



# General Assembly

Distr.: General  
23 March 2010

Original: English

**United Nations Commission  
on International Trade Law**  
Forty-third session  
New York, 21 June-9 July 2010

## **Draft Supplement to the UNCITRAL Legislative Guide on Secured Transactions dealing with security rights in intellectual property**

**Note by the Secretariat**

**Addendum**

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## **VI. Rights and obligations of the parties to a security agreement relating to intellectual property**

[*Note to the Commission: For paras. 1-5 and recommendation 247, see A/CN.9/WG.VI/WP.42/Add.5, paras. 1-5, and recommendation 246; A/CN.9/689, paras. 33-34; A/CN.9/WG.VI/WP.39/Add.6, paras. 1-5; A/CN.9/685, paras. 73-75; A/CN.9/WG.VI/WP.37/Add.3, paras. 19-22; A/CN.9/670, paras. 96-103; A/CN.9/WG.VI/WP.35/Add.1, paras. 62 and 63; A/CN.9/667, paras. 104-108; A/CN.9/WG.VI/WP.33/Add.1, paras. 26-30; and A/CN.9/649, paras. 57-59.*]

### **A. Application of the principle of party autonomy**

1. With few exceptions, the law recommended in the *Guide* generally recognizes the freedom of the parties to the security agreement to tailor their agreement so as to meet their practical needs (see recommendation 10). The principle of party autonomy applies equally to security rights in intellectual property, subject to any limitations specifically introduced by law relating to intellectual property (see recommendation 4, subpara. (b)). For example, unless otherwise provided by law relating to intellectual property, an owner/grantor and its secured creditor may agree between themselves that: (a) the secured creditor may exercise some of the rights of the owner/grantor (for example, to deal with authorities and renew registration or pursue infringers; see A/CN.9/700/Add.1, para. 23); (b) the owner/grantor may not grant licences (in particular exclusive licences) without the consent of the secured creditor; or (c) the secured creditor may collect royalties owed to the owner/grantor as a licensor even before default on the part of the grantor.

### **B. Preservation of the encumbered intellectual property**

2. Under the law recommended in the *Guide*, the party in possession of an encumbered asset has the obligation to take reasonable steps to preserve it (see recommendation 111). Similar rules apply to intellectual property. For example, the grantor has an obligation to deal with authorities, pursue infringers and renew registrations. In some States, law relating to patents provides that the owner/grantor may not revoke or limit the encumbered patent without the consent of the secured creditor.

3. In addition, under the law recommended in the *Guide*, a secured creditor is free to agree with an owner/grantor, in the security agreement or in a separate agreement, that the secured creditor would be entitled to take steps to preserve the encumbered asset (see recommendation 10). With respect to intellectual property, this could include dealing with authorities, pursuing infringers or renewing registrations even before default, provided that this is not prohibited by law relating to intellectual property (see recommendation 4, subpara. (b)). If the owner/grantor failed to exercise these rights in a timely fashion, the encumbered intellectual property could lose its value, a result that could negatively affect the use of intellectual property as security for credit. Thus, it would appear appropriate to apply the general approach in the *Guide*, allowing the grantor and secured creditor to agree on steps the secured creditor might take to preserve the encumbered asset,

to intellectual property as well (to the extent not prohibited by the law relating to intellectual property). This approach would not interfere with the rights of the owner/grantor as its consent would be necessary. Similarly, this approach would not interfere with law relating to intellectual property because such an agreement would be ineffective, if it were concluded in violation of law relating to intellectual property. States enacting the recommendations of the *Guide* may wish to consider their law relating to intellectual property so as to determine whether such agreements should be permitted, as this would facilitate the use of intellectual property as security for credit.

4. Moreover, under the law recommended in the *Guide*, the secured creditor should be able to request the owner/grantor to allow the secured creditor to protect the value of the encumbered intellectual property, for example, by renewing registrations or pursuing infringers (see recommendation 10), unless prohibited by law relating to intellectual property (see recommendation 4, subpara. (b)). Otherwise, the value of the encumbered intellectual property could diminish and such a result could negatively affect the use of intellectual property as security for credit.

5. If the owner/grantor accepted this request (or the secured creditor was authorized by agreement with the owner/grantor to take steps to preserve the encumbered intellectual property), the secured creditor would be entitled to exercise those rights with the explicit consent of the owner/grantor; if the owner/grantor did not respond, the secured creditor would be entitled to exercise those rights with the implicit consent of the owner/grantor; and, if the owner/grantor rejected the request, the secured creditor would not be entitled to exercise those rights. In addition, if the owner/grantor failed to pursue infringers or renew registrations, the secured creditor could consider that that failure constituted an event of default as described in the security agreement and could enforce its security right in the encumbered intellectual property. Again, these results would not interfere with law relating to intellectual property as recommendation 4, subparagraph (b), would defer to that law in case of any inconsistency.

## **Recommendation 246<sup>1</sup>**

### **246. Right of the secured creditor to preserve the encumbered intellectual property**

The law should provide that the grantor and the secured creditor may agree that the secured creditor is entitled to take steps to preserve the encumbered intellectual property.

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<sup>1</sup> If it could be included in the *Guide*, this recommendation would be placed in chapter VI, Rights and obligations of the parties to a security agreement, as recommendation 116 bis.

## VII. Rights and obligations of third-party obligors in intellectual property financing transactions

[*Note to the Commission: For paras. 6 and 7, see A/CN.9/WG.VI/WP.42/Add.5, paras. 6-7; A/CN.9/689, para. 35; A/CN.9/WG.VI/WP.39/Add.6, paras. 6 and 7; A/CN.9/685, para. 76; A/CN.9/WG.VI/WP.37/Add.3, para. 23; A/CN.9/670, para. 104; A/CN.9/WG.VI/WP.35/Add.1, para. 64; A/CN.9/667, para. 109; A/CN.9/WG.VI/WP.33/Add.1, para. 32; and A/CN.9/649, para. 60.*]

6. Where a licensor assigns to its assignee (whether an outright assignee or a secured creditor, see the terms “assignee”, “assignment” and “secured creditor” in the introduction to the *Guide*, sect. B) its claim against a licensee for the payment of royalties under a licence agreement, the licensee (as the debtor of the assigned receivable) would be a third-party obligor under the *Guide* and its rights and obligations would be the rights and obligations of a debtor of a receivable. Similarly, where a licensee assigns to its assignee its claim against a sub-licensee for the payment of sub-royalties under a sub-licence agreement, the sub-licensee would be a third-party obligor with respect to the licensee’s assignee in the sense of the *Guide*.

7. As a result, for example, in a claim by an assignee of a licensor’s right to the payment of royalties, a licensee as a debtor of the assigned receivable may raise against the licensor’s assignee all defences and rights of set-off arising from the licence agreement or any other agreement, which are part of the same transaction and of which the licensee could avail itself as if the assignment had not been made and such claim had been made by the licensor. In addition, the licensee may raise against such an assignee any other right of set-off, provided that that right was available to the licensee at the time notification of the assignment was received by the licensee. However, any defences or rights of set-off that may be available to the licensee under law other than secured transactions law for breach of an agreement between the licensor and the licensee that the licensor will not assign its rights to the payment of royalties are not available to the licensee against the licensor’s assignee (see recommendation 120). As such, the exercise of a right of set-off is not subject to the priority rules in the *Guide*. This recommendation also is subject to the principle of deference to law relating to intellectual property embodied in recommendation 4, subparagraph (b).

## VIII. Enforcement of a security right in intellectual property

[*Note to the Commission: For paras. 8-32, see A/CN.9/WG.VI/WP.42/Add.5, paras. 8-32; A/CN.9/689, para. 36; A/CN.9/WG.VI/WP.39/Add.6, paras. 8-32; A/CN.9/685, paras. 77-86; A/CN.9/WG.VI/WP.37/Add.3, paras. 24-48; A/CN.9/670, paras. 105-114; A/CN.9/WG.VI/WP.35/Add.1, paras. 65-89; A/CN.9/667, paras. 110-123; A/CN.9/WG.VI/WP.33/Add.1, paras. 35-44; and A/CN.9/649, paras. 61-73.*]

## A. Intersection of secured transactions law and law relating to intellectual property

8. States typically do not provide for specific enforcement remedies for security rights in intellectual property in their laws relating to intellectual property. The general law of secured transactions normally applies to the enforcement of security rights in intellectual property. To the extent that law relating to intellectual property in some States actually does address the enforcement of security rights in different types of intellectual property, it typically engrafts existing secured transactions enforcement regimes onto the regime governing intellectual property. As a consequence, States that enact the *Guide's* recommendations will normally be substituting the *Guide's* recommended enforcement regime for the prior enforcement regime derived from, for example, a civil code and code of civil procedure, the common law of floating and fixed charges, a mortgage act or some other general law of enforcement, as the case may be.

9. This approach of the *Guide* to the enforcement of security rights applies not only to intellectual property (for example, a patent, a copyright or a trademark), but also to other rights that are derived from these types of intellectual property. Hence, consistently with the United Nations Assignment Convention, assets, such as rights to the payment of royalties and licence fees, are treated as receivables and are subject to the enforcement regime recommended in the *Guide* for assignments (that is, outright transfers, security transfers and security rights) in receivables (see A/CN.9/700/Add.2, paras. 21-29). Likewise, a licensor's or sub-licensor's other contractual rights as against a licensee or sub-licensee will also be governed by a State's general law of obligations and security rights in those contractual rights will be enforced under a State's general secured transactions law. And again, a licensee's or sub-licensee's rights of use are treated in the same way as a lessee's or purchaser's rights and are governed by a State's general law of obligations, except as regards questions of registration (where specifically mentioned in law relating to intellectual property).

10. On occasion, States incorporate special procedural controls on the enforcement of security rights in intellectual property into law relating to intellectual property. In addition, the general procedural norms of secured transactions law in a State may be given a specific content in the context of enforcement of security rights in intellectual property. So, for example, the determination of what is commercially reasonable where the encumbered asset is intellectual property may depend on law and practice relating to intellectual property. This standard of commercial reasonableness may well vary from State to State, as well as from one intellectual property regime to another. The *Guide* recognizes this procedural variation and, in so far as any procedural rules apply specifically to security rights in intellectual property and impose greater obligations on parties than those of the enforcement regime set out in the recommendations of the *Guide*, they will, under the principle set forth in recommendation 4, subparagraph (b), displace the general recommendations of the *Guide*. If these procedural rules apply to security rights in assets other than intellectual property as well, they will be displaced by the recommendations of the *Guide* in States that enact them.

11. As for substantive enforcement rights of secured creditors, once a State adopts the recommendations of the *Guide*, there is no reason to develop different or

unusual remedial principles to govern enforcement of security rights in intellectual property. The *Guide* merely recommends a more efficient, transparent and effective enforcement regime for a secured creditor's rights, without in any way limiting the rights that the owner of intellectual property may exercise to protect its rights against infringement or to collect royalties from a licensee or sub-licensee. As pointed out in the chapter of the draft Supplement on the creation of a security right in intellectual property (see A/CN.9/700/Add.2, para. 9), the secured creditor generally cannot acquire security in more rights than the rights with which the grantor is vested at the time of the conclusion of the security agreement or when the grantor acquires rights in the encumbered asset or the power to encumber it (see recommendation 13).

## **B. Enforcement of a security right relating to different types of intellectual property**

12. The *Guide* recommends a detailed regime governing the enforcement of security rights in different types of encumbered asset. Its basic assumption is that enforcement remedies must be tailored to ensure the most effective and efficient enforcement while ensuring appropriate protection of the rights of the grantor and third parties. This assumption and approach recommended in the *Guide* should apply equally to the enforcement of security rights in the various categories of intellectual property. Currently, the law of most States recognizes a wide variety of rights relating to intellectual property, including:

- (a) The intellectual property in itself;
- (b) Receivables arising under a licence agreement;
- (c) The licensor's other contractual rights under a licence agreement;
- (d) The licensee's rights under a licence agreement; and
- (e) The owner's, licensor's and licensee's rights in tangible assets with respect to which intellectual property is used.

13. The enforcement regime recommended in the *Guide*, and applicable to each of these different rights in intellectual property, will be discussed separately in the following sections.

## **C. Taking "possession" of documents necessary for the enforcement of a security right in intellectual property**

14. The right of the secured creditor to take possession of the encumbered asset as set forth in recommendations 146 and 147 of the *Guide* is normally not relevant if the encumbered asset is an intangible asset such as intellectual property (as the term "possession", as defined in the *Guide*, means actual possession; see the introduction to the *Guide*, sect. B). These two recommendations deal only with the taking of possession of tangible assets. However, consistently with the general principle of extrajudicial enforcement, the secured creditor should be entitled to take possession of any documents necessary for the enforcement of its security right where the encumbered asset is intellectual property, whether or not those documents were

specifically mentioned as encumbered assets in the security agreement. Such a right will normally be provided for in the security agreement.

15. It may be thought that, where a secured creditor takes possession of a tangible asset that is produced using intellectual property or in which a chip containing a programme produced using intellectual property is included, the secured creditor is also taking possession of the encumbered intellectual property. This is not the case. It is important to distinguish properly the asset encumbered by the security right. Even though many tangible assets, whether equipment or inventory, may be produced through the application of intellectual property such as a patent, the security right is in the tangible asset and does not, in absence of specific language in the security agreement purporting to encumber the intellectual property itself, encumber the intellectual property used to produce the asset. The use referred to here means use consistent with the authorization of the owner or other licensor; if the use is unauthorized, the products are unauthorized and the secured creditor may be an infringer if the secured creditor uses the encumbered asset in an unauthorized manner. So, for example, the secured creditor may take possession of a tangible asset, such as a compact disc or a digital video disc, and may exercise its enforcement remedies against the discs under the rules of the law recommended in the *Guide*. In cases where the secured creditor also wishes to obtain a security right in the intellectual property itself (including, to the extent the grantor has the right to sell or otherwise dispose of, or license the intellectual property, the right to sell or otherwise dispose of, or license it), it would be necessary for the secured creditor to specifically describe such intellectual property as encumbered assets in the security agreement with the grantor (see A/CN.9/700/Add.2, paras. 32-36, and recommendation 243).

#### **D. Disposition of encumbered intellectual property**

16. Under the law recommended in the *Guide*, upon the grantor's default, the secured creditor has the right to dispose of or grant a licence in the encumbered intellectual property (but always within the limits of the rights of the grantor; see recommendation 148). As a result, if the grantor is the owner, the secured creditor should, in principle, have the right to sell (assign) or otherwise dispose of, or license the encumbered intellectual property. However, if the grantor had previously granted an exclusive licence to a third party free of the security right, upon default, the secured creditor would be unable to grant another licence covering the same use within the geographical limits of the licence, as the grantor had no such right at the time the secured creditor acquired its security right (*nemo dat quod non habet*). The situation will be different if, for example, the grantor grants an exclusive licence that is limited geographically. However, the secured creditor may be able to grant another licence outside the geographical limits of the exclusive licence granted by the grantor.

17. In the above-mentioned situation, under the law recommended in the *Guide*, simply by exercising its enforcement rights, the enforcing secured creditor does not acquire the intellectual property against which the security right is being enforced. Instead, the secured creditor disposes of the encumbered intellectual property (by assigning or licensing it) in the name of the grantor. Under law relating to intellectual property, until the assignee or licensee (as the case may be) that acquires



the rights upon a disposition by the enforcing secured creditor registers a notice (or other document) of its rights in the relevant registry (assuming the rights in question may be registered), the grantor will appear on the registry as the owner of the relevant intellectual property.

### **E. Rights acquired through disposition of encumbered intellectual property**

18. Under the law recommended in the *Guide*, rights in intellectual property acquired through judicial disposition would be regulated by the relevant law applicable to the enforcement of court judgements (see recommendation 160). In the case of an extrajudicial disposition in line with the provisions of secured transactions law, the first point to note is that the transferee or licensee takes its rights directly from the grantor. The secured creditor that chooses to enforce its rights in this manner does not become the owner merely as a result of this enforcement process, unless the secured creditor acquires the encumbered intellectual property in total or partial satisfaction of the secured obligation or at an enforcement sale (see recommendations 148 and 156).

19. The second point is that the transferee or licensee could only take such rights as were actually encumbered by the enforcing creditor's security right. Under the law recommended in the *Guide*, the transferee or licensee would take the intellectual property free of the security right of the enforcing secured creditor and any lower-ranking security rights, but subject to any higher-ranking security rights. Similarly, a good-faith transferee or licensee that acquired a right in intellectual property pursuant to an extrajudicial disposition that is inconsistent with the provisions of the secured transactions law would take the intellectual property free of the security right of the enforcing secured creditor and any lower-ranking security rights (see recommendations 161-163).

20. Under the law recommended in the *Guide*, a security right in a tangible asset extends to and may be enforced against attachments to that asset (see recommendations 21 and 166). To ensure that the security right also covers assets produced or manufactured by the grantor from encumbered assets, the security agreement normally provides expressly that the security right extends to such manufactured assets. Where the encumbered asset is intellectual property, it is important to determine whether the asset that is disposed of to the transferee or licensee is simply the intellectual property as it existed at the time the security right became effective against third parties or whether it also includes any subsequent enhancements to it (for example, an improvement to a patent or an adaptation of copyrighted work). Generally, laws relating to intellectual property treat such improvements ("updates", "adaptations" or "enhancements") as separate assets and not as integral parts of existing intellectual property. As a result, the prudent secured creditor that wishes to ensure that improvements are encumbered with the security right should describe the encumbered asset in the security agreement in a manner that ensures that improvements are directly encumbered by the security right (see A/CN.9/700/Add.2, para. 40 and 41).

## **F. Proposal by the secured creditor to acquire the encumbered intellectual property**

21. Under the enforcement regime recommended in the *Guide*, the secured creditor has the right to propose to the grantor that it acquire the grantor's rights in total or partial satisfaction of the secured obligation. If the grantor is the owner of intellectual property, the secured creditor could itself become the owner in the way prescribed by law relating to intellectual property, provided that the grantor and any other interested party (such as the debtor, any other person owing performance of the secured obligation or any person with rights in the encumbered asset) do not object (see recommendations 156-159). Should the owner have licensed its intellectual property to a licensee that acquired its rights under the licence agreement free of the rights of the enforcing secured creditor, when the secured creditor acquires the intellectual property from the grantor, it acquires that right subject to the prior-ranking licence in accordance with the *nemo dat* principle. Once a secured creditor becomes the owner of intellectual property, its rights and obligations are regulated by the relevant law relating to intellectual property. In particular, the secured creditor may need to register a notice or document confirming that it acquired the intellectual property to enjoy the rights of an owner or to obtain any relevant priority. Finally, the secured creditor that acquires the encumbered intellectual property in total or partial satisfaction of the secured obligation would take the intellectual property free of the security right of any lower-ranking security rights, but subject to any higher-ranking security rights (see recommendation 161).

## **G. Collection of royalties and other licence fees**

22. Under the enforcement regime recommended in the *Guide*, where the encumbered asset is the right to receive payment of royalties and other fees under a licence agreement, the secured creditor should be entitled to enforce the security right by simply collecting the royalties and other licence fees upon default and notification to the person that owes the royalties or fees (see recommendation 168). In all these situations, the right to the payment of royalties and other licence fees is, for the purposes of secured transactions laws, a receivable (see A/CN.9/700/Add.2, paras. 22-29). Thus, the rights and obligations of the parties will be governed by the principles pertaining to receivables that are set forth in the United Nations Assignment Convention and the regime recommended in the *Guide* for receivables. Once again, the secured creditor that has taken a security right in the right to the payment of present and future royalties is entitled to enforce only such rights to the payment of royalties (including rights to the payment of future royalties under existing licenses) as were vested in the grantor (licensor) at the time of the conclusion of the security agreement or when the grantor acquired rights in the encumbered receivable or the power to encumber it (see recommendation 13). In addition, subject to any contrary provision of law relating to intellectual property (see recommendation 4, subpara. (b)), the secured creditor's rights to collect royalties includes the right to collect or otherwise enforce any personal or property right that secures payment of the royalties (see recommendation 169).

## **H. Licensor's other contractual rights**

23. In addition to the right to collect royalties, the licensor will normally include a number of other contractual rights in its agreement with the licensee (see A/CN.9/700/Add.2, para. 21). These may include, for example, a limitation in the licence agreement on the right of the licensee to grant any sub-licence or a prohibition on the granting of security rights by the licensee in its rights under the licence agreement, including the right to terminate the licence agreement under a set of specified conditions. These rights will remain vested in the licensor if the security right is only in the right to the payment of royalties. However, if the secured creditor also wishes to obtain a security right in these other rights of the licensor, they would have to be included in the description of the encumbered assets in the security agreement. It should also be noted that, if the secured creditor enforces its security right and takes the encumbered and licensed intellectual property subject to a licence, as a matter of contract law, the secured creditor will be bound by the terms and conditions of the licence agreement.

## **I. Enforcement of security rights in tangible assets with respect to which intellectual property is used**

24. In principle, except where the so-called "exhaustion doctrine" applies, the intellectual property owner has the right to control the manner and place in which the encumbered tangible assets with respect to which intellectual property is used (in line with the authorization of the owner), are sold. That is, in the event that the relevant intellectual property right has not been exhausted, the secured creditor should be able to dispose of the tangible assets only upon default and only if there is an authorization from the intellectual property owner (it is assumed that the security agreement does not encumber the intellectual property right itself; see A/CN.9/700/Add.2, paras. 32-36, and recommendation 243).

25. As there is no universal understanding of the "exhaustion doctrine" (often referred to as "exhaustion of rights" or "first-sale doctrine"), the draft Supplement makes reference to the doctrine not as a universal concept, but as it is actually understood in each State. Nonetheless, where the exhaustion doctrine applies under law relating to intellectual property, the basic idea is that an intellectual property owner will lose or "exhaust" certain rights when specific conditions are met, such as the first marketing or sale of the product embodying the intellectual property. For example, the ability of a trademark owner to control further sales of a product bearing its trademark is generally "exhausted" following the initial sale of that product. The rule serves to protect a person that resells that product from infringement liability. However, it is important to note that such protection extends only to the point where the products have not been altered so as to be materially different from those originating from the trademark owner. In addition, the exhaustion doctrine does not apply if a licensee produces products bearing the licensed trademark without complying with the terms and conditions of the licence agreement (for example, as to quality or quantity).

26. In situations where a product is produced with the use of intellectual property that has been licensed to a licensee and that licensee attempts to create a security right in that product, under law relating to intellectual property, the licence

agreement may provide that the licensee cannot grant a security right in that product; the licence agreement may also provide that a secured creditor may only enforce its security right in a manner agreed to by the licensor. In both these cases, the licensor will typically provide in the licence agreement that the licence may be revoked by the licensor if the licensee as grantor or the secured creditor acts in a manner that is contrary to the limitations contained in the licence agreement. As a consequence, in order to enforce effectively its security right in the product, in the absence of prior agreement between the secured creditor and the owner/licensor, the secured creditor would: (a) need to obtain the consent of the owner/licensor; or (b) rely on the relevant law relating to intellectual property and the operation of the exhaustion doctrine.

27. In cases where the secured creditor also wished to obtain a security right in the intellectual property itself (including, to the extent the grantor has the right to sell or license the intellectual property, the right to sell or license it), it would be necessary for the secured creditor to specifically refer to such intellectual property as an encumbered asset in the security agreement. Here, the encumbered asset is not the product produced using the intellectual property, but rather the intellectual property itself (or the licence to manufacture tangible assets using the intellectual property). A prudent secured creditor will normally seek to take a security right in such intellectual property so as to be able to enforce its security right and sell or license the intellectual property to ensure that the licensee will be able to continue the production of any partially completed products.

## **J. Enforcement of a security right in a licensee's rights**

28. In the discussion above, the grantor of the security right has been assumed to be the owner of the relevant intellectual property. The encumbered asset is one or more of the following rights: (a) the intellectual property itself; (b) the right of the owner/licensor to receive royalties and fees; or (c) the right of the owner/licensor to enforce other contractual terms relating to the intellectual property. Only in the discussion of security rights in tangible assets produced by using intellectual property (paras. 24-27 above) were the rights of the owner/licensor and the rights of the licensee treated together. However, most of the issues addressed in sections C-H also are relevant in situations where the encumbered asset is not the intellectual property itself but the rights of a licensee (or sub-licensee) arising from a licence agreement (see A/CN.9/700/Add.2, paras. 30 and 31). In cases where the encumbered asset is merely a licence, the secured creditor obviously may only enforce its security right against the licensee's rights and may do so only in a manner that is consistent with the terms of the licence agreement.

29. In situations where the grantor is a licensee, upon the grantor's default, the secured creditor will have the right to enforce its security right in the licensee's rights under the licence agreement and to dispose of the licence to a transferee, provided that the licensor consents or the licence is transferable, which is rarely the case. Likewise, the enforcing secured creditor may grant a sub-licence, provided that the licensor consents or the grantor-licensee had, under the terms of the licence agreement, the right to grant sub-licences. In situations where the secured creditor proposes to a grantor/licensee to acquire the licence in total or partial satisfaction of the secured obligation and neither the grantor nor any other interested party (such as

the debtor, any other person owing performance of the secured obligation or any person with rights in the encumbered asset; see recommendations 156-158) object (and the licence agreement does not prohibit the transfer of the licence), the secured creditor becomes vested with the licence according to the terms of the licence agreement between the licensee and the licensor. Assuming that registration of licences is possible under law relating to intellectual property, registration of the licence by the licensee-secured creditor that acquires the licence in total or partial satisfaction of the secured obligation may be a condition of the effectiveness of the licensee's rights or may simply serve information purposes.

30. Where the encumbered asset is the sub-licensor's right to the payment of royalties under a sub-licence agreement, the regime recommended in the *Guide* treats the asset as a receivable. This means that the secured creditor of the licensee/sub-licensor may collect the royalties to the extent that these were vested in the grantor/sub-licensor at the time when the security right in the receivable is enforced. In the case where creation by the licensee/sub-licensor of a security right in its right to payment of royalties owed by its sub-licensee constitutes a breach of an initial or intervening licence agreement, the licensor would retain all its contractual rights under the licence agreement, including the right to terminate that agreement, and the secured creditor of the licensee/sub-licensor would also retain its right to collect sub-royalties, at least, as long as the licensor did not terminate the licence agreement.

31. Where the encumbered asset is another contractual right stipulated in the sub-licence agreement, the secured creditor may enforce its security right in this contractual right as if it were any other encumbered asset. The fact that the licensor may have revoked the licence for the future or may have itself claimed a prior right to receive payment of sub-royalties, has no direct bearing on the right of the secured creditor to enforce these other contractual rights set out in the licence agreement.

32. The rights acquired by a transferee or sub-licensee of the encumbered licensee's rights upon disposition by the secured creditor or by a secured creditor that acquires the licensee's rights in total or partial satisfaction of the secured obligation may be significantly limited by the terms and conditions of the licence agreement. For example, a non-exclusive licensee cannot enforce the intellectual property against another non-exclusive licensee or against an infringer of the intellectual property. Only the licensor (or the owner) may do so, although, in some States, exclusive licensees may join the licensor as a party to the proceedings or even pursue infringers on their own. In addition, depending upon the terms and conditions of the licence agreement and the description of the encumbered asset in the security agreement, a transferee of the licence may not have access to information such as a source code. In order to ensure the effectiveness of the licence being transferred or sub-licensed, the security agreement will have to include such rights within the description of the assets encumbered by the grantor-licensee, to the extent that the licence agreement and relevant law permits it to encumber these rights as well.

## **IX. Acquisition financing in an intellectual property context**

[*Note to the Commission: For paras. 33-61 and recommendation 247, see A/CN.9/WG.VI/WP.42/Add.5, paras. 33-58, and recommendations 247-252; A/CN.9/689, paras. 37-40; A/CN.9/WG.VI/WP.39/Add.5, note after para. 19; A/CN.9/685, paras. 66-70; and A/CN.9/670, paras. 32-36.*]

### **A. Introduction**

33. Historically and in contemporary commercial and legal practice, many States have enacted a special regime to govern acquisition financing with respect to tangible assets. In accordance with these widespread practices, the discussion of acquisition financing in the *Guide* focuses on tangible assets such as consumer goods, equipment and inventory. The *Guide* does not make recommendations with respect to acquisition financing of other types of tangible asset such as negotiable instruments and negotiable documents. In addition, the *Guide* does not recommend that a special regime be established for acquisition financing with respect to intangible assets. Moreover, the *Guide* does not address explicitly the question whether a security right, and in particular an acquisition security right in a tangible asset with respect to which software is used, extends to the software (an intangible asset). However, the draft Supplement makes clear that a security right of any type in a tangible asset does not extend to intellectual property used with respect to that asset (see A/CN.9/700/Add.2, paras. 32-36, and recommendation 243).

34. In particular, the *Guide* leaves open the question whether, in a modern credit economy, it would be useful to permit the creation of acquisition security rights in favour of lenders that finance the acquisition (but not the original creation) of intellectual property. Such an approach would provide general parity in the treatment of tangible assets and intellectual property assets. Given the important differences in legal regimes between intellectual property and other types of asset, if such an approach were adopted, the principles of the *Guide* on acquisition financing with respect to tangible assets could not simply be transposed to the intellectual property context. They would have to be adapted, as discussed in sections B and C below, to apply with respect to intellectual property.

### **B. Unitary approach**

35. The basic idea of providing a special regime of acquisition financing for intellectual property is not unknown. For example, in some legal systems, a creditor may obtain an acquisition security right in copyrighted software, but only if: (a) the security right accompanies an acquisition security right in a tangible asset; (b) the software is acquired by the grantor in a transaction integrated with the transaction in which the grantor acquired the tangible asset; and (c) the grantor acquires the software for the principal purpose of using the software in the tangible asset. In other legal systems, it is possible for a secured creditor to obtain an acquisition security right in intangible assets (including intellectual property, whether or not the intellectual property is used in connection with tangible assets). In yet other legal systems, where the general law as set forth, for example, in a civil code does not contain the concept of an acquisition security right, a similar result may be achieved

through a reservation of title, a financial lease or a hypothec securing the sales price of a movable asset. In each of these cases, the transaction may relate to an intangible asset, including an intellectual property right, although this is not common. Finally, in yet other legal systems, it is possible to use a “mortgage” or “fixed charge” to secure the payment obligation of the purchaser of intellectual property and, in such cases, the “mortgage” or “fixed charge” may prevail over a pre-existing “floating charge”.

36. The rules on acquisition financing in the law recommended in the *Guide* are meant to rationalize and streamline different legal techniques by which creditors may obtain an acquisition security right in a tangible asset. Achieving general parity in regimes governing tangible assets and intellectual property rights would require a number of basic adjustments to the law recommended in the *Guide*. More specifically, it would be necessary:

(a) To provide explicitly that acquisition security rights can exist in intellectual property, as well as in a tangible asset;

(b) To provide that States could adopt either a unitary or a non-unitary approach to acquisition financing;

(c) To eliminate any references to possession and delivery of the encumbered asset; and

(d) To develop appropriate distinctions between the acquisition financing of the intellectual property right itself and the acquisition financing of a licence or sub-licence of that intellectual property right.

37. In addition to these general adjustments, a number of more specific adjustments would be required. These adjustments would relate to: (a) the third-party effectiveness and priority of an acquisition security right in intellectual property; (b) the priority of a security right registered in an intellectual property registry; and (c) the priority of a security right in proceeds of encumbered intellectual property. These specific adjustments are considered below in turn.

#### **1. Third-party effectiveness and priority of an acquisition security right in intellectual property**

38. In the chapter on acquisition financing, the *Guide* distinguishes between three different types of tangible asset, namely, consumer goods, inventory and assets other than inventory or consumer goods (such as equipment). The law recommended in the *Guide* provides that an acquisition security right in consumer goods (that is, goods used or intended to be used by the grantor for personal, family or household purposes; see terminology in the introduction to the *Guide*, sect. B) is automatically effective against third parties upon its creation (that is, is effective against third parties without the need for registration) and has priority against a competing non-acquisition security right (recommendation 179).

39. The law recommended in the *Guide* offers alternatives for obtaining third-party effectiveness in relation to inventory and equipment. Under one alternative, an acquisition security right in tangible assets other than consumer goods or inventory (that is, equipment) would have priority over a competing non-acquisition security right granted in the same asset by the same grantor, provided that a notice of the acquisition security right was registered in the general security rights registry within

a short period of time after the grantor obtained possession of the asset (recommendation 180, alternative A, subpara. (a)). A different rule would apply with respect to security rights in inventory (that is, in assets held by the grantor for sale, lease or licence in the ordinary course of the grantor's business; see terminology in the introduction to the *Guide*, sect. B). In this situation, registration in the general security rights registry would have to occur before delivery of the inventory to the grantor and secured creditors with earlier registered non-acquisition security rights are notified of the acquisition secured creditor's intention to claim an acquisition security right, once again before delivery of the inventory to the grantor (see recommendation 180, alternative A, subpara. (b)). By contrast, under a second alternative, no distinction would be drawn between inventory and assets other than consumer goods or inventory. Under this alternative, the rule applicable under the first alternative to assets other than inventory would apply to all types of asset other than consumer goods (see recommendation 180, alternative B).

40. To adapt the law recommended in the *Guide* to intellectual property rights, the following adjustments would be necessary. In cases in which the intellectual property that is subject to an acquisition security right is held by the grantor for personal, family or household purposes, the acquisition security right would be treated according to the same rules as those that govern an acquisition security right in consumer goods. In cases in which the intellectual property that is subject to an acquisition security right is held by the grantor for sale or licence in the ordinary course of the grantor's business, the acquisition security right would be treated according to the same rules as those that govern an acquisition security right in inventory. And in cases in which the intellectual property that is subject to an acquisition security right is not held by the grantor for sale, lease or licence in the ordinary course of the grantor's business or for personal, family or household purposes, the acquisition security right would be treated according to the same rules as those that govern an acquisition security right in tangible assets other than inventory or consumer goods. In adapting the law recommended in the *Guide* to intellectual property rights, the expression "sale, lease or license" should also be adapted to fit an intellectual property context in a manner that would be consistent with law relating to intellectual property. For example, if under law relating to intellectual property intellectual property is not properly the subject of a "sale", the term "sale" should be understood as meaning an "assignment" of intellectual property. Similarly, if under intellectual property law intellectual property is not properly the subject of a "lease", this term may not be applicable to intellectual property.

41. As intellectual property may be held for multiple purposes, reference in this chapter should always be made to the primary (or predominant) purpose for which the relevant intellectual property is held by a person. The same criterion should be used in this chapter for determining whether a transaction was in the ordinary course of business, rather than whether the transaction was based on standard terms agreed upon without negotiation. As a result, if intellectual property is held by the grantor primarily for sale or licence, a transaction relating to such intellectual property would typically be a transaction in the grantor's ordinary course of business.

42. If these adjustments were made, the rules relating to third-party effectiveness and priority of acquisition security rights in intellectual property would be as



follows. In cases where the intellectual property right is acquired for personal, family or household purposes, the acquisition security right would be automatically effective against third parties upon its creation (that is, effective against third parties without the need for registration) and would have priority against a competing non-acquisition security right (transposing recommendation 179). In cases involving inventory and equipment, it would be necessary to transpose both alternatives set out in the *Guide*. Under alternative A, an acquisition security right in intellectual property or a licence for use in the licensee's business and not for licensing or sub-licensing respectively would have priority over another security right granted in the same asset by the same grantor, provided that a notice of the acquisition security right was registered in the general security rights registry within a short period of time after the grantor acquired the intellectual property or licence (transposing recommendation 180, alternative A, subpara. (a)). Also under this alternative, an acquisition security right in intellectual property or a licence not held by the grantor for use in its business but meant for licensing or sub-licensing respectively would have priority over another security right granted in the same asset by the same grantor, provided that a notice of the acquisition security right was registered in the general security rights registry prior to the license being granted and secured creditors with earlier registered non-acquisition security rights were notified of the acquisition secured creditor's intention to claim an acquisition security right before the grant of the license (transposing recommendation 180, alternative A, subpara. (b)). Under alternative B, the regime governing intellectual property rights held for use in the grantor's business and not for licensing or sub-licensing would apply for all types of intellectual property or licences (transposing recommendation 180, alternative B).

## **2. Priority of a security right registered in an intellectual property registry**

43. As a general rule, the law recommended by the *Guide* does not seek to modify any rules set out in other law that are applicable to specialized registries whether in relation to third-party effectiveness (recommendations 34, 38 and 42) or priority (recommendations 77 and 78). This policy is also adopted in the chapter on acquisition financing (recommendation 181). Two consequences follow. Firstly, the special priority status granted to an acquisition security right over prior registered non-acquisition security rights refers only to security rights registered in the general security rights registry and not to security rights registered in specialized registries. Secondly, the general priority afforded by other law to security rights registered in specialized registries is maintained by the law recommended in the *Guide*, regardless of whether the security right is or is not an acquisition security right. Thus, the priority of an acquisition security right in intellectual property registered in an intellectual property registry does not override the priority of an earlier-registered security right registered in the intellectual property registry. If the priority rules set out by other law governing the specialized registry itself afford priority to a later-registered acquisition security right, this priority would not be affected by the law recommended in the *Guide*.

44. The approach recommended in the *Guide* is justified by the need to avoid interfering with specialized registration regimes. However, it could create an obstacle to acquisition financing to the extent an acquisition security right in intellectual property would not have a special priority status as against any type of security right registered in an intellectual property registry. As already mentioned

(see A/CN.9/700/Add.3, para. 9), States enacting the recommendations of the *Guide* may wish to review their law relating to intellectual property with a view to determining whether the registration of notices of security rights in an intellectual property registry should be permitted. States may also wish to consider extending the special priority status of an acquisition security right to an acquisition security right registered in an appropriate manner in an intellectual property registry.

45. The following example may be useful in clarifying why such a regime might merit consideration. State A that has enacted the recommendations of the *Guide* also decides to permit registration of notices of security rights in intellectual property (even future intellectual property) in the relevant intellectual property registry as a method of achieving third-party effectiveness. A bank has extended credit to the grantor, and this credit is secured by a security right in all present and future intellectual property rights of the grantor. The bank has made that right effective against third parties by registering in the specialized registry. The security right in each future item of intellectual property is not effective against third parties until the grantor acquires that item. Nonetheless, under the general priority principles recommended in the *Guide*, which the State would presumably adopt if it were to permit registration of notices of security rights in future intellectual property, priority dates from the date of registration (see recommendation 76).

46. The grantor then wants to acquire a particular item of intellectual property on credit. The seller is willing to sell on credit only if it is granted a security right in the item to secure the remaining payment obligation. Under the rules of the law recommended in the *Guide*, there is no way that the seller can achieve the status of an acquisition financier with a special priority over already registered non-acquisition security rights. If the seller registers in the intellectual property registry, it will be second in line behind the bank. That is to say, even if the seller wishing to achieve the special priority status of an acquisition security right follows all the steps necessary to claim such a right and registers a notice in the general security rights registry (see recommendation 180 as transposed), recommendation 181 will cede before the priority set out in the specialized registry (which typically provide that registration in a specialized registry always beats registration in the general registry (see recommendation 77)). Thus, if the earlier-registered security right in present and future intellectual property is registered in the relevant intellectual property registry, there is no way for an acquisition financier that takes a security right in the intellectual property being sold to achieve a special priority with respect to that property. Such a seller would have to rely on a transaction by which it retained title to the intellectual property right in question, provided that law relating to intellectual property recognized that approach (see paras. 60-63 below). The same situation could occur where: (a) the grantor seeks to acquire an exclusive licence, which is treated as a transfer of the intellectual property itself; (b) a licensor would be willing to grant a non-exclusive licence on credit if it is granted additional protection beyond that which it would get by simply terminating the licence agreement; (c) a licensee, as a sub-licensor, is willing to grant a non-exclusive sub-licence only if it can acquire a security right in the rights of a sub-licensee and any rights to payment of sub-royalties payable to the sub-licensee by a sub-sub-licensee; and (d) the acquisition financing is provided not by the owner as transferor or as licensor, nor by the licensee as sub-licensor, but by a third-party lender.

47. Under the rules of the law recommended in the *Guide*, in the examples mentioned above, there is no way that the seller, licensor or lender can achieve the status of an acquisition financier with a special priority over already registered non-acquisition security rights. Even if the seller, licensor or lender registers in the intellectual property registry, it will still be second in line behind the bank with a security right in all present and future assets of a grantor. That is to say, even if the seller, licensor or lender wishing to achieve the special priority status of an acquisition security right follows all the steps necessary to claim such a right and registers a notice in the general security rights registry (see recommendation 180 as transposed), recommendation 181 will cede before the priority set out in the specialized registry (which typically provide that registration in a specialized registry always beats registration in the general registry (see recommendation 77)). Thus, if the earlier-registered security right in present and future intellectual property is registered in the relevant intellectual property registry, there is no way for an acquisition financier that takes a security right in the intellectual property being sold or licensed to achieve a special priority with respect to that property (see paras. 56-59 below).

*[Note to the Commission: The Commission may wish to consider substituting text along the following lines for paragraphs 45-48: "A transferor or licensor of intellectual property that is subject to specialized registration can obtain the benefits of an acquisition secured creditor, since any secured creditor of a transferee or licensee can register only after the registration of the transfer or licence. For example, at the same time A registers a transfer or licence to B on credit, A registers a security right in the intellectual property to secure any outstanding payment obligation. Due to the different operation of the specialized registration (asset-specific registration), the general financier of B can only register after the transfer or licence to B is registered, A will necessarily obtain its security right before the general financier of B, A in effect has functionally the same priority benefit as with an acquisition security right. Thus, the application of the principles of an acquisition security financing right for intellectual property need only apply in cases where a security right in the intellectual property is subject to registration in the general security rights registry recommended in the Guide.]*

### **3. Priority of a security right in proceeds of encumbered intellectual property**

48. A key feature of the acquisition financing regime recommended in the *Guide* relates to the treatment of acquisition security rights in proceeds of encumbered assets. The general rule in the law recommended by the *Guide* is that the priority of a security right in proceeds should follow that of the security right in the original encumbered assets (recommendations 76 and 100). By contrast, the priority of a security right in proceeds of an asset that was subject to an acquisition security right does not automatically follow that of the initial encumbered asset. Once again, a distinction is drawn between consumer goods, inventory and assets other than inventory or consumer goods, such as equipment (see recommendation 185). As in the case of the original encumbered asset, the *Guide* offers alternatives.

49. Under alternative A, a security right in proceeds of tangible assets other than inventory or consumer goods has the same priority as the acquisition security right itself (recommendation 185, alternative A, subpara. (a)). However, a security right in proceeds of inventory only has this priority if the proceeds are not in the form of

receivables, negotiable instruments, rights to payment of funds credited to a bank account or rights to receive proceeds under an independent undertaking (recommendation 185, alternative A, subpara. (b)). Under alternative B, the security right in proceeds of the original encumbered asset has only the priority of a non-acquisition security right (recommendation 185, alternative B). The consequence is that, when either of the alternatives of recommendation 185 is transposed to acquisition security rights in intellectual property, the revenue stream generated by the licensing or sub-licensing of an intellectual property right continues to be encumbered with the security right. An additional consequence is that the security right in the royalties will not have the special priority of an acquisition security right.

50. It might be argued that this direct transposition is not optimal in the case of acquisition security rights in intellectual property. For example, intellectual property owners and licensors typically rely on their rights to payment of royalties so as to be able to develop new ideas protected by intellectual property rights and give a licence to others to use them. Additionally, if the rights of secured creditors with an all-asset security right in rights of licensees always had priority over the rights of secured creditors in rights of intellectual property owners or licensors, owners or licensors would not be able to effectively use their rights to payment of royalties as security for credit. By contrast, it might also be argued that intellectual property owners and licensors could achieve an equivalent result by ensuring that they or their secured creditors: (a) obtained a security right in or an outright assignment of a right to payment of a percentage of the sub-royalties payable to the licensee as a sub-licensor by sub-licensees and registered a notice thereof in the relevant intellectual property registry before any registration in that registry by a secured creditor of the licensee; (b) obtained a security right in or an outright assignment of a right to payment of a percentage of the sub-royalties payable to the licensee as a sub-licensor by sub-licensees and registered first a notice thereof in the general security rights registry; or (c) obtained a subordination agreement from the secured creditor of the licensee.

51. As the objective of transposing the recommendations of the *Guide* to the intellectual property context is to ensure a parity of treatment between acquisition security rights in tangible assets and acquisition security rights in intellectual property, it is preferable to retain the same outcome in both cases. This would be particularly important where a grantor created a general security right over all its present and future tangible and intangible assets. As a result, in the draft Supplement, it is recommended that the rules recommended in the *Guide* with respect to security rights in proceeds of original encumbered tangible assets subject to an acquisition security right be transposed without further modification into the regime governing acquisition financing of intellectual property. This result achieves an appropriate balance between the needs of the licensor to collect royalties and the needs of the financier extending credit to the licensee based on the licensee's rights to the payment of sub-royalties. For example, upon the licensee's default in the payment of royalties, the licensor will normally have the right to terminate the licence agreement and recover the licensed intellectual property. If the licensee's secured creditor (whose security right in the rights to payment of royalties as proceeds of intellectual property will have priority over the security right of the licensor's secured creditor) wants to be able to obtain benefits from the licensed intellectual property, the secured creditor will need to cure the default, paying past

due and even future royalties. Alternatively, if the licensee's secured creditor does not want to do so, it may be able to retain the royalties already collected, but would be unable to collect future royalties if the licensor terminates the licence agreement. This means that, from the licensor's perspective, the essential risk is for royalties collected by the licensee or its secured creditor but not paid to the licensor. The licensor may address this risk by contractual terms relating to the timing of accounting and payments.

**4. Examples illustrating how the acquisition financing recommendations of the *Guide* could apply in an intellectual property context**

52. The following may be useful in clarifying how the recommendations of the *Guide* could apply in an intellectual property context. In all these examples, the owner or a later secured creditor financing the acquisition of intellectual property or a licence in intellectual property has an acquisition security right with special priority over a non-acquisition security right under the conditions described in the examples.

**(a) Acquisition security right in intellectual property securing the purchase price of the intellectual property used in the grantor's business**

53. B creates a security right in all of its present and future movable assets (including intellectual property) in favour of SC, who takes the actions necessary to make that security right effective against third parties. Subsequently, B acquires a patent from O to be used in B's business. Pursuant to the agreement between B and O, B agrees to pay the purchase price to O over time and B grants O a security right in the patent to secure B's obligation to pay the purchase price. O makes that security right effective against third parties within a short period of time such as 20 or 30 days after B obtains the patent. O's security right is an acquisition security right and has priority over the security right of SC (see recommendation 180, alternative A, subpara. (a), or alternative B, subpara. (b)). Whether the priority of O's security right extends to proceeds of the patent in the form of receivables, negotiable instruments, rights to payment of funds credited to a bank account or rights to receive proceeds under an independent undertaking depends on which version of recommendation 185 a State enacts. Under alternative A, the priority of O's security right carries over into the proceeds (see recommendation 185, alternative A, subpara. (a), as transposed). Under alternative B, O's security right in the proceeds would have only the priority of a non-acquisition security right (see recommendation 185, alternative B, as transposed).

**(b) Acquisition security right in intellectual property securing the purchase price of the intellectual property used for sale or licence**

54. B creates a security right in all of its present and future movable assets (including intellectual property) in favour of SC1, who takes the actions necessary to make the security right effective against third parties. Subsequently, B acquires a patent from O for the purpose of licensing it to third parties in the ordinary course of B's business. B obtains the money necessary to pay the purchase price to O by borrowing money from SC2, to whom B grants a security right in the patent to secure B's repayment obligation. Before B obtains the patent, SC2: (a) takes the actions necessary to make its security right effective against third parties; and

(b) notifies SC1 that SC2 will have an acquisition security right. SC2's security right is an acquisition security right and has priority over the security right of SC1 (see recommendation 180, alternative A, subpara. (b), and alternative B, subpara. (b), as transposed). The priority of SC2's security right does not extend to proceeds of the patent in the form of receivables, negotiable instruments and rights to payment of funds credited to a bank account or rights to receive proceeds under an independent undertaking, although it does extend to other types of proceeds (see recommendation 185, alternative A, subpara. (b), and alternative B, as transposed).

**(c) Acquisition security right in an intellectual property licence securing the purchase price of the licence used in the grantor's business**

55. B has created a security right in all of its present and future movable assets (including intellectual property) in favour of SC, who has taken the actions necessary for that security right to be effective against third parties. Subsequently, B obtains a licence from O to use a patent owned by O in B's business. B agrees to pay the licence fee to O over time and grants O a security right in B's rights as licensee to secure B's payment obligation. O makes that security right effective against third parties within a short period of time such as 20 or 30 days after B obtains the licence. O's security right in B's rights under the licence agreement is an acquisition security right and has priority over the security right of SC (see recommendation 180, alternative A, subpara. (a), or alternative B, subpara. (b)). Whether the priority of O's security right extends to proceeds of B's rights as licensee in the form of receivables, negotiable instruments and rights to payment of funds credited to a bank account or rights to receive proceeds under an independent undertaking depends on which version of recommendation 185 a State enacts. Under alternative A, the priority of O's security right carries over to the receivables (see recommendation 185, alternative A, subpara. (a), as transposed). Under alternative B, O's security right in the receivables would have only the priority of a non-acquisition security right (see recommendation 185, alternative B, as transposed). It should be noted that O's rights pursuant to its security right are separate from and subject to different requirements than are O's rights under the licence agreement to terminate the licence agreement upon B's default in its obligations under the licence agreement.

**(d) Acquisition security right in an intellectual property licence securing the purchase price of the licence used for sale or licence**

56. B grants a security right in all of its present and future movable assets (including intellectual property) to SC1, who takes the actions necessary to make the security right effective against third parties. Subsequently, B obtains a licence from O, the patent owner, for the purpose of sub-licensing the patent to third parties in the ordinary course of B's business. B obtains the money necessary to pay its licence fee by borrowing money from SC2, to whom B grants a security right in B's rights as licensee to secure B's repayment obligation. Before B obtains the licence, SC2: (a) takes the actions necessary to make its security right effective against third parties; and (b) notifies SC1 that SC2 will have an acquisition security right. SC2's security right is an acquisition security right and has priority over the security right of SC1 (see recommendation 180, alternative A, subpara. (b), and alternative B, subpara. (b), as transposed). The priority of SC2's security right does not extend to proceeds of the licence in the form of receivables, negotiable instruments and rights

to payment of funds credited to a bank account, although it does extend to other types of proceeds (see recommendation 185, alternative A, subpara. (b), and alternative B, as transposed).

**(e) Acquisition security right in an intellectual property licence securing the purchase price of the licence used in the grantor's business and for sale or licence**

57. Software Company B acquires the intellectual property rights for an operating system for personal computers in a transaction pursuant to which it grants a security right in the operating system to SC to secure B's obligation to pay the purchase price. B acquires the operating system so as to offer a licence of that operating system to any person who is willing to pay the licence fee and agree to comply with the terms of the licence agreement. B will also utilize the operating system on the personal computers owned by B. Because the predominant use of the operating system by B is to hold it for sale or licence to others, the rules that apply to acquisition security rights in inventory apply to SC's acquisition security right.

58. Manufacturer B acquires a patent for a piece of manufacturing equipment in a transaction pursuant to which it grants a security right in the patent to SC to secure B's obligation to pay the purchase price. B will use the patent in its own business and will not generally offer it for licence to others. However, B grants licences to use the patent to two of its subsidiaries. Because it is not the predominant use of the patent by B to hold it for sale or licence to others, the rules that apply to acquisition security rights in assets other than inventory or consumer goods apply to SC's acquisition security right.

**C. Non-unitary approach**

59. Section B of this chapter addresses the issue of intellectual property acquisition financing on the hypothesis that a State adopts the "unitary approach" to acquisition financing as provided in recommendations 178-186 of the *Guide*. They are based on the assumption that, if a State adopts the unitary approach to acquisition financing of tangible assets, it would also adopt the unitary approach to acquisition financing of intellectual property. To do otherwise would risk creating unnecessary confusion in relation to creation, third-party effectiveness, priority and enforcement of transactions providing for acquisition financing.

60. For the same reasons, if a State adopts the "non-unitary approach" to acquisition financing of tangible assets, it is reasonable to assume that the State would also adopt the non-unitary approach to acquisition financing of intellectual property. The non-unitary approach to acquisition financing of intellectual property rights might be reflected, for example, by contractual terms providing for a conditional transfer (which, under law relating to intellectual property, may include a conditional exclusive licence), a retention-of-title right, a financial lease right or a similar transaction with respect to an intellectual property right. Under the non-unitary approach, in addition, it is possible for an owner or for a third-party financier such as a bank to take an acquisition security right of the type available under the unitary approach.

61. Each of these acquisition financing transactions can be adapted relatively easily to the financing of intellectual property rights. Unlike the case with the

unitary approach, however, it is not possible to directly transpose the recommendations governing retention-of-title rights and financial lease rights to situations where the licensee is acquiring a non-exclusive licence. In these situations, there is no particular right that is being retained by the licensor in addition to its continuing right as owner (subject to the terms of the licence). The normal remedy for the licensor in such cases is simply to revoke the licence. By contrast, a non-licensor acquisition financier (for example, a bank that finances acquisition of the licence by the licensee) would take an ordinary acquisition security right in the licensee's rights.

62. In drafting provisions to enact a non-unitary regime for acquisition financing, States would have to take into account two considerations. Firstly, in order to ensure the same functional outcomes as would result were the unitary approach to be adopted, States will have to address all the issues covered by the recommendation relating to the unitary approach as set out in this chapter (see recommendation 247). Secondly, specific provisions of the law to be enacted would have to be adjusted in the same manner that, for tangible assets, recommendations 192-194 and recommendation 199 of the *Guide* (non-unitary approach) were adjusted to mirror recommendations 180 and 185 of the *Guide* (unitary approach) respectively. In other words, to achieve a non-unitary regime for acquisition financing of intellectual property rights, States would need to provide detailed rules to address issues of third-party effectiveness and the transformation of a transferee's ownership right, retention-of-title or similar right into a security right in the proceeds of the intellectual property that was transferred or title in which was retained (for a discussion of these adjustments in the case of the *Guide*'s non-unitary approach to acquisition financing, see the *Guide*, chap. IX).

## **Recommendation 247<sup>2</sup>**

### **Application of acquisition security right provisions to security rights in intellectual property**

247. The law should provide that the provisions on an acquisition security right in a tangible asset also apply to an acquisition security right in intellectual property or a licence of intellectual property. For the purpose of applying these provisions:

- (a) Intellectual property or a licence of intellectual property:
  - (i) Held by the grantor for sale or licence in the ordinary course of the grantor's business is treated as inventory; and
  - (ii) Used or intended to be used by the grantor for personal, family or household purposes is treated as consumer goods; and
- (b) Any reference to:
  - (i) Possession of the encumbered asset by the secured creditor does not apply;

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<sup>2</sup> If it could be included in the *Guide*, this recommendation would be placed in chapter IX, Acquisition financing, as recommendation 186 bis.



(ii) The time of possession of the encumbered asset by the grantor refers to the time the grantor acquires the encumbered intellectual property or licence of intellectual property; and

(iii) The time of the delivery of the encumbered asset to the grantor refers to the time the grantor acquires the encumbered intellectual property or licence of intellectual property.

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