide discusses acquisition financing with respect to tangible property. It provides for a unitary approach to acquisition financing, in the context of which all rights securing the payment of the purchase price for tangible property fall under a unitary notion of a security right with the result that, with the exception of certain special provisions for acquisition security rights, the provisions applicable to security rights apply to acquisition security rights (for the definition of "acquisition security right", see A/CN.9/631/Add.1, Introduction, sect. B, Terminology and rules of interpretation). As an alternative, the draft guide provides for a non-unitary approach to acquisition financing, in the context of which the terminology of various types of rights securing the purchase price of tangible property is maintained, while certain special provisions are introduced to ensure that acquisition financing rights (for the definition of "acquisition financing right", see A/CN.9/631/Add.1, Introduction, sect. B, Terminology and rules of interpretation) are treated as functional equivalents of acquisition security rights.

2. Possible asset-specific adjustments

79. The provisions of the draft guide with respect to acquisition financing apply only to tangible property. One of the results of this approach is that standard intellectual property licences, in the context of which the licensor by definition reserves title and assignments of intellectual property with a right to terminate are not assimilated to security rights. This result is generally accepted as being appropriate. However, an inadvertent result of this approach is that the draft guide does not discuss acquisition financing with respect to intellectual property. In view of the importance of this type of financing, the draft guide should address it.

80. An example may illustrate the issue. A grantor grants a lender a security right in all its existing and future intellectual property. The lender registers a notice of its security in the general security rights register. A licensor then grants the grantor a licence of intellectual property. The licensor would like a mechanism to gain priority over the lender's pre-existing security right, for example to secure a right to receive royalties. Under the priority rules in the draft guide, since priority is mainly determined on the basis of order of registration, the licensor has no mechanism to do so without an acquisition security right. Thus, in order to provide parity between sellers of goods and licensors of intellectual property, an acquisition financing right would seem appropriate. On the other hand, if priority is determined by the rules of a specialized intellectual property registry, an acquisition financing right is unnecessary (at least in legal systems in which such a specialized registry exists and, in any case, only with respect to intellectual property rights that may be registered in such a registry). This is because the lender cannot gain priority unless it makes a new registration identifying the specific intellectual property, and the licensor can always record the licence as soon as it is made and before the lender can file. It will be necessary to study in what situations an acquisition financing right is appropriate for intellectual property.

K. Law applicable to a security right in intellectual property

1. General approach of the draft guide

81. Under the draft guide, the creation, third-party effectiveness, priority and enforcement of a security right in intangible property is subject to the law of the State in which the grantor is located (see A/CN.9/631, recommendation 204). The grantor is located in the State in which it has its place of business. In the case of places of business in more than one State, reference is made to the State in which the grantor has its central administration (see A/CN.9/631, recommendation 207).

82. The mutual rights and obligations of the grantor and the secured creditor with respect to the security right are governed by the law chosen by them and, in the absence of a choice of law, by the law governing the security agreement (see A/CN.9/631, recommendation 212).

2. Possible asset-specific adjustments

83. A new asset-specific recommendation may need to be introduced with respect to the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right in intellectual property. Intellectual property conventions adopt the principle of territoriality. The consequence is that all issues concerning security rights in intellectual property are referred to the law of the place where the secured creditor exercises its security right (*lex protectionis*).

84. In addition, under the principle of minimum rights, all States parties to those conventions accord a basic level of protection to intellectual property owners and their successors. Finally, under the principle of national treatment, each State has to treat nationals of another State no less favourably than it treats its own nationals. This creates a system in which nationals of any State know that in any other State they will be accorded at least certain minimum rights, along with any greater rights

that are accorded to locals. The benefits of this structure, including ease of administration and fairness in application, have been proven by experience.

85. Other possible approaches are based on the principle of “material reciprocity” or “country of origin”, in which the rights of a person in the home or “origin” State determines the extent of a person’s rights in another State. A further approach could be to provide that the third-party effectiveness and priority of a security right in intellectual property is governed by the law of the grantor’s location, with the exception of a priority contest between a secured creditor and a transferee under an outright transfer of an intellectual property right, which would be governed by the law of the State in which the intellectual property right is used or protected.

86. From the point of view of lenders, it would be more efficient to look to a single national law, as recommended in the draft guide (i.e. the law of the location of the grantor), to determine issues of creation, third-party effectiveness, priority and enforcement of a security right regardless of the State where these issues arise. However, from the point of view of intellectual property owners, these issues with respect to a security right also entail issues regarding ownership and enforcement of the right, especially in the context of minimum rights and national treatment, issues that are determined under the territoriality principle. Thus, further work is needed on the appropriate law for security rights in intellectual property.

IV. Conclusions

87. The draft guide contains a general part and an asset-specific part, since not all States may need all asset-specific parts of the draft guide. The general part of the draft guide applies to security rights in intellectual property. However, the asset-specific part of the draft guide does not contain provisions (commentary or recommendations) dealing with security rights in intellectual property. For this reason, the draft guide defers to intellectual property law with respect to any inconsistency between its general part and intellectual property law. In addition, the draft guide draws the attention of States to the need to consider adjusting their laws to avoid any such inconsistencies without, however, providing any specific guidance in that regard.

88. The Commission may wish to consider that such guidance may be usefully provided in an asset-specific appendix of the draft guide, in view of the generally recognized importance of intellectual property as security for credit and the detrimental effects that may flow from an inadequate coordination between secured transactions and intellectual property laws. In addition, the Commission may wish to consider that such work would be feasible to the extent it would involve asset-specific commentary and recommendations such as those mentioned above. As indicated by the Colloquium on Security Interests in Intellectual Property Rights, an important element ensuring the feasibility of this work would be the participation of representatives of international organizations with expertise in the area of intellectual property, such as WIPO, international associations of intellectual property practitioners, together with international organizations and international associations of secured financing experts, in a balanced way that would adequately reflect the various practices and the various legal systems of the world.

89. The Commission may wish to entrust to Working Group VI the preparation of an asset-specific text on security rights in intellectual property that would usefully supplement the work of the Commission on the draft guide by providing specific guidance with respect to security rights in intellectual property. The Commission may also wish to consider inviting international organizations with expertise in the area of intellectual property, such as WIPO, and international associations of intellectual property and secured financing practitioners, to participate actively in this work.
