United Nations A/CN.9/WG.VI/WP.37

General Assembly

Distr.: Limited
9 February 2009

Original: English

United Nations Commission on International Trade Law
Working Group VI (Security Interests)
Fifteenth session
New York, 27 April-1 May 2009

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

Note by the Secretariat

Contents

V.09-80675 (E)

I. Introduction

A. Background

[*Note to the Working Group: For paras. 1-8, see A/CN.9/WG.VI/WP.35, paras. 1-7, A/CN.9/667, para. 16, A/CN.9/WG.VI/WP.36, para. 12, 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]

---

[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.

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 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]

8. At its fourteenth session (Vienna, 20-24 October 2008), the Working Group continued its work based on a note prepared by the Secretariat entitled "Annex to the UNCITRAL Legislative Guide on Secured Transactions dealing with security rights in intellectual property (A/CN.9/WG.VI/WP.35 and Add.1). At that session,

---

[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-second Session, Supplement No. 17* (A/62/17), para. 326.

the Working Group requested the Secretariat to prepare a revised version of the draft Annex reflecting the deliberations and decisions of the Working Group (see A/CN.9/667, para. 15). The Working Group also referred to Working Group V (Insolvency Law) certain matters relating to the impact of insolvency on a security right in intellectual property (see A/667, paras. 129-140). In that connection, it was widely felt that every effort should be made to conclude discussions of these matters as soon as possible, so that their results could be included in the draft Annex by the fall of 2009 or the early spring of 2010 and the draft Annex could be submitted to the Commission for final approval and adoption at its forty-third session in 2010 (see A/CN.9/667, para. 143).

B. The interaction between secured transactions law and law relating to intellectual property

[*Note to the Working Group: For paras. 9-14, see A/CN.9/WG.VI/WP.35, paras. 8-11, A/CN.9/667, paras. 17-19 and A/CN.9/WG.VI/WP.33, paras. 76-82*.]

9. With only limited exceptions, the recommendations of the *Guide* apply to security rights in all types of movable asset, including intellectual property (see recommendations 2 and 4-7). With respect to intellectual property, the law recommended in the *Guide* does not apply in so far as its provisions are inconsistent with national law or international agreements, to which the State enacting the law is a party, relating to intellectual property (see recommendation 4, subparagraph (b)).

10. Recommendation 4, subparagraph (b), sets out the basic principle with respect to the interaction of secured transactions and intellectual property law. The meaning given to the term "intellectual property" is intended to ensure consistency of the *Guide* with intellectual property laws and treaties (see para. 15 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. The scope of recommendation 4, subparagraph (b), will, consequently, be broader or narrower, depending on how a State defines the scope of intellectual property. It is understood that a State will do so 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"), as provided in those treaties.

11. 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 law relating to intellectual property. 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 A/CN.9/WG.VI/WP.37/Add.1, section II.A.4), 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.

12. It bears noting, however, that rules of law relating to intellectual property in some States relate only to forms of secured transactions that are not unique to

intellectual property 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 law relating to intellectual property to coordinate it with the secured transactions law recommended in the *Guide*. In that connection, States enacting the law recommended in the *Guide* will have to ensure that their law reflects in particular the integrated and functional approach recommended in the *Guide*, without modifying the basic policies and objectives of their law relating to intellectual property.

13. 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 intellectual property 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, have priority and be enforced as provided in the general recommendations of the *Guide*.

14. 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 coordinate their secured transactions law with their law relating to intellectual property.

C. Terminology

[*Note to the Working Group: For paras. 15-32, see A/CN.9/WG.VI/WP.35, paras. 12-21, A/CN.9/667, paras. 20-22, A/CN.9/WG.VI/WP.33, paras. 39-60, and A/CN.9/649, paras. 104-107*.]

(a) Intellectual property

15. As already mentioned, the *Guide* uses the term "intellectual property", referring to intellectual property rights, such as copyrights, trademarks and patents. Thus, references in the *Guide* to "intellectual property" are to be understood as references to "intellectual property rights", such as the rights of an author or inventor (an "owner"), or a lesser rights holder, such as licensor, that is not an owner, or a licensee. The commentary explains that the meaning given to the term

"intellectual property" in the *Guide* is intended to ensure consistency of the *Guide* with law relating to intellectual property, while at the same time respecting the right of a State enacting the recommendations of the *Guide* to align the definition with its own law (national law and treaties). That is, as already mentioned, the *Guide* treats as "intellectual property", for the purposes of the *Guide*, whatever an enacting State considers to be intellectual property in compliance with its international obligations.

16. For purposes of secured transactions law, the intellectual property right itself is distinct from the income streams that flow from it, such as the income received from the exercise of broadcasting rights. In addition, a licence agreement is not a secured transaction and does not create a security right. Thus, secured transactions law does not affect the rights and obligations of a licensor or a licensee under a licence agreement. For example, the owner's or lesser rights holder's ability to limit the transferability of its intellectual property rights remains unaffected.

(b) Law and law relating to intellectual property

17. As also already mentioned, the commentary also clarifies that references to the term "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. In particular, the expression "law relating to intellectual property" means law that governs specifically security rights in intellectual property, and not law that generally governs security rights in various types of asset and that may happen to govern security rights in intellectual property. An example of such a "law relating to intellectual property" might be intellectual property law that applies specifically to pledges of rights in software.

(c) Security right

18. The *Guide* uses the term "security right" to refer to all types of property right in a movable asset that are created by agreement to secure payment or other performance of an obligation, irrespective of how they are denominated. Thus, the term "security right" would cover the right of a pledge or mortgagee of intellectual property, as well as of transferee in a transfer for security purposes. States that adopt the recommendation of the *Guide* may wish to review their law relating to intellectual property and coordinate the terminology used in that law with the terminology used in the law recommended in the *Guide*.

(d) Licence

19. 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. In addition, under the *Guide*, a licence agreement does not create a security right and a right to terminate a licence agreement is not a security right.

20. However, the exact meaning of these terms is left to law relating to intellectual property, as well as to 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)[8] and the Singapore Treaty on the Law of Trademarks (2006)).[9] 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".

21. In addition, the *Guide* does not affect in any way the particular characterization of rights under a licence agreement given by law relating to intellectual property. For example, the *Guide* does not affect the nature of rights created under an exclusive licence agreement as rights in rem or the nature of an exclusive licence as a transfer, as is the case under some laws relating to intellectual property. Moreover, the *Guide* does not affect any limitations included in the licence agreement as to the transferability of licensed rights.

(e) Encumbered asset

22. The *Guide* uses the term "encumbered asset" to denote an asset that is subject to a security right. While the *Guide* refers by convention to "a security right in an encumbered asset", what is really encumbered and meant is "a security right in whatever right the grantor has in an encumbered asset". The point is clear when a lessee encumbers its limited rights in a movable asset or in immovable property, but less clear when the encumbered asset is an intellectual property right. With respect to intangible assets such as intellectual property rights, the additional complication is that they may exist without material support. For example, a copyright in music may exist without it being recorded or performed or even transcribed onto a music sheet. The copyright arises as a moral right from its inception, even though some form of material support may be necessary for purposes of evidence or registration (where registration is foreseen under law relating to copyright).

23. The *Guide* also uses various terms to denote the particular type of intellectual property that may be used as an encumbered asset without interfering with the nature, the content or the legal consequences of such terms for purposes of intellectual property, contract or property law. These types of intellectual property that may be used as security for credit are the rights of an author or inventor (an "owner"), the rights of a lesser rights holder that is not an owner such as a licensor or licensee under a licence agreement, and the rights in intellectual property used with respect to a tangible asset. The owner or lesser rights holder can transfer all its rights to a transferee and that transferee becomes an owner or rights holder. The owner or lesser rights holder may also transfer only part of its rights to a licensee and to that extent the licensee becomes a rights holder.

24. The term "owner" refers to the person that is entitled to enforce the exclusive rights flowing from intellectual property or its transferee (i.e. the creator, author or inventor and its successor). The term "rights holder" refers to a person that has some rights (e.g. a licensee typically has the right to use the licensed intellectual property). A secured creditor (or, in some States, an exclusive licensee) may be an

---

[8] http://www.wipo.int/export/sites/www/about-ip/en/development_iplaw/pdf/pub835.pdf.

[9] http://www.wipo.int/treaties/en/ip/singapore.

owner or a rights holder, provided that that is the will of the parties and that law relating to intellectual property permits it.

25. The rights of a licensor include the right to claim payment of royalties. The rights of a licensee include the licensee's authorization to use the licensed intellectual property in accordance with the terms of the licence agreement and possibly the right to enter into sub-licence agreements and the right to obtain payment of sub-royalties. The rights of a grantor of a security right in a tangible asset with respect to which intellectual property is used are described in the agreement between the secured creditor and the grantor (owner or lesser rights holder of the relevant intellectual property) in line with secured transactions law and law relating to intellectual property.

(f) Receivable and assignment

26. The term "receivable" is used in the *Guide* and in the United Nations Assignment Convention to reflect a right to payment of a monetary obligation and thus, for the purposes of the *Guide*, includes the right of a licensor (that may be an owner or a lesser rights holder) to obtain payment of licence royalties (without affecting terms and conditions of the licence agreement relating to the payment of royalties, such as that payments are to be staggered or that there might be percentage payments depending on market conditions or sales figures).

27. The term "assignment" is used in the *Guide* with respect to receivables to denote not only outright transfers but also 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 an intellectual property owner. While the term "assignment" used with respect to receivables includes "outright assignments of receivables", the term "transfer" used with respect to intellectual property rights does not include the outright transfer of intellectual property rights. Similarly, the term "transfer" is not used in the *Guide* to denote a licence agreement. Whether a licence agreement is a transfer under law relating to intellectual property is a different matter.

(g) Grantor

28. As already mentioned, in a secured transaction relating to intellectual property, the encumbered asset may be the intellectual property rights of the intellectual property owner or the rights of a holder of lesser rights, such as the rights of a licensor or the authorization of the licensee to use the licensed intellectual property and perhaps the right to grant sub-licences and receive payment of sub-royalties. Thus, depending on the kind of asset that is encumbered, the term "grantor" will refer to an owner or a lesser rights holder, such as a licensor or 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.

(h) Competing claimant

29. 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" in the sense of a claimant that competes with a secured creditor (i.e. another secured creditor with a security right in the same asset, another creditor of the grantor that has a right in the same asset, the insolvency representative in the insolvency of the grantor, or a buyer or other transferee or a lessee or licensee of the same asset). The term competing claimant is essential for the application in particular of the priority rules recommended in the *Guide*, such as for example of the rule in recommendation 76, under which a secured creditor with a security right in receivables that registered a notice of its security right in the general security rights registry has priority over another secured creditor that received a security right in the same receivables by the same grantor before the other secured creditor but failed to register.

30. In law relating to intellectual property, however, the notion of a "competing claimant" is not used, and priority conflicts typically refer to conflicts among transferees and licensees, even if no conflict with a secured creditor is involved (infringers are not competing claimants and, if they are only alleged infringers that prove that they have a legitimate claim, they are transferees or licensees, and not infringers). Secured transactions law does not interfere with the resolution of such conflicts that do not involve a secured creditor, unless, of course, the transfer is a transfer for security purposes, which is treated as a secured transaction. Thus, a conflict between two outright transferees would not be covered by the *Guide*. However, a conflict between an outright transferee of intellectual property rights and a transferee for security purposes of the same intellectual property rights by the same grantor would be covered by the *Guide* (subject to the limitation of recommendation 4, subparagraph (a)).

(i) Secured creditor

31. The *Guide* recognizes that a security agreement creates a security right, that is, a limited property right, not an ownership right, in an encumbered asset, provided, of course, that the grantor has the right to create a security right in the asset. 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 approach is mainly intended to protect the grantor/owner that retains ownership and often possession or control of the encumbered asset, while sufficiently securing the secured creditor if the grantor or other debtor defaults on the payment of the secured obligation. In any case, secured creditors normally 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 necessarily become an owner. In this case, the secured creditor merely exercises its 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.

32. For the purposes of secured transactions law, this characterization of a security agreement and the rights of a secured creditor applies to situations where the encumbered asset is intellectual property. However, the *Guide* does not affect different characterizations under law relating to intellectual property law with respect to matters specific to intellectual property. Under law relating to intellectual property, a security agreement may be characterized as a transfer of the intellectual property rights of an owner and the secured creditor may have the rights of an owner (or a lesser rights holder), such as to deal with State authorities, grant licences or sue infringers. So, for example, nothing in secured transactions law prevents a secured creditor from agreeing with the grantor/owner (or lesser rights holder) to become an owner (or a lesser rights holder) of the encumbered intellectual property. If the agreement does or is intended to secure the performance of an obligation and intellectual property law permits a secured creditor to become an owner (or a lesser rights holder), the term "secured creditor" may denote an owner (or a lesser rights holder) to the extent permitted under law relating to intellectual property. In such a case, secured transactions law will apply with respect to issues normally addressed in that law, such as the creation, third-party effectiveness, priority and enforcement of a security right; and law relating to intellectual property will apply with respect to issues that are normally addressed in that law, such as dealing with State authorities, granting licences or suing infringers.

D. Examples of intellectual property financing practices

[*Note to the Working Group: For paras. 33-46, see A/CN.9/WG.V/WP.35, paras. 22-41, A/CN.9/667, paras. 23-24, A/CN.9/WG.VI/WP.33, paras. 8-21, and A/CN.9/649, para. 108*.]

33. 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.

34. 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 (i.e. the rights of an owner, the rights of a licensor or the rights of a licensee). 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 4 below each involve such a situation. In examples 1 and 2, the encumbered assets are the rights of an owner. In example 3, the encumbered assets are the rights of a licensor, and, in example 4, the encumbered assets are the rights of a licensee.

35. The second category of transactions involves situations in which assets other than intellectual property rights, such as inventory or equipment, serve as security for credit, but 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 5 and 6.

36. 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 7, which involves a credit facility to a manufacturer, secured by a security right covering substantially all of the manufacturer's assets, including its intellectual property rights.

37. Each of the examples illustrates how owners, licensors and licensees of intellectual property rights, or owners of assets that rely for their value on intellectual property, 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 owners of the intellectual property, will affect the lender's willingness to extend the requested credit and the cost of such credit. 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.[10]

38. A practical question applicable to all examples is how the borrower can ensure that it receives an accurate appraisal of the value of its intellectual property. Valuation of assets to be encumbered is an issue that any prudent secured creditor will have to address irrespective of the type of asset to be encumbered. However, valuation of intellectual property is harder as it raises the issue whether intellectual property may be exploited economically to generate income. For example, once a patent is created, the question arises whether it has any commercial application and, if so, what would be the amount of income that could be generated from the sales of any patented product.

39. 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 appraising the value of 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. National authorities develop valuation methodologies. In addition, international organizations, such as WIPO, provide training for valuation of intellectual property in general or for the purpose of licence agreements in particular. Moreover, other international organizations, such as the Organization for Economic Cooperation and Development, have developed standards for the valuation of intellectual property as assets that can be used as security for credit.

---

[10] 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.

Example 1 (rights of an owner in a portfolio of patents and patent applications)

40. 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. Bank A evaluates which patents and patent applications it will include in the "borrowing base" (that is, the pool of patents and patent applications to which Bank A will agree to attribute 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 and valuation 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 (rights of a licensor in royalties from the licence of comic characters)

41. Company B, 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 B wishes to borrow money from Bank B secured by the anticipated stream of royalty payments arising under these licence agreements. Company B provides Bank B with a list of the licences, the credit profile of the licensees, and the status of each licence agreement. Bank B then requires Company B 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 B until further notice.

Example 3 (rights of a licensor in royalties from the licence of a motion picture)

42. Company C, a motion picture company, wishes to produce a motion picture. Company C 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 C 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 C, Bank C and the distributor/licensee enter into an "acknowledgement and assignment" agreement under which the licensee acknowledges the prior security right of Bank C and the assignment of its royalty payments to Bank C, while Bank C agrees that, in case of enforcement of its security right in the licensor's rights, it will not terminate the licence so long as the licensee makes payments and otherwise abides by the terms of the licence agreement.

Example 4 (authorization of a licensee to use licensed software)

43. Company D 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 D also incorporates into its products software components that it licenses from third parties (and then sub-licences to its customers). Company D wishes to borrow money from Bank D secured by a security right in its rights as licensee of intellectual property from third parties, that is, its right to use and incorporate into its software some software components that it licenses from third parties. For evidence, the software developer can provide Bank D with a copy of its software components licence.

Example 5 (rights of a manufacturer of trademarked inventory)

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

Example 6 (rights of a distributor of trademarked inventory)

45. Company F, one of Company E's distributors, wishes to borrow money from Bank F secured in part by its inventory of designer jeans and other clothing that it purchases from Company E, a significant portion of which bears well-known trademarks licensed by Company F from third parties. Company F provides Bank F with invoices from Company E evidencing that it acquired the jeans in an authorized sale, or copies of the agreements with Company E evidencing that the jeans distributed by Company F are genuine. Bank F extends credit to Company F against the value of the inventory.

Example 7 (security right in all assets of an enterprise)

46. Company G, 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 G's existing and future assets, including all existing and future intellectual property rights that it owns or licenses from third parties.

E. Key objectives and fundamental policies

[*Note to the Working Group: For paras. 47-53, see A/CN.9/WG.VI/WP.35, paras. 42-45, A/CN.9/667, paras. 25-28, A/CN.9/WG.VI/WP.33, paras. 61-75, and A/CN.9/649, paras. 88-97*.]

47. 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 B, 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 D, 3, of the *Guide*).

48. 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 not interfering with the legitimate rights of the owners, licensors and licensees of intellectual property under law relating to intellectual property, contract or general property law. 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));

(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)).

49. A general policy of law relating to intellectual property law is to encourage the creation and dissemination of new ideas or discoveries. To accomplish this general policy, law relating to intellectual property accords certain exclusive rights to intellectual property owners and lesser rights holders, such as licensors or licensees. 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 law relating to intellectual property. The principle is set out in

recommendation 4, subparagraph (b) (see A/CN.9/WG.VI/WP.37/Add.1, section II, A, 4).

50. 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 an owner or lesser rights holder, such as a licensor or licensee, may exercise or impede their rights to preserve the value of their intellectual property rights by preventing their unauthorized use. In this regard, it should be emphasized that 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 law relating to intellectual property to prevent unauthorized use of intellectual property or to protect the value of intellectual property and thus to encourage further innovation and creativity.

51. Similarly, this key objective of promoting secured credit while not interfering with the objectives of law relating to intellectual property means that neither the existence of the secured credit regime nor the creation of a security right in intellectual property should diminish the value of intellectual property. Thus, for example, it is important to note that the creation of a security right in intellectual property should not be misinterpreted as constituting an 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) by the owner or the secured creditor.

52. 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).

53. Finally, secured transactions law should not provide that the purported creation of a security right in the rights of a licensee that are, as a matter of law relating to intellectual property, not transferable except with the consent of the licensor results in the transfer of such rights without the consent of the owner.