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Annex to the UNCITRAL Legislative Guide on Secured Transactions dealing with security rights in intellectual property (Part 1)

Note by the Secretariat*

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* This note is submitted two weeks less than the required ten weeks prior to the start of the meeting because of an extremely heavy workload and the need to complete consultations and finalize subsequent amendments.

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I. Introduction

A. Background

[*Note to the Working Group: For paras. 1-7, see A/CN.9/WG.VI/WP.33, paras. 1-5, A/CN.9/WG.VI/WP.34, paras. 10-11 and A/63/17, para. 326.*]

1. At its thirty-ninth session, in 2006, the Commission considered its future work on secured financing law. It was noted that intellectual property rights (e.g. copyrights, patents and trademarks) were increasingly becoming an extremely important source of credit and should not be excluded from a modern secured transactions law. In addition, it was noted that the recommendations of the draft Legislative Guide on Secured Transactions ("the draft Guide") generally applied to security rights in intellectual property to the extent that they were not inconsistent with intellectual property law. Moreover, it was noted that, as the recommendations had not been prepared with the special intellectual property law issues in mind, the draft Guide suggested that enacting States might consider making any necessary adjustments to the recommendations to address those issues.[1]

2. In order to provide more guidance to States, the suggestion was made that the Secretariat should prepare, in cooperation with international organizations with expertise in the fields of secured financing and intellectual property law and in particular the World Intellectual Property Organization (WIPO), a note for submission to the Commission at its fortieth session, in 2007, discussing the possible scope of work that could be undertaken by the Commission as a supplement to the draft Guide. In addition, it was suggested that, in order to obtain expert advice and the input of the relevant industry, the Secretariat should organize expert group meetings and colloquiums as necessary.[2] After discussion, the Commission requested the Secretariat to prepare, in cooperation with relevant organizations and in particular WIPO, a note discussing the scope of future work by the Commission on intellectual property financing. The Commission also requested the Secretariat to organize a colloquium on intellectual property financing ensuring to the maximum extent possible the participation of relevant international organizations and experts from various regions of the world.[3]

3. Pursuant to that decision of the Commission, the Secretariat organized in cooperation with WIPO a colloquium on security rights in intellectual property rights (Vienna, 18 and 19 January 2007). The colloquium was attended by experts on secured financing and intellectual property law, including representatives of Governments and national and international, governmental and non-governmental organizations. At the colloquium, several suggestions were made with respect to adjustments that would need to be made to the draft Guide to address issues specific to intellectual property financing.[4]

4. At the first part of its fortieth session (Vienna, 25 June-12 July 2007), the Commission considered a note by the Secretariat entitled "Possible future work on

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[1] *Official Records of the General Assembly, Sixty-first Session, Supplement No. 17* (A/61/17), paras. 81 and 82.

[2] Ibid., para. 83.

[3] Ibid., para. 86.

[4] See http://www.uncitral.org/uncitral/en/commission/colloquia/2secint.html.

security rights in intellectual property" (A/CN.9/632). The note took into account the conclusions reached at the colloquium. In order to provide sufficient guidance to States as to the adjustments that they might need to make in their laws to avoid inconsistencies between secured financing and intellectual property law, the Commission decided to entrust Working Group VI (Security Interests) with the preparation of an annex to the draft Guide specific to security rights in intellectual property rights.[5]

5. At its resumed fortieth session (Vienna, 10-14 December 2007), the Commission finalized and adopted the UNCITRAL Legislative Guide on Secured Transactions ("the Guide") on the understanding that an annex to the Guide specific to security rights in intellectual property rights would subsequently be prepared.[6]

6. At its thirteenth session (New York, 19-23 May 2008), Working Group VI considered a note by the Secretariat entitled "Security rights in intellectual property rights" (A/CN.9/WG.VI/WP.33 and Add.1). At that session, the Working Group requested the Secretariat to prepare a draft of the annex to the Guide on security rights in intellectual property ("the Annex") reflecting the deliberations and decisions of the Working Group (see A/CN.9/649, para. 13). At the same session, the Working Group felt that, while due deference should be expressed to intellectual property law, the point of reference for the Annex should be the Guide and not national secured transactions law (see A/CN.9/649, para. 14). As the Working Group was not able to reach agreement as to whether certain matters related to the impact of insolvency on a security right in intellectual property (see A/CN.9/649, paras. 98-102) were sufficiently linked with secured transactions law so as to justify their discussion in the Annex, it decided to revisit those matters at a future meeting and to recommend that Working Group V (Insolvency Law) be requested to consider those matters (see A/CN.9/649, para. 103).

7. At its forty-first session (New York, 16 June-3 July 2008), the Commission noted with satisfaction the good progress achieved by the Working Group. The Commission also noted the above-mentioned discussion and decision of Working Group VI with respect to certain insolvency-related matters and decided that Working Group V should be informed and invited to express any preliminary opinion at its next session. It was also decided that, should any remaining issue require joint consideration by the two Working Groups after that session, the Secretariat should have the discretion to organize, after consulting with the chairpersons of the two Working Groups, a joint discussion of the impact of insolvency on a security right in intellectual property when the two Working Groups meet back to back in the Spring of 2009.[7]

B. The interaction between secured transactions and intellectual property law under the Guide

8. With only limited exceptions, the recommendations of the Guide apply to security rights in all types of movable asset, including intellectual property (see

[5] *Official Records of the General Assembly, Sixty-second Session, Supplement No. 17* (A/62/17 (Part I)), paras. 156, 157 and 162.

[6] Ibid., *Sixty-second Session, Supplement No. 17* (A/62/17 (Part II)), paras. 99-100.

[7] Ibid., *Sixty-third Session, Supplement No. 17* (A/63/17), para. 326.

recommendations 2 and 4-7). With respect to intellectual property, the recommendations of the Guide do not apply to the extent that they are inconsistent with national law or international agreements relating to intellectual property (see recommendation 4, subparagraph (b)). Recommendation 4, subparagraph (b) sets out the basic principle with respect to the interaction of secured transactions and intellectual property law (dealing, for example, with patents, trademarks or copyrights) under the Guide. The meaning given to the term "intellectual property" is intended to ensure consistency of the Guide with intellectual property laws and treaties (see para. 12 below). The term "law relating to intellectual property" includes both statutory and case law and is broader than the term "intellectual property law", but narrower than general contract or property law.[8] The scope of recommendation 4, subparagraph (b), will, consequently, be broader or narrower, depending on how a State defines the scope of intellectual property in compliance with its international obligations flowing from intellectual property law treaties (such as the Agreement on Trade Related Aspects of Intellectual Property Rights – generally referred to as "the TRIPS Agreement").

9. The purpose of recommendation 4, subparagraph (b), is to ensure that, when States adopt the recommendations of the Guide, they do not inadvertently change basic rules of intellectual property law. As issues relating to the existence, validity and content of a grantor's intellectual property rights are matters to which the Guide does not speak (see section II.A.4 below), the occasions for possible conflict in regimes on these issues are limited. Nevertheless, in matters relating to the creation, third-party effectiveness, priority and enforcement of a security right in intellectual property, it is possible that in some States the two regimes will provide for different rules. Where this is the case, recommendation 4, subparagraph (b), preserves the precedence of the intellectual property-specific rule. It bears noting, however, that intellectual property law rules in some States relate only to forms of secured transactions that are not unique to intellectual property law and that will no longer be available once a State adopts the recommendations of the Guide (e.g. pledges, mortgages and transfers or trusts of intellectual property for security purposes). For this reason, States that adopt the Guide may also wish to review their intellectual property laws to achieve a better integration of the two regimes, reflecting in particular the integrated and functional approach recommended in the Guide, without modifying the basic policies and objectives of their intellectual property laws.

10. The Annex is intended to provide guidance to States with respect to such an integrated secured transactions and intellectual property law system. Building on the commentary and the recommendations of the Guide, the Annex discusses how the principles of the Guide apply where the encumbered asset consists of an intellectual property right and, where necessary, adds new commentary and recommendations. As is the case with the other asset-specific commentary and recommendations, the intellectual-property-specific commentary and recommendations modify or supplement the general commentary and recommendations of the Guide. Accordingly, subject to contrary provisions of law relating to intellectual property and any asset-specific commentary and recommendations of the Annex, a security right in intellectual property may be created, be made effective against third parties,

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[8] In spite of the difference between the terms "law relating to intellectual property" and "intellectual property law", for convenience, they are used interchangeably in this Annex.

have priority and be enforced as provided in the general recommendations of the Guide.

11. While it is not the purpose of the Annex to make any recommendations for changes to a State's law relating to intellectual property, as mentioned above, it may have an impact on that law. The Annex discusses this impact and, occasionally, includes in the commentary modest suggestions for the consideration of enacting States (the expression used is "States might" or "States may wish to consider …", rather than "States should"). These suggestions are based on the premise that, by enacting secured transactions laws of the type recommended by the Guide, States have made a policy decision to modernize their secured transactions law. The suggestions seek, therefore, to point out where this modernization might lead States to consider how best to integrate their secured transactions and intellectual property law regimes.

C. Terminology

[*Note to the Working Group: For paras. 12-21, see A/CN.9/WG.VI/WP.33, paras. 39-60, and A/CN.9/649, paras. 104-107.*]

12. As already mentioned, the Guide uses the term "intellectual property" (Introduction, section E). The commentary explains that the meaning given to the term in the Guide is intended to ensure consistency of the Guide with intellectual property laws and treaties, while at the same time respecting the right of the legislature in a State enacting the recommendations of the Guide to align the definition with its own law (national law and treaties). That is, the Guide treats as "intellectual property", for the purposes of the Guide, whatever an enacting State considers to be intellectual property.

13. As also already mentioned, the commentary also clarifies that references to "law" throughout the Guide include both statutory and non-statutory law. In addition, the Guide clarifies that the expression "law relating to intellectual property" (see recommendation 4, subparagraph (b)) is broader than intellectual property law (dealing, for example, with patents, trademarks or copyrights) but narrower than general contract or property law.

14. While the Guide relies on the law of an enacting State for the meaning of the terms used to denote the particular types of intellectual property (e.g. patent, trademark or copyright) or transaction (e.g. transfer or licence of intellectual property), it has its own terminology for matters of secured transactions law. For example, it uses the term "security right" to refer to all types of right that secure an obligation, irrespective of how they are denominated. Thus, the term "security right" would cover the right of a transferee in a transfer for security purposes.

15. The Guide also uses the term "licence" and, in intellectual-property-specific contexts, draws a distinction, first, between the licence agreement and the licence (i.e. the authorization to use the licensed intellectual property) and, second, between exclusive licences and non-exclusive ones. However, the exact meaning of these terms is left to intellectual property, contract and other law that may be applicable (such as the Joint Recommendation Concerning Trademark Licences, adopted by the

Paris Union Assembly and the WIPO General Assembly (2000)[9] and the Singapore Treaty on the Law of Trademarks (2006)).[10] In particular, the Guide does not interfere with the limits or terms of a licence agreement that may refer to the description of the specific intellectual property, the authorized or restricted uses, geographic area of use, and the duration of use. For example, an exclusive licence to exercise the "theatrical rights" in Film A in Country X for "10 years starting 1 Jan. 2008" may be given and it will be different from an exclusive licence to exercise the "video rights" in Film A in Country Y for "10 years starting 1 Jan. 2008". In addition, the Guide does not affect in any way the particular characterization of rights under a licence agreement given by intellectual property law (e.g., in some systems, an exclusive licence agreement creates rights in rem or amounts even to a transfer of various exclusive rights flowing from the intellectual property). However, under the Guide, the term "security right" is not used to denote an exclusive or non-exclusive licence. Rather, a security right in intellectual property, as in any other movable asset, is often defined by reference to the right of the secured creditor, in the case of the grantor's default, to obtain payment or other performance of the secured obligation from the economic value of the intellectual property (i.e. the exploitation rights, licensing rights and rights to claim royalties derived from exploitation and licensing rights).

16. Furthermore, the Guide uses various terms to denote the particular type of intellectual property that may be given as security for credit (i.e. rights of a rights holder, rights of a licensor or of a licensee) without interfering with the nature, the content or the legal consequences of such terms for purposes of intellectual property, contract or property law.

17. The term "receivable" is used in the Guide to reflect a right to payment of a monetary obligation and thus, for the purposes of the Guide, includes the right of the licensor to obtain payment of licence royalties. The term "assignment" is used in the Guide with respect to receivables to denote pure outright transfers, transfers for security purposes (treated under the Guide as security devices) and transactions creating a security right in a receivable. To avoid creating the impression that the recommendations of the Guide relating to assignments of receivables apply also to "assignments" of intellectual property, the term "transfer" (rather than the term "assignment") is used in the Annex to denote the transfer of the rights of a rights holder with respect to intellectual property.

18. In a secured transaction relating to intellectual property, the encumbered asset may be the intellectual property rights of the rights holder. In this case, the Guide's term "grantor" will denote a rights holder. However, the encumbered asset may be a lesser right, such as a licensee's authorization to use the licensed intellectual property in accordance with the terms of the licence agreement, including the right to enter into sub-licence agreements and to obtain payment of sub-royalties (provided that they are transferable under the terms of the licence agreement and the relevant law). In this case, the term "grantor" will refer to a "licensee". Finally, as is the case with any secured transactions relating to other types of movable asset, the term "grantor" may reflect a third party granting a security right in intellectual property to secure the obligation owed by a debtor to a secured creditor.

[9] http://www.wipo.int/export/sites/www/about-ip/en/development_iplaw/pdf/pub835.pdf.
[10] http://www.wipo.int/treaties/en/ip/singapore.

19. In secured transactions law, the concept of a “competing claimant” is used to identify parties other than the secured creditor in a specific security agreement that might claim a right in the encumbered assets or the proceeds from its disposition. Thus, the Guide uses the term “competing claimant” (e.g. another secured creditor or a transferee, lessee or licensee of an encumbered asset) in the sense of a claimant that competes with a secured creditor. In intellectual property law, however, the notion of a “competing claimant” is not used, and priority conflicts typically refer to conflicts among transferees, licensees and infringers, even if no conflict with a secured creditor is involved. Secured transactions law does not interfere with the resolution of such conflicts that do not involve a secured creditor.

20. The Guide recognizes that a security agreement creates a limited property right (a security right) in an encumbered asset (provided, of course, that the grantor has the right to create a security right in the asset) and does not amount to a transfer of ownership. Thus, in the Guide, the term “secured creditor” (which includes a transferee by way of security) is not used to denote a transferee or an owner. In other words, a secured creditor that acquires a security right under the Guide is not presumed to acquire ownership thereby. This is because normally secured creditors do not wish to accept the responsibilities and costs of ownership, and the Guide does not require that the secured creditor do so. This means, for example, that, even after the creation of a security right, the owner of the encumbered asset may exercise all its rights as an owner (subject, of course, to any limitations it may have agreed to with the secured creditor). Accordingly, when the secured creditor disposes of the encumbered asset enforcing its security right after default, the secured creditor does not thereby become an owner. In this case, the secured creditor merely exercises the owner’s rights with the consent of the owner given when the owner granted the security right. Only where, after default, the secured creditor becomes the owner after exercising the remedy of proposing to acquire the grantor’s ownership rights in the encumbered asset in total or partial satisfaction of the secured obligation (in the absence of any objection by the debtor and the debtor’s other creditors), or acquires the grantor’s ownership rights by purchasing the asset at a public sale, may the secured creditor become an owner.

21. This characterization of a security agreement and the rights of a secured creditor applies equally to situations where the encumbered asset is intellectual property. However, the Guide does not affect different characterizations under intellectual property law as long as they are dealing with intellectual property law matters. Under intellectual property law, a security agreement may be characterized as a transfer of the intellectual property rights of a rights holder and the secured creditor may have the rights of a rights holder (e.g. to deal with State authorities, grant a licence or sue infringers). So, for example, nothing in secured transactions law prevents a creditor from agreeing with a rights holder to become a rights holder, as long as the agreement does not relate to securing the performance of an obligation. If the agreement does or is intended to secure the performance of an obligation and intellectual property law permits a secured creditor to become a rights holder, then the term “secured creditor” may denote a rights holder to the extent provided by intellectual property law and the rights of the secured creditor with respect to the encumbered intellectual property will be determined in accordance with secured transactions and intellectual property law as provided in the Guide.

D. Examples of intellectual property financing practices

[*Note to the Working Group: For paras. 22-41, see A/CN.9/WG.VI/WP.33, paras. 8-21, and A/CN.9/649, para. 108.*]

22. To provide a backdrop for the analysis in the Annex, this section sets forth a number of hypothetical fact patterns involving secured transactions in which intellectual property rights are used as encumbered assets.

23. Secured transactions involving intellectual property rights can usefully be divided into three broad categories. The first category consists of transactions in which the intellectual property rights themselves serve as security for the credit. In these transactions, the provider of credit is granted a security right in patents, trademarks, copyrights or other intellectual property rights of the borrower. Examples 1 though 5 below each involve such a situation. Thus, Example 1 presents a situation in which a pharmaceutical company wishes to obtain credit secured by its portfolio of patents and patent applications. Example 2 involves a manufacturer of photocopy machines that wishes to uses its trademark, patents and trade secrets as security for a loan. In Example 3, the borrower is a publisher of comic books that licenses the likenesses of its comic book characters to clothing manufacturers for imprinting on T-shirts and other items of clothing, and the proposed security consists of the anticipated stream of royalty payments under the licence agreements. In Example 4, the encumbered assets are rights in a motion picture of the producer of the film. Finally, Example 5 involves a loan to a software developer whose products incorporate software that it licenses from third parties. Although these five examples differ greatly in terms of the nature of the businesses and types of intellectual property rights involved, they share one common characteristic: in each example, the collateral for the credit consists of the borrower’s intellectual property rights, either its own rights or those licensed from third parties.

24. The second category of transactions involves situations in which assets other than intellectual property rights, such as inventory or equipment, serve as security for the credit, but where the value of these assets is based to some extent upon intellectual property rights with which they are associated. This category of transactions is illustrated by Examples 6 though 9. Example 6 involves a situation in which the borrower is a clothing manufacturer, and the assets to be encumbered consist of the grantor’s inventory of high-fashion clothing bearing valuable trademarks licensed by the manufacturer from the third-party owners of the trademarks. In Example 7, the grantor is a distributor (rather than the manufacturer) of the inventory described in Example 6. Example 8 involves a retail book store that wishes to secure a credit facility with its stock of books copyrighted in the name of third-party authors and publishers. Finally, in Example 9, the grantor is a manufacturer of equipment that incorporates patented technology licensed to the manufacturer by the owner of the patent.

25. The third category of transaction involves financing transactions that combine the elements of the first two categories. An illustration of this type of transaction is found in Example 10, which involves a credit facility to a manufacturer, secured by an “enterprise mortgage” covering substantially all of the manufacturer’s assets, including its intellectual property rights.

26. Each of these categories of transaction involves not only different types (or combinations) of encumbered asset, but also presents different legal issues for a prospective lender or other credit provider.

Category 1

Example 1 (portfolio of patents and patent applications)

27. Company A, a pharmaceutical company that is constantly developing new drugs, wishes to obtain a revolving line of credit from Bank A secured in part by Company A's portfolio of existing and future drug patents and patent applications. Company A provides Bank A with a list of all of its existing patents and patent applications, as well as their chain of title, valuation and royalty receivables. Bank A evaluates which patents, patent applications and royalty receivables it will include in the "borrowing base" (that is, the pool of patents and patent applications to which Bank A will agree to assign value for borrowing purposes), and at what value they will be included. In connection therewith, Bank A obtains an appraisal of the patents and patent applications from an independent appraiser of intellectual property. Bank A then obtains a security right in the portfolio of patents and patent applications and registers a notice of its security right in the appropriate national patent registries (assuming that the applicable law provides for registration of security rights in the patents registry). When Company A obtains a new patent, it provides its chain of title, valuation and potential royalty stream to Bank A for inclusion in the borrowing base. Bank A evaluates the information, determines how much additional credit it will extend based on the new patent, and adjusts the borrowing base. Bank A then makes appropriate registrations in the patent offices reflecting its security right in the new patent.

Example 2 (trademark, patents and trade secrets of a manufacturer)

28. Company B, a well-known manufacturer of photocopy machines, wishes to borrow money from Bank B secured in part by its trademark, its patents used in connection with the photocopy machines and the trade secrets used in its manufacturing process (all of which has been appraised at €100 million by an independent appraiser). Company B is engaged in ongoing sales of its photocopy machines and licensing of its trademark and patents to generate cash flow that is used, in part, to repay the loan. Company B provides Bank B with a list of all countries in which the trademark and patents have been registered or used, along with a list of all approved licensees of the marks and patents. As part the loan documentation, Bank B registers its security right in the appropriate national trademark and patent registries (assuming that the applicable law provides for registration of security rights in these registries).

Example 3 (royalty financing)

29. Company C, a publisher of comic books, licenses its copyrighted characters to a wide array of manufacturers of clothing, toys, interactive software and accessories. The licensor's standard form of licence agreement requires licensees to report sales, and pay royalties on such sales, on a quarterly basis. Company C wishes to borrow money from Bank C secured by the anticipated stream of royalty payments arising under these licence agreements. Company C provides Bank C with a list of the licences, the credit profile of the licensees, and the status of each licence

agreement. Bank C then requires Company C to obtain an "estoppel certificate" from each licensee verifying the existence of the licence, the absence of default and the amount due, and confirming the licensee's agreement to pay future royalties to Bank C until further notice.

Example 4 (motion picture financing)

30. Company D, a motion picture company, wishes to produce a motion picture. Company D sets up a separate company to undertake the production and hire the individual writers, producers, directors and actors. The production company obtains a loan from Bank D secured by the copyright, service contracts and all revenues to be earned from the exploitation of the motion picture in the future. The production company then enters into licence agreements with distributors in multiple countries who agree to pay "advance guarantees" against royalties upon completion and delivery of the picture. For each licence, the production Company D, Bank D and the distributor/licensee enter into an "acknowledgement and assignment" agreement under which the licensee acknowledges the prior security right of Bank D and the assignment of its royalty payments to Bank D, while Bank D agrees that, in case of enforcement of its security right in the licence, it will not terminate the licence so long as the licensee makes payments and otherwise abides by the terms of the licence agreement.

Example 5 (software development financing)

31. Company E is a developer of sophisticated software used in various architectural applications. In addition to certain software components created by the company's in-house software engineers (which the company licenses to its customers), Company E also incorporates into its products software components that it licenses from third parties (and then sub-licences to its customers). Company E wishes to borrow money from Bank E secured by a security right in all of its intellectual property rights, including: (a) its rights in the software components that it develops in-house; (b) its rights as licensee of intellectual property from third parties; and (c) all royalties received by Company E from licensing (and sub-licensing) its programs to its customers.

Category 2

Example 6 (trademarked inventory owned by manufacturer)

32. Company F, a manufacturer of designer jeans and other high-fashion clothing, wishes to borrow money from Bank F secured in part by Company F's inventory of finished goods. Many of the items manufactured by Company F bear well-known trademarks licensed from third parties under licence agreements that give Company F the right to manufacture and sell the goods. Company F provides Bank F with its trademark licence agreements evidencing its right to use the trademarks.

Example 7 (trademarked inventory owned by distributor)

33. Company G, one of Company F's distributors, wishes to borrow money from Bank G secured in part by its inventory of designer jeans and other clothing that it purchases from Company F, a significant portion of which bears well-known

trademarks licensed by Company F from third parties. Company G provides Bank G with invoices from Company F evidencing that it acquired the jeans in an authorized sale, or copies of the agreements with Company F evidencing that the jeans distributed by Company G are genuine.

Example 8 (retail book store financing)

34. Company H, a retail book store, seeks a loan from Bank H secured by Company H's inventory of hardcover and paperback books. The copyrights in all of the books are owned by the authors and publishers of the books. Company H acquires its books in two ways. First, it buys individual copies from publishers. Second, recently, Company H has been taking some books "on consignment" and agreeing to provide shelf space and advertising. Company H only pays for the books when they are sold; it has the right to return the books after several months if they remain unsold.

Example 9 (financing the manufacturing of equipment under a licence agreement)

35. Company I is the licensee of a patent under a licence agreement that gives Company I the right to manufacture and sell equipment that includes technology covered by the patent. Company I wishes to obtain financing for its business secured by the equipment it manufactures and the receivables arising from sales of the equipment to Company I's customers.

Category 3

Example 10 (enterprise mortgage)

36. Company J, a manufacturer and distributor of cosmetics, wishes to obtain a €200 million credit facility to provide ongoing working capital for its business. Bank J is considering extending this facility, provided that the facility is secured by an "enterprise mortgage" granting to the bank a security right in substantially all of Company J's existing and future assets, including all existing and future intellectual property rights that it owns or licenses from third parties.

37. Each of the above examples illustrates how owners or licensees of intellectual property rights, or owners of assets that rely for their value on intellectual property rights, can use these assets as security for credit. In each case, a prudent prospective lender will engage in due diligence to ascertain the nature and extent of the rights of the owners and licensees of the intellectual property involved, and to evaluate the extent to which the proposed financing would or would not interfere with such rights. The ability of a lender to address these issues in a satisfactory manner, obtaining consents and other agreements where necessary from the rights holders of the intellectual property, will affect the lender's willingness to extend the requested credit and the cost of such credit.

38. Each of the examples presents different legal issues for a prospective lender. Some of the issues presented by Examples 1 through 5 (transactions in which the security consists of intellectual property rights) are as follows:

(a) Is there an efficient and straightforward method for creating a security right in the relevant categories of intellectual property rights and making it effective against third parties? Are the procedures for creating a security right costly in terms of notarial fees or other formal requirements, or registration fees, which will increase the cost of the credit to the borrower? Are these costs justified because of the increased benefits the lender receives through protection of the intellectual property rights that comprise its collateral, which can reduce the cost and increase the amount of the credit that the lender is willing to make available to the borrower because of this increased protection? Is there a way for the lender to easily and inexpensively search the record to establish the priority of its security right in the intellectual property right before it extends credit? Will the security right be effective against an insolvency trustee for the grantor of the security right?

(b) In the case of intellectual property rights that are registered in multiple jurisdictions, will the lender be entitled according to the laws of each of those jurisdictions to register its security rights in such jurisdictions? What benefits or detriments arise from such registrations, and what is the cost of the registrations?

(c) Are there certain categories of intellectual property rights referred to in the examples in which a security right cannot be created under applicable law in one or another jurisdiction?

(d) Can the security right be created in a way that covers not only existing intellectual property rights, but also future intellectual property rights that the grantor develops or acquires? For example, in Example 1, can the security right granted to Bank A automatically extend to new drug patents obtained by Company A and new patent applications filed by Company A?

(e) Where the proposed encumbered asset includes royalty producing licences or sub-licences (as in Examples 3, 4 and 5), is there a straightforward procedure for the borrower to grant a security right in the revenue streams under these licences or sub-licences? Do any of the licences or sub-licences, by their terms, prohibit or otherwise restrict the ability of the licensor or sub-licensor to grant a security right in the licence or sub-licence? If so, what is the effect of such a prohibition or restriction under applicable law (e.g. is such a prohibition or other restriction recognized or deemed to be unenforceable)?

(f) In each of Examples 1 though 5, is there an efficient way for the lender to enforce its security rights in the relevant intellectual property rights if the grantor defaults under the financing arrangement?

39. Examples 6 through 9 present a somewhat different series of issues for a lender:

(a) Using Example 6 for purposes of illustration, if Bank F wishes to realize on its security consisting of trademarked goods if it enforces its security right, would it be required to obtain the consent of the licensors of the trademarks, or to pay royalties to such licensors or otherwise comply with other obligations of Company F under the licence agreements? Alternatively, does Bank F have a right to dispose of the trademarked goods without the consent of the trademark owners? These issues will, of course, require the lender to examine the relevant licence agreements;

(b) What would happen if, while the financing to Company F is outstanding, one of the licensors of the trademarks becomes insolvent? Would the insolvency administrator for that licensor be able to terminate the licence to Company F? If, on the other hand, the licensor is not insolvent, but is nevertheless in default to its own lender, and that lender transfers the trademark to a third party in connection with the enforcement of its security right, would that transfer terminate the licence to Company F? Would the result depend on whether Company F's licence was made before or after the grant of the security right to the licensor's lender? What effect would that termination have on the ability of Bank F, upon a default by Company F under its credit facility with Bank F, to dispose of existing goods that were manufactured under the licence while the licence agreement was in effect?

(c) If Company F becomes insolvent, would it nevertheless be able to continue to operate under the licences if Company F reorganizes under applicable insolvency law, or, at a minimum, have the right under the licence agreements to complete existing work-in-process? Under what circumstances, if any, would Company F have the right under applicable insolvency law in connection with a sale of its business to a third party, with the approval of the insolvency court, to assign the licences to that third party?

(d) Do the licence agreements in favour of Company F impose any limitations on Company F's ability to disclose confidential information to Bank F that Bank F might require in order to evaluate the trademarks as collateral? In other words, does Bank F have a right to obtain confidential information of the licensor that is subject to non-disclosure? And can Bank F then use the confidential information without restriction?

(e) In Examples 7 and 8, the banks are faced with similar due diligence issues as the bank in Example 6. Are the answers in Example 7 any different because Company G is a distributor of the goods in question rather than a manufacturer? Are the answers in Example 8 any different because the intellectual property rights in question consist of copyrights rather than trademarks? What difference does it make that some copies are sold (and may trigger exhaustion; see para. 93 below and A/CN.9/WG.VI/WP.35/Add.1, paras. 81-84), while other copies are consigned?

(f) Are the answers in Example 9 any different because the intellectual property rights in question consist of patents rather than trademarks?

40. Finally, Example 10 presents the increasingly common situation of a credit facility secured by an enterprise mortgage. This efficient and cost-effective security device, which creates a security right in all or substantially of a grantor's existing and future assets, is recognized in an increasing number of States (subject, in some States, to carve-outs for unsecured creditors and other limitations) (for a more detailed discussion of enterprise mortgages, see section II, A, 7 (d), paras. 64-70 of the Guide). Often, a grantor's intellectual property rights are included in the broad security grant of an enterprise mortgage. Consistent with the approach consistently taken by this Annex, however, that grant is subject to the specific provisions and requirements of intellectual property law concerning creation, third-party effectiveness, priority and enforcement of security rights. Nevertheless, the enterprise mortgage may still have significant value for a secured creditor. For example, in the grantor's insolvency proceedings, the security right in the intellectual property created by the enterprise mortgage may well be effective against the grantor's insolvency administrator. Also, if the grantor's business is sold in the insolvency proceedings, such security right may enable the creditor to argue

successfully that it is entitled to a larger percentage of the proceeds of the sale, especially in situations where the sale price for the business is based to a significant extent of the grantor's intellectual property.[11]

41. A practical question applicable to all ten examples is how the borrower can ensure that it receives an accurate appraisal of the value of its intellectual property, thereby maximizing the amount of credit available to it based on the intellectual property. Secured transactions law cannot answer this question. However, insofar as it affects the use of intellectual property as security for credit, some of the complexities involved in valuing intellectual property need to be understood and addressed. For example, although the appraisal must take into account the value of the intellectual property itself and the expected cash flow, there are no universally accepted formulae for so doing. Because of the increasing importance of intellectual property as security for credit, in some States, lenders and borrowers are often able to seek guidance from independent appraisers of intellectual property.

E. Key objectives and fundamental policies

[*Note to the Working Group: For paras. 42-45, see A/CN.9/WG.VI/WP.33, paras. 61-75, and A/CN.9/649, paras. 88-97.*]

42. The overall objective of the Guide is to promote secured credit. In order to achieve this general objective, the Guide elaborates and discusses several additional objectives, including the objectives of predictability and transparency (see Introduction, section C, 2, of the Guide). The Guide also rests on and reflects several fundamental policies. These include providing for comprehensiveness in the scope of secured transactions laws, the integrated and functional approach to secured transactions (under which all transactions performing security functions, however denominated, are considered to be security devices) and the possibility of granting a security right in future assets (see Introduction, section C, 3, of the Guide).

43. These key objectives and fundamental policies are equally relevant to secured transactions relating to intellectual property. Accordingly, the overall objective of the Guide with respect to intellectual property is to promote secured credit for businesses that own or have the right to use intellectual property, by permitting them to use rights pertaining to intellectual property as encumbered assets, while also protecting the legitimate rights of the rights holders, licensors and licensees of intellectual property. Similarly, all the objectives and fundamental policies mentioned above apply to secured transactions in which the encumbered asset is or includes intellectual property. For example, the Guide is designed to:

(a) Allow persons with rights in intellectual property to use intellectual property as security for credit (see Key objective 1, subparagraph (a));

(b) Allow persons with rights in intellectual property to use the full value of their assets to obtain credit (see Key objective 1, subparagraph (b));

[11] Some of these questions might be addressed in asset-specific intellectual property legislation. For example, article 19 of the Council Regulation (EC) No. 40/94 on the Community Trademark provides that a security right may be created in a community trademark and, on request of one of the parties, such a right may be registered in the community trademark registry.

(c) Enable persons with rights in intellectual property to create a security right in such rights in a simple and efficient manner (see Key objective 1, subparagraph (c));

(d) Allow parties to secured transactions relating to intellectual property maximum flexibility to negotiate the terms of their security agreement (see Key objective 1, subparagraph (i));

(e) Enable interested parties to determine the existence of security rights in intellectual property in a clear and predictable way (see Key objective 1, subparagraph (f));

(f) Enable secured creditors to determine the priority of their security rights in intellectual property in a clear and predictable way (see Key objective 1, subparagraph (g)); and

(g) Facilitate efficient enforcement of security rights in intellectual property (see Key objective 1, subparagraph (h)).

44. The general policy of intellectual property law is to encourage the creation and dissemination of new ideas or discoveries. To accomplish this general policy, intellectual property law accords certain exclusive rights to rights holders. To ensure that the key objectives of secured transactions law will be achieved in a way that does not interfere with the objectives of intellectual property law and thus provide mechanisms to fund the development and dissemination of new works, the Guide states a general principle for dealing with the interaction of secured transactions law and intellectual property law. The principle is set out in recommendation 4, subparagraph (b) (see section II, A, 4 below). At this stage, it is sufficient to note that the regime elaborated in the Guide does not, in itself, in any way define the content of any intellectual property right, describe the scope of the rights that a holder, licensor or licensee may exercise or impede the rights of the rights holder to preserve the value of its rights by preventing the unauthorized use of intellectual property. In this regard, the key objective of promoting secured credit with respect to intellectual property should be achieved in a way that does not interfere with the objectives of intellectual property law to prevent unauthorized use of intellectual property or to protect the value of intellectual property and thus to encourage further innovation and creativity.

45. Similarly, this key objective should be understood in an intellectual property context as referring to the need to neither diminish the value of intellectual property nor result in the inadvertent abandonment of intellectual property (e.g. failure to use a trademark properly, to use it on all goods or services or to maintain adequate quality control may result in loss of value to, or even abandonment of, the intellectual property). In addition, in the case of goods or services associated with marks, secured transactions law should avoid causing consumer confusion as to the source of goods or services (e.g. where a secured creditor replaces the manufacturer’s name and address on the goods with a sticker bearing the creditor’s name and address or retains the trademark and sells the goods in a jurisdiction where the trademark is owned by a different person). Finally, secured transactions law should not provide that the granting of a security right in the rights of a licensee under a personal licence could result in the transfer of such rights without the consent of the rights holder.

II. Scope of application and party autonomy

[*Note to the Working Group: For paras. 46-67, see A/CN.9/WG.VI/WP.33, paras. 82-108, and A/CN.9/649, paras. 81-87.*]

A. Broad scope of application

46. The Guide applies to security rights in all types of movable asset, including intellectual property, created or acquired by a legal or natural person, to secure all types of obligation, and to all transactions serving security purposes, regardless of how they are denominated by the parties or characterized by prior law (see recommendations 2 and 8). The Annex has an equally broad scope with respect to security rights in intellectual property.

1. Encumbered assets covered

47. The question of characterization of types of intellectual property and the question of whether each type of intellectual property is transferable (and may thus be encumbered) are matters of intellectual property law. However, the Guide and the Annex are based on the general assumption that a security right may be created in a patent, a trademark and the economic rights under a copyright (but not in the moral rights of an author, if not permitted under intellectual property law). The Guide and the Annex are also based on the assumption that the encumbered asset may be various exclusive rights of a rights holder, the rights of a licensor or the rights of a licensee. However, there is an important qualification to the scope of the Guide and the Annex as just set out. In line with general rules of property law, the right to be encumbered has to be transferable under general property and intellectual property law.

2. Transactions covered

48. As mentioned, the Guide applies to all transactions serving security purposes, regardless how they are denominated by the parties or by intellectual property law. In other words, whether intellectual property law characterizes the transfer of an intellectual property right to a creditor for security purposes as a conditional transfer or even as an "outright" transfer of the right, the Guide characterizes this transaction as giving rise only to a security right and thus applies to it.

3. Outright transfers of intellectual property

49. The Guide applies to the outright transfer (i.e. pure transfer of ownership) of receivables (recommendation 3). As the Guide treats royalties payable by the licensee of intellectual property as receivables, it applies to the outright transfer of the right to receive royalties. The inclusion of outright transfers of receivables in the scope of the Guide reflects the fact that such transfers are usually seen as financing transactions and are often difficult in practice to distinguish from loans against the receivables.

50. The Guide also applies to transfers of all movable assets for security purposes, which it treats as security devices (see recommendation 2, subparagraph (d)). However, the Guide does not apply to outright transfers of any other movable asset,

including intellectual property, except to the extent that there is a priority conflict between an outright transferee of the asset and a secured creditor with a security right in the asset. The reason for the exclusion of outright transfers of any other movable asset, including intellectual property, is that they are sufficiently covered by other law, including intellectual property law and, in the case of some types of intellectual property, made subject to specialized registration.

4. Limitations on scope

51. The Guide assumes that, in order to facilitate access to financing based on intellectual property, States enacting the recommendations of the Guide will include rules on security rights in intellectual property in their modern secured transactions regime. However, the Guide also recognizes that this must be done in a manner that is consistent with the policies and infrastructure of the intellectual property laws of the enacting State (see recommendation 4, subparagraph (b)).

52. The potential points of intersection between secured transactions and intellectual property law are dealt with in detail in the various chapters of this Annex. To provide a context for this more detailed discussion of the implications of recommendation 4, subparagraph (b), it is helpful at this point to delineate: (a) issues that are clearly the province of intellectual property law and are not intended to be affected in any way by the Guide; and (b) issues on which the rules set out in the Guide may be pre-empted or supplemented by a rule of the law relating to intellectual property that regulates the same issue in a different manner from the Guide.

(a) Distinction between intellectual property rights and security rights in intellectual property

53. The Guide addresses only legal issues unique to secured transactions law as opposed to issues relating to the nature and legal attributes of the asset that is the object of the security right. The latter are the exclusive province of the body of property law that applies to the particular asset (with the partial unique exception of receivables to the extent outright transfers of receivables are also covered in the Guide).

54. In the context of intellectual property financing, it follows that the Guide does not affect, and does not purport to affect, issues relating to the existence, validity, and content of a grantor’s intellectual property. These issues are determined solely by the applicable intellectual property law. Of course, the secured creditor will need to pay attention to those rules in order to assess the existence and quality of the assets to be encumbered, but this would apply to any other asset. What follows is an illustrative list of issues addressed by intellectual property law relevant to that assessment:

Copyright:

(a) The determination of who is the author or joint author;

(b) The duration of copyright protection;

(c) The limitations on and exceptions to protection;

(d) The nature of protection (expression embodied in the work, as opposed to the idea behind it, and the dividing line between these);

(e) The scope and transferability of moral rights;

(f) The relationship between the transferees of the author of a pre-existing work and the holders of the copyright in a derivative work;

(g) Attribution of original ownership in the case of commissioned works and works created by an employee within the scope of employment.

Patents:

(a) The determination of who is the inventor or joint inventor;

(b) Legal consequences of registration (e.g. validity) of a patent and where to register;

(c) Scope and duration of protection;

(d) The grounds for invalidity challenges (obviousness or lack of novelty);

(e) Whether prior publication precludes patentability;

(f) Whether protection is granted on a first-to-file basis or to the first person to conceive of the invention or reduce it to practice.

Trademarks:

(a) The determination of who is the first user or the rights holder of the trademark;

(b) Whether protection of the trademark is granted on a first-to-use or a first-to-register rule;

(c) Whether ex ante use is a pre-requisite to registration in a trademark registry or whether the right is secured by initial registration and maintained by later use;

(d) The basis of protection of the right (distinctiveness);

(e) The basis for losing protection (holder's failure to ensure that mark retains its association with the owner's goods in the marketplace), as in the case of:

(i) Licensing without the licensor directly or indirectly controlling the quality or character of the goods or services associated with the trademark (so-called "naked licensing"); and

(ii) Altering the trademark so its appearance does not match the trademark as registered;

(f) Whether the trademark may be transferred with or without goodwill.

(b) Areas of potential overlap between secured transactions and intellectual property law

55. The issues just addressed do not create any necessity for deference to intellectual property law since the Guide does not purport to address these issues in the first instance. In other words, they are not issues where the principle of

recommendation 4, subparagraph (b), has any application. The deference issue arises when the law relating to intellectual property of the enacting State provides an intellectual property-specific rule on an issue falling within the scope of the Guide, namely, an issue relating to the creation, third-party effectiveness, priority, enforcement of or law applicable to a security right in intellectual property.

56. The precise scope and implications of deference cannot be stated in the abstract since there is great variation among States on the extent to which intellectual-property-specific rules have been established, and indeed even within the same State depending on which category of intellectual property is at issue. The following examples are, however, illustrative of some typically encountered patterns.

Example 1

57. Some States, in which security rights are created by a transfer of title to the encumbered asset, do not permit security rights to be created in a trademark, owing to concerns that the secured creditor's title would impair the quality control required of the trademark holder. Adoption of the recommendations of the Guide by such a State would eliminate the rationale for this prohibition, since the grantor retains ownership of encumbered assets under the Guide's concept of security right. Nonetheless, adoption of the recommendations of the Guide would not automatically eliminate the prohibition. The requirement for deference means that a specific amendment to relevant intellectual-property-specific legislation would be needed.

Example 2

58. In a few States, as a matter of intellectual property law, registration in a specialized intellectual property registry is a mandatory pre-requisite to either the creation or the third-party effectiveness either of outright transfers only or both of outright transfers and security rights in the category of intellectual property subject to that registry. In view of the principle of deference to intellectual property law embodied in recommendation 4, subparagraph (b), adoption of the Guide's recommendations would not affect the operation of such a rule and such specialized registration will continue to be required. However, deference to intellectual property law may have the effect of compromising the Guide's goal of facilitating secured transactions. Unlike the case with the general security rights registry recommended by the Guide, it is often not possible to register in existing intellectual property registries a notice of security right against the name of the grantor or to cover future intellectual property. Rather, security rights may be registered only in existing intellectual property and new notices must be registered for a security right to extend to each new intellectual property acquired by the grantor in the future.

Example 3

59. In some States, intellectual property law provides for registration of both outright transfers and security rights in their intellectual property registries, but registration is not mandatory in the sense of being an absolute precondition to creation or third-party effectiveness. However, registration has priority consequences in that an unregistered transaction can be defeated by a registered transaction. In the case of such a State, recommendation 4, subparagraph (b), would

preserve that intellectual property law rule of the State and, accordingly, a secured creditor desiring optimal protection may need to register in both the general security rights registry and in the intellectual property registry. This is because: (a) registration in the general security rights registry is a necessary pre-requisite to third-party effectiveness under secured transactions law; and (b) registration in the intellectual property registry will be necessary to protect the secured creditor against the risk of finding its security right defeated by the registration of a competing outright transfer or security right in the intellectual property registry under the intellectual-property-specific priority rules.

60. In some States, registration of transfers and security rights in the intellectual property registry only provides protection against a prior unregistered transfer or security right only if the person with the registered right took without notice of the unregistered right (e.g. if the person is a bona fide purchaser). In States, in which this rule is a rule of intellectual property law to which the Guide defers pursuant to recommendation 4, subparagraph (b) (as opposed to a general rule of secured transactions law present throughout the State's legal system), adoption of the Guide's recommendation will raise the further question as to whether registration of a security right in intellectual property in the general security rights registry constitutes constructive notice to a subsequent secured creditor that registers its security right in the intellectual property registry. If so, under the law of a State that has such a bona fide purchaser rule, it would be unnecessary for a secured creditor that has registered in the general security rights registry to also register in the intellectual property registry in order to prevail as against subsequent transferees and secured creditors.

Example 4

61. As a matter of intellectual property law, some States provide for registration in their intellectual property registries of transfers of, but not of security rights in, intellectual property. In such situations, registration has priority consequences only as between transferees, and not as between a transferee and a secured creditor. In States that adopt this approach, a secured creditor will need to ensure that all transfers of intellectual property to its grantor are duly registered in the intellectual property registry so as to avoid the risk of the grantor's title being defeated by a subsequent registered transfer. Otherwise, however, the secured creditor's rights will be determined by the secured transactions regime. Likewise, the secured creditor will need to ensure that a transfer for security purposes made to it by the grantor is duly registered in the intellectual property registry in order to avoid the risk that a subsequent transferee of the grantor will defeat the security transfer to the secured creditor.

Example 5

62. As a matter of intellectual property law, in some States, registration of transfers and security rights in an intellectual property registry is purely permissive and intended only to facilitate identification of the current rights holder. Failure to register neither invalidates the transaction nor affects its priority (although it might create evidentiary presumptions). In States that adopt this approach, the position is essentially the same as when no specialized registry exists at all, as is often the case for copyright. Where these issues are dealt with by intellectual property law, the

Guide defers to it. Where, however, these issues are left to be determined by general property law, no issue of deference arises since the pre-Guide rules were not derived from the law relating to intellectual property but rather from property law generally. Thus, adoption of the Guide will replace the existing rules on creation, third-party effectiveness, priority and so forth for security rights in intellectual property. Of course, the old rules on these issues will continue to apply to outright transfers of intellectual property since the Guide only covers security rights in intellectual property. Consequently, the secured creditor will need to verify the quality of any outright transfers of intellectual property to its grantor. But this type of risk management is no different from that necessary for any other type of encumbered asset for which a specialized registry does not exist.

Example 6

63. The question of who has title to intellectual property in a chain of transferees is a matter of intellectual property law. At the same time, the question of whether a transfer is an outright transfer or a transfer for security purposes is a matter of general property and secured transactions law.

Example 7

64. Again, intellectual property law may provide for specialized rules governing the manner in which a creditor may seize and sell intellectual property in satisfaction of a judgement against the rights holder. In this case, the Guide's enforcement regime would defer to intellectual property law. However, if there is no specific rule of intellectual property law on the matter and the enforcement of judgements is a matter left to the Code of Civil Procedure or an Executions Act, then the enforcement regime for security rights elaborated in the Guide would take precedence over general national rules relating to the compulsory enforcement of obligations and judgements. Similarly, if there is no specific rule of intellectual property law on extrajudicial enforcement, the relevant regime of the Guide on extrajudicial enforcement of security rights in intellectual property would apply (see A/CN.9/WG.VI/WP.35/Add.1, chapter on enforcement).

B. Application of the principle of party autonomy to security rights in intellectual property

65. The Guide generally recognizes the principle of party autonomy, although it does elaborate a number of exceptions (see recommendations 10 and 111-112). This principle applies equally to security rights in intellectual property to the extent that intellectual property law does not limit party autonomy (see A/CN.9/WG.VI/WP.35/Add.1, paras. 62-63). It should be noted that recommendations 111-113 apply only to tangible assets, as they refer to the possession of encumbered assets and intangible assets are by definition not subject to possession.

66. A special expression of the principle of party autonomy in secured transactions relating to intellectual property would be the following: a grantor and a secured creditor may agree that the secured creditor may acquire certain of the rights of a rights holder under intellectual property law and thus be entitled to register or renew

registrations, as well as to sue infringers. This agreement could take the form of a special clause in the security agreement or a separate agreement between the grantor and the secured creditor, since the secured creditor does not, by the mere fact of obtaining a security right, become a rights holder (unless intellectual property law characterizes the rights of a secured creditor under the Guide as rights of a rights holder or permits the rights holder and the secured creditor to agree that the secured creditor will be the rights holder).

67. It should also be noted that damages received as a result of infringement of intellectual property rights would fall under the definition of "proceeds" ("whatever is received in respect of encumbered assets"), to which the security right in the original encumbered intellectual property would be extended. However, the right to pursue infringement claims (as opposed to the right to receive payment of damages for infringement) is a different matter. This right would not constitute proceeds as they would not fall under the words "whatever is received in respect of encumbered assets" in the definition that qualify the indicative (i.e. non-exhaustive) list of items contained in the definition ("including … and claims arising from defects in, damage or loss of an encumbered asset").

III. Creation of a security right in intellectual property

[*Note to the Working Group: For paras. 68-102, see A/CN.9/WG.VI/WP.33, paras. 112-133, and A/CN.9/649, paras. 16-28.*]

68. The general remarks and recommendations of the Guide with respect to the creation of a security right apply to security rights in intellectual property (see recommendations 13-19), as supplemented by the asset-specific remarks in the following paragraphs.

A. The concepts of creation and third-party effectiveness

69. With respect to all types of encumbered asset (including intellectual property), the Guide draws a distinction between the creation of a security right (its effectiveness as between the parties) and its effectiveness against third parties, providing different requirements to achieve each of these outcomes. In many States, intellectual property law may not draw such a distinction (see A/CN.9/WG.VI/WP.35/Add.1, paras. 1-3).

70. If, in a particular State, law relating to intellectual property law addresses the matter and draws no distinction between creation and third-party effectiveness of a security right in intellectual property, the recommendations of the Guide concerning the requirements for creation and third-party effectiveness do not apply to the extent they are inconsistent with that law. Thus, these matters are determined by reference to the relevant rules of intellectual property law. If law relating to intellectual property does not address these matters, however, the recommendations of the Guide apply to them. States enacting the recommendations of the Guide may wish to consider reviewing their laws relating to intellectual property to determine whether different concepts and requirements on matters relating to the creation and third-party effectiveness of security rights in intellectual property serve specific policy objectives of intellectual property law (rather than other law, such as general

property law, contract law or secured transactions law) and should be retained or whether they should be harmonized with the relevant concepts and requirements of the law recommended in the Guide.

B. Unitary concept of a security right

71. To the extent law relating to intellectual property permits the creation of a security right in intellectual property, it may do so by referring to outright or conditional transfers of intellectual property, mortgages, pledges, trusts or similar terms. The Guide uses the term "security right" to refer to all transactions that serve security purposes. This is referred to as the "unitary approach" to secured transactions. Although the Guide contemplates, by exception, that States taking the non-unitary approach in the limited context of acquisition financing may retain transactions denominated as retention of title or financial lease, this exception only applies to tangible assets, and would, consequently, not be relevant in an intellectual property context. States enacting the recommendations of the Guide may wish to review their law relating to intellectual property with a view to: (a) replacing all terms used to refer to the right of a secured creditor with the term "security right"; or (b) providing that, whatever the term used, rights performing security functions are treated in the same way and that such a way is not inconsistent with the treatment of security rights in the Guide.

C. Requirements for the creation of a security right in intellectual property

72. Under the Guide, the creation of a security right in an intangible asset requires a written agreement. In addition, the grantor must have rights in the asset to be encumbered or the power to encumber it. The 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 recommendations 13-15). As already mentioned, no additional step is required for the creation of a security right in an intangible asset. Any additional step (e.g. registration of a notice in a general security rights registry) is aimed at ensuring the third-party effectiveness of such a security right.

73. However, intellectual property laws in many States impose different requirements for the creation of a security right in such property. For example, registration of a security right in intellectual property (e.g. a transfer for security purposes, a mortgage or pledge of intellectual property) may be required for the creation of a security right. In addition, under law relating to intellectual property, the intellectual property to be encumbered may need to be described specifically in a security agreement. Thus, a sufficient description under the Guide (e.g. one that embraces "all intellectual property") may not be sufficient under intellectual property law. All depends on the particular provisions of the relevant intellectual property law regime. Similarly, as intellectual property registries index registered documents by the intellectual property, and not the grantor's name or other identifier, a document that merely states "all intellectual property of the grantor" would not be sufficient for registration in that registry. It would instead be necessary

to identify each intellectual property right in the security agreement and in any registered document.

74. In all these situations, under the principle embodied in recommendation 4, subparagraph (b), the law recommended in the Guide would apply only in so far as it is not inconsistent with law relating to intellectual property. Of course, States enacting the Guide may wish to consider reviewing their laws relating to intellectual property to determine whether the different concepts and requirements with respect to the creation of security rights in intellectual property serve specific policy objectives of intellectual property law and should be retained or whether they should be harmonized with the relevant concepts and requirements of the law recommended in the Guide.

D. Rights of a grantor in the intellectual property to be encumbered

75. As mentioned, a grantor must have rights in the asset to be encumbered or the power to encumber it (see recommendation 13). This is a principle of secured transactions law that applies equally to intellectual property. In addition, as a matter of general property law, a grantor may encumber its assets only to the extent that the assets are transferable under general property law. This principle too applies to secured transactions relating to intellectual property. So, a rights holder may only encumber its rights to the extent these rights are transferable under intellectual property law. In particular, a licensee of intellectual property may encumber its licence only to the extent the licence is transferable under intellectual property law and the terms of the licence agreement.

E. Distinction between a secured creditor and a rights holder with respect to intellectual property

76. The question of who has title and whether the parties may determine it for themselves is a matter of intellectual property law. In any case, for the purposes of secured transactions law under the Guide, the creation of a security right does not change the rights holder of the encumbered intellectual property and the secured creditor does not become a rights holder on the sole ground that it acquired a security right (unless intellectual property law characterizes the rights of a secured creditor under the Guide as the rights of a rights holder or simply permits the rights holder and the secured creditor to agree that the secured creditor will be the rights holder).

77. Under the Guide, the secured creditor may become a rights holder, if, after default, it acquires the encumbered intellectual property in satisfaction of the secured obligation, which requires the consent of the grantor and its other creditors (see recommendations 156-157), or purchases the encumbered intellectual property at a public sale (see recommendations 141 and 148). Secured creditors, of course, have an interest in knowing how their rights and obligations will be characterized under intellectual property law, but this will not be determinative of how their rights will be characterized under secured transactions law. Nor will it determine the manner by which those rights will be enforced under secured transactions law (see A/CN.9/WG.VI/WP.35/Add.1, chapter on enforcement).

F. Types of rights in intellectual property that may be subject to a security right

78. Under the Guide, a security right may be created in the rights of a rights holder or the rights of a licensor or a licensee under a licence agreement. In addition, a security right may be created in intellectual property used with respect to a tangible asset (e.g. designer watches or clothes bearing a trademark). The intellectual property needs to be transferable under intellectual property law and covered in the security agreement.

1. Rights of a rights holder

79. The Guide applies to secured transactions in which the encumbered assets are the rights of a rights holder. Accordingly, an effective and enforceable security right may be created to the extent these rights are transferable under intellectual property law. These rights include the following rights of a rights holder: the right to prevent unauthorized use of intellectual property and to sue infringers, the right to register intellectual property and the right to authorize others to use the intellectual property.

80. Typically, the essence of the rights of a rights holder lies in its ability to prevent unauthorized use and to sue infringers of intellectual property. If, under intellectual property law, these rights are transferable, they may be encumbered with a security right and the Guide will apply to such security right. If these rights are inalienable, under intellectual property law, they may not be encumbered by a security right, since the Guide does not affect legislative prohibitions to the transferability of assets other than certain prohibitions with respect to future receivables and receivables assigned in bulk (see recommendation 18).

81. With respect to the right of the rights holder to sue infringers, it should be noted that, if, at the time a security right is created, an infringement has been committed, the rights holder has sued infringers and infringers have paid compensation, the amount paid prior to the creation of a security right would not be part of the encumbered intellectual property and the secured creditor could not claim it in the case of default as part of the originally encumbered asset. However, if the compensation is paid after the creation of the security right (for an infringement that occurred before or after the creation of the security right), the secured creditor may claim it as proceeds of the originally encumbered asset. If the compensation has not been paid, the receivable could be part of the originally encumbered intellectual property and, in the case of default, the secured creditor could claim it. If the lawsuit is still pending at the time of creation of the security right, the secured creditor should be able to give the buyer of the intellectual property in the case of default standing to continue the lawsuit (if permitted under intellectual property law).

82. Similar considerations apply to the question of whether the right to register intellectual property or renew a registration may be transferred and thus be part of encumbered intellectual property. Whether the right to register or renew registration of intellectual property is an inalienable right of the rights holder is a matter of intellectual property law. Whether it is part of the encumbered intellectual property is a matter of the description of the encumbered asset in the security agreement.

2. Rights of a licensor

83. As mentioned above, a licence agreement is not a secured transaction and it does not create a security right. However, under the Guide, a security right may be created in a licensor's rights. If a licensor is a rights holder, it can create a security right in its rights as mentioned above. In addition, such a licensor may create a security right in its right to claim royalties and possibly other contractual rights of value. These other contractual rights might include, for example, the licensor's right to compel the licensee to advertise the licensed intellectual property or product with respect to which the intellectual property is used, or the right to compel the licensee to market the licensed intellectual property only in a particular manner. If the licensor is not a rights holder (but a licensee that grants a sub-licence), it may create a security right in its right to claim royalties or other contractual rights of value.

84. Following the approach taken in most legal systems and reflected in the United Nations Assignment Convention, the Guide treats rights to receive payment of royalties as receivables, that is, as an asset that is separate from the intellectual property from which they flow, just as rents are separate assets from the movable or immovable property from which they flow. This means that the general discussion and recommendations dealing with receivables, as modified by the receivables-specific discussion and recommendations, apply to rights to receive the payment of royalties. Thus, under the Guide, statutory prohibitions that relate to the assignment of future receivables or receivables assigned in bulk or partial assignments are rendered unenforceable (see recommendation 23). However, other statutory prohibitions or limitations are not affected (see recommendation 18). Of course, this treatment would be subject to laws relating to intellectual property that may either expand or contract the capacity of parties to override any statutory prohibitions. Such laws would include, in particular, international accounting rules as to how or when royalties are earned (e.g. International Accounting Standard No. 38 of the International Accounting Standards Board). Such rules provide that royalties that have not been earned under applicable accounting rules at the time they are assigned are subject to particular accounting treatments. Thus, the parties to a licence agreement and to a security agreement creating a security right in the licensor's right to receive such royalties should take this into account in their transactions.

85. Under the Guide, if a licence (or a sub-licence) agreement, under which royalties are payable, includes a contractual provision that restricts the ability of the licensor (or a sub-licensor) to assign the royalties to a third party ("assignee"), an assignment of the royalties by the licensor (or sub-licensor) is nonetheless effective and the licensee (or sub-licensee) cannot terminate the licence agreement (or sub-licence agreement) on the sole ground of the assignment of the royalties (see recommendation 24). However, under the Guide, the rights of a licensee (as a debtor of the assigned receivables) are not affected except as otherwise provided in the secured transactions law recommended in the Guide (see recommendation 117, subparagraph (a)). Specifically, the licensee is entitled to raise against the assignee all defences or rights of set-off arising from the licence agreement or any other agreement that was part of the same transaction (see recommendation 120, subparagraph (a)). In addition, the Guide does not affect any liability that the licensor may have under other law for breach of the anti-assignment agreement (see recommendation 24).

86. It is important to note that recommendation 24 applies only to receivables, and not to intellectual property rights. This means that it does not apply to an agreement between a licensor and a licensee according to which the licensee does not have the right to grant sub-licences.

87. It is equally important to note that recommendation 24 applies only to an agreement between a creditor of a receivable and the debtor of the receivable that the receivable owed to the creditor by the debtor may not be assigned. It does not apply to an agreement between a creditor of a receivable and the debtor of the receivable that the debtor may not assign receivables that the debtor may have against third parties. Thus, recommendation 24 does not apply to an agreement between a licensor and a licensee that the licensee will not assign its right to receive payment of sub-licence royalties from third-party sub-licensees. Such an agreement may exist, for example, where the licensor and the licensee agree that sub-licence royalties will be used by the licensee to further develop the licensed intellectual property. Thus, the Guide does not affect the right of the licensor to negotiate the licence agreement with the licensee so as to control who can use the intellectual property or the flow of royalties from the licensee and sub-licensees.

88. In addition, recommendation 24 does not apply to an agreement between a licensor and a licensee that the licensor will terminate the licence agreement if the licensee violates the agreement not to assign royalties payable to the licensee by sub-licensees. In this context, it should be noted that the right of the licensor to terminate the licence agreement if the licensee breaches this agreement gives the sub-licensees a strong incentive to make sure that the licensor gets paid. Moreover, recommendation 24 does not affect the right of the licensor to: (a) agree with the licensee that part of the licensee's royalties (representing a source for the payment of the royalties the licensee owes to the licensor) be paid by sub-licensees to an account in the name of the licensor; or (b) obtain a security right in the licensee's future royalties to be paid by sub-licensees, register a notice in that regard in the general security rights registry and thus obtain a security right with priority over the licensee's other creditors (subject to the rules of the Guide for obtaining third-party effectiveness and priority of security rights).

89. Finally, it should be noted that the Guide's provisions with respect to limitations to the assignment of receivables apply only to contractual (not legislative) limitations. Many countries have "author-protective" or similar legislation that designates a certain portion of income earned from exploitation of the intellectual property rights as "equitable remuneration" or the like which must be paid to authors or other entitled parties or their collecting societies. These laws often make such payment rights expressly non-assignable. The Guide's recommendations with respect to limitations to the assignment of receivables do not apply to these or other legislative limitations (see also paras. 99-100 below).

3. "Rights"[12] of a licensee

90. A licensee is authorized to use the licensed intellectual property in line with the terms of the licence agreement. In addition, if a licensee has, under the terms of the licence agreement, the authority to grant sub-licences and the sub-licence agreement provides for the payment of royalties, the licensee has a right to claim such royalties from sub-licensees. Some intellectual property laws provide that the licensee may not create a security right in its authorization to use the licensed intellectual property or in its right to receive royalties from sub-licensees without the licensor's consent (an exception may arise where the licensee sells its business as a going concern). The reason is that it is important that the licensor has control over the licensed intellectual property, determining who can use it. Otherwise, the confidentiality and the value of the information associated with the intellectual property right may be jeopardized. If the licence is assignable and the licensee assigns it, the assignee will take the licence subject to the terms and conditions of the licence agreement. The Guide does not affect these licensing practices.

4. Rights in intellectual property used with respect to a tangible asset

91. Intellectual property may be used with respect to a tangible asset. For example: a tangible asset may be manufactured according to a patented process or through the exercise of patented rights; jeans may bear a trademark or cars may contain a chip which includes a copy of copyrighted software; or a CD may contain a software programme or a heat pump may contain a patented product.

92. Where intellectual property is used in connection with a tangible asset, two different types of asset are involved. One is the intellectual property; another is the tangible asset. These assets are separate. Intellectual property law allows a rights holder the ability to control many but not all uses of the tangible asset. For example, intellectual property law allows a rights holder to prevent unauthorized duplication of a book, but not to prevent an authorized bookstore that bought the book to sell it or the end-buyer to make notes in the margin while reading. As such, a security right in intellectual property does not extend to the tangible asset with respect to which intellectual property is used, and a security right in a tangible asset does not extend to the intellectual property used with respect to the tangible asset, unless the security agreement otherwise, explicitly or implicitly, provides. In other words, the extent of the security right depends on the description of the encumbered asset in the security agreement. In this regard, the question arises as to whether the description should be specific (e.g. "all my inventory with all associated intellectual property rights and other rights") or whether a general description ("all my inventory") would suffice. It would seem that a general description would be in line with the principles of the Guide and the reasonable expectations of the parties, with the realization that separate assets are involved. At the same time, key principles of intellectual property law should be respected. To the extent law relating to intellectual property requires a specific description of the encumbered intellectual property, enacting States may wish to review their laws relating to intellectual

[12] The term "rights of the licensee" is a generic term intended to cover the authorization granted to the licensee to use the licensed intellectual property and, possibly, grant other licences, and the right to receive payment of licence royalties from sub-licensees. It is not intended to address the question of the legal nature of the licence or its contents, which is a matter for intellectual property law.

property to consider, for example, whether the requirement for a specific description should apply to intellectual property used with respect to tangible assets.

93. As already mentioned, a security right in a tangible asset, in connection with which an intellectual property right is used, does not extend to the intellectual property used with respect to the tangible asset, but does apply to the tangible asset itself, including those characteristics of the asset that use the intellectual property (e.g. the security right applies to a television set as a functioning television set). Thus, a security right in such an asset does not give the secured creditor the right to manufacture additional assets using the intellectual property. Upon default, however, the secured creditor could exercise the remedies recognized under secured transactions law, provided that such exercise of remedies did not interfere with rights existing under intellectual property law. It may be that, under applicable intellectual property law, the concept of "exhaustion" (or similar concepts) might apply to the enforcement of the security right (see A/CN.9/WG.VI/WP.35/Add.1, paras. 81-84).

94. The above-mentioned remarks may be summarized with the following recommendation:

> "The law should provide that, unless otherwise specified in the security agreement, a security right in intellectual property does not extend to the tangible assets with respect to which it is used, and a security right in such tangible assets does not extend to the intellectual property. However, nothing in this recommendation limits the ability of a secured creditor with a security right in such intellectual property to deal with the tangible assets to the extent permitted by intellectual property law, nor does it limit the ability of a secured creditor with a security right in the tangible assets to deal with the tangible assets to the extent permitted by intellectual property law."

G. Security rights in future intellectual property

95. The Guide provides that grantors may grant security rights in future assets, namely assets created or acquired by the grantor after the creation of a security right (see recommendation 17). In principle, this recommendation applies to intellectual property. Accordingly, under the Guide, a security right could be created in future intellectual property (as to legislative limitations in that regard, see recommendation 18 and paras. 96-99 below). This approach is justified by the commercial utility in allowing a security right to extend to future intellectual property. Many intellectual property laws follow the same approach, allowing rights holders to obtain financing useful in the development of new works, provided of course that their value can be reasonably estimated in advance. 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 the production of motion pictures or software to be produced in the future.

96. However, in certain cases, intellectual property law may limit the transferability of various types of future intellectual property to achieve specific policy goals. For example, in some cases, a transfer of rights in new media or technological uses that are unknown at the time of the transfer may not be effective in view of the need to protect authors. In other cases, transfers of future rights may

be subject to a statutory right of cancellation after a certain period. In other cases, the notion of "future intellectual property" may include registrable rights created but not yet registered. Statutory prohibitions may also take the form of a requirement for a specific description of intellectual property. They may also be the result of the *nemo dat* principle, in accordance with which a creditor obtaining a security right does not obtain any rights greater than the rights of the grantor. In particular, if the grantor were a licensee, the licensee could not give anything more than the right granted to the licensee from the licensor.

97. Other limitations on the use of future intellectual property as security for credit may be the result of the meaning of the concepts of "improvements" or "adaptations" under intellectual property law. The secured creditor should understand how these concepts are interpreted under intellectual property law and how they may affect the concept of "ownership", which is essential in the creation of a security right in intellectual property. This determination is of particular relevance in the case of software, for example. In this case, a lender's security on a version of a software which exists at the time of the financing may not extend to modifications made to that version following the financing if it is determined that, under intellectual property laws, the modifications to such version are considered to be new works (adaptations) for which a new transfer is required. Similar considerations may apply if software incorporates patents that are subject to "improvements". As is the case with other statutory prohibitions, the Guide does not affect these prohibitions (see recommendation 18).

98. If law relating to intellectual property limits the transferability of future intellectual property, the Guide does not apply to this matter. Otherwise, the Guide applies and permits the creation of a security right in future assets (see recommendation 17). Where intellectual property law includes limitations to the transferability of future intellectual property, these limitations are often intended to protect the rights holder. Again, States enacting the Guide may wish to review their intellectual property law with a view to establishing whether the benefits from these limitations outweigh the benefits from the use of such assets as security for credit.

H. Legislative or contractual limitations on the transferability of intellectual property

99. Specific rules of intellectual property law may limit the ability to create an effective security right in certain types of intellectual property. In many States, only the economic rights of an author are transferable; the moral rights are not transferable. In addition, legislation in many States provides that an author's right to receive equitable remuneration may not be transferable, at least prior to actual receipt of payment by the author. Moreover, in many States, trademarks are not transferable without their associated goodwill. The Guide respects all these on the transferability of intellectual property (see recommendation 18).

100. The only limitations on the transferability of certain assets that the Guide may affect are the legislative limitations on the transferability of future receivables, receivables assigned in bulk and parts or undivided interests in receivables, as well as to contractual limitations on the assignment of receivables arising for the sale or licence of intellectual property rights (see recommendations 23-25). In addition, the

Guide may affect contractual limitations, but only with respect to receivables (not intellectual property) and only in a certain context, that is, in an agreement between the creditor of a receivable and the debtor of that receivable. (see paras. 84-86 above).

I. Acquisition financing and licence agreements

101. The Guide provides that acquisition-financing arrangements with respect to tangible assets (i.e. retention-of-title sales, financial leases and purchase-money lending transactions) should be treated as secured transactions and provides two approaches to such transactions (a unitary approach and a non-unitary approach) from which a State may choose to implement this treatment (see recommendations 9 and 187-202).

102. A licence agreement might be seen as having some of the characteristics of a secured transaction, since it involves: (a) financing of the licensee by the licensor to the extent that royalties are payable in future periodical instalments; (b) the grant of permission to the licensee by the licensor for the licensee to use the intellectual property rights under the conditions set out in the licence agreement; and (c) the retention of title in the intellectual property rights by the licensor. However, a licence agreement is not a secured transaction. In a licence agreement, the licensor remains the owner and does not become a secured creditor, and the licensee does not acquire title, nor does it automatically have the right to give a security right in the licence or give a sub-licence to a third party, if this is not permitted under the licence and intellectual property law. Thus the Guide does not apply to a licence agreement, although it deals with the question whether a licensee takes a licence free or subject to a security right (see A/CN.9/WG.VI/WP.35/Add.1, chapter on priority).