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

Note by the Secretariat

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I. Introduction

A. Background

[*Note to the Working Group: For paras. 1-12, see A/CN.9/WG.VI/WP.37, paras. 1-8, A/CN.9/670, paras. 17 and 117, A/CN.9/WG.VI/WP.37/Add.4, chapter XI, note to the Working Group, paras. 1-4, 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 and 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 (for example, 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

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

[2] Ibid., para. 83.

[3] Ibid., para. 86.

adjustments that would need to be made to the draft Guide to address issues specific to intellectual property financing.[4]

4. At the first part of its fortieth session (Vienna, 25 June–12 July 2007), the Commission considered a note by the Secretariat entitled "Possible future work on 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). That note included a brief discussion of insolvency-related matters. 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.[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, the Working Group requested the Secretariat to prepare a revised version of the draft

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

[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 and 100.

[7] Ibid., *Sixty-second Session, Supplement No. 17* (A/62/17 (Part I)), para. 326.

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/CN.9/667, paras. 129-143). 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).

9. At its thirty-fifth session (Vienna, 17-21 November 2008), Working Group V reviewed the issues involving insolvency law referred to it by Working Group VI for inclusion in the draft Annex and confirmed that the responses given in the table at the end of document A/CN.9/667 accurately reflected the impact of the Insolvency Guide. In that connection, it was suggested that those considerations might be included in a commentary to be prepared. With respect to the possibility that a licensee under a licence agreement rejected by the insolvency representative of the licensor might be permitted, under some laws, to continue to exercise its rights under that agreement notwithstanding the rejection, the Working Group agreed that it was not in a position to properly consider that question without a better understanding of the scope and extent of the issues involved and requested the Secretariat to prepare a working paper, for consideration at its next session, that would provide background information on the discussion of the treatment of contracts that had taken place in the course of the development of the Insolvency Guide and the recommendations that had been adopted. Working Group V reached the same conclusion with respect to the issue of whether a secured creditor could request the licensor's insolvency representative or the insolvency court to set a deadline within which the insolvency representative should decide whether to continue or reject a licence agreement and set a special hearing before the insolvency court to address any dispute (see A/CN.9/666, paras. 112-117).

10. At its fifteenth session (New York, 27 April–1 May 2009), the Working Group continued its work based on a note prepared by the Secretariat entitled "Draft Annex to the UNCITRAL Legislative Guide on Secured Transactions dealing with security rights in intellectual property" (A/CN.9/WG.VI/WP.37 and Add.1-4). At that session, 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.9/670, para. 16). In addition, the Working Group, having taken note of a note by the Secretariat entitled "Discussion of intellectual property in the Legislative Guide on Insolvency Law" (A/CN.9/WG.V/WP.87), approved the substance of the discussion of the impact of insolvency of a licensor or licensee of intellectual property on a security right in that party's rights under a licence agreement (see A/CN.9/WG.VI/WP.37/Add.4) and referred it to Working Group V (see A/CN.9/670, paras. 116-122). Moreover, the Working Group had a preliminary discussion about its future work programme (see A/CN.9/670, paras. 123-126).

11. At its thirty-sixth session (New York, 18-22 May 2009), Working Group V (Insolvency Law) considered the insolvency-related issues referred to it by Working Group VI on the basis of documents A/CN.9/WG.V/WP.87 and A/CN.9/WG.VI/WP.37/Add.4 and an extract from the report of the Working Group (see A/CN.9/670, paras. 116-122). At that session, Working Group V approved the

contents of those parts of the draft Annex dealing with the impact of insolvency of a licensor or licensee of intellectual property on a security right in that party's rights under a licence agreement, as set forth in document A/CN.9/WG.VI/WP.37/Add.4, paragraphs 22-40, and the conclusions and revisions of Working Group VI reached at its fifteenth session (see A/CN.9/670, paras. 116-122).

12. At its sixteenth session (Vienna, 2-6 November 2009), the Working Group continued its work based on a note prepared by the Secretariat entitled "Draft Supplement to the UNCITRAL Legislative Guide on Secured Transactions dealing with security rights in intellectual property" (A/CN.9/WG.VI/WP.39 and Add.1-7). […]

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

[*Note to the Working Group: For paras. 13-18, see A/CN.9/WP.37, paras. 9-14, A/CN.9/670, para. 18, 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*.]

13. 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 insofar 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)).

14. 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 paras. 26-28 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. The term "law relating to intellectual property" is used in the Supplement to refer to national law or law flowing from international agreements, to which a State is a party, relating to intellectual property 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 (see para. 29 below).

15. 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.39/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.

16. 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* (for example, 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.

17. The Supplement 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 Supplement 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 Supplement, 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*.

18. While it is not the purpose of the Supplement 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 Supplement 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[8]

[*Note to the Working Group: For paras. 19-39, see A/CN.9/WG.VI/WP.37, paras. 15-32, A/CN.9/670, paras. 19 and 20, A/CN.9/WG.VI/WP.35, paras. 12-21,*

[8] For the easy reference of the reader, the Supplement follows the order in which the issues are discussed in the *Guide* (that is, Introduction with terminology, examples and key objectives and fundamental polices, Scope, Creation of a security right etc.).

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) Competing claimant

19. In secured transactions law, the concept of a "competing claimant" is used to identify parties other than the secured creditor in a specific security agreement that might claim a right in an encumbered asset or the proceeds from its disposition (see term "competing claimant", Introduction to the *Guide*, para. 20). Thus, the *Guide* uses the term "competing claimant" in the sense of a claimant that competes with a secured creditor (that is, 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, 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 acquired a security right in the same receivables by the same grantor before the other secured creditor but failed to register.

20. 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 (including a transferee in a transfer for security purposes, who is treated in the *Guide* as a secured creditor). 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)).

(b) Encumbered asset

21. 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 "whatever right the grantor has in an asset and intends to encumber".

22. 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 law relating to intellectual property, as well as contract and property law. These types of intellectual property that may be used as security for credit include the rights of an intellectual property owner ("owner"), the rights of an assignee or successor in title to an owner, the rights of a licensor or licensee under a licence agreement and the rights in intellectual property used with respect to a tangible asset, provided that the intellectual property right is described as an encumbered asset in the security agreement. The owner, licensor or licensee may encumber all or part of its rights.

23. Under law relating to intellectual property, the rights of an intellectual property owner generally include the right to prevent unauthorized use of its intellectual property, the right to renew registrations and the right to transfer and grant licences in its intellectual property. For example, in the case of a patent, the patent owner has exclusive rights to prevent certain acts, such as making, using or selling the patented product without the patent owner's authorization.

24. Typically, under law relating to intellectual property law and contract law, the rights of a licensor and a licensee depend on the terms of the licence agreement (in the case of a contractual licence), law (in the case of compulsory or statutory licence) or the legal consequences of specific conduct (in the case of an implied licence). In addition, normally, the rights of a licensor include the right to claim payment of royalties and terminate the licence agreement. Similarly, 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, licensor or licensee of the relevant intellectual property) in line with secured transactions law and law relating to intellectual property.

(c) Grantor

25. 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, the rights of a licensor (including the right to the payment of royalties) or the authorization of the licensee to use or exploit the licensed intellectual property, the right to grant sub-licences and the right to the payment of sub-royalties. Thus, depending on the kind of intellectual property that is encumbered, the term "grantor" will refer to an owner, a licensor or a licensee (although, unlike an owner, a licensor or a licensee may not necessarily enjoy exclusive rights as this term is understood under law relating to intellectual property). Finally, as is the case with any secured transaction relating to other types of movable asset, the term "grantor" may reflect a third party granting a security right in its intellectual property to secure the obligation owed by a debtor to a secured creditor.

(d) Intellectual property

26. Under the *Guide*, the term "intellectual property" means copyrights, trademarks, patents, service marks, trade secrets and designs and any other asset considered to be intellectual property under the domestic law of the enacting State or under an international agreement to which the enacting State is a party (such as,

for example, neighbouring, allied or related rights[9] or plant varieties). Thus, references in the *Guide* to "intellectual property" are to be understood as references to "intellectual property rights", such as the rights of an intellectual property owner, licensor or licensee. The commentary to the *Guide* 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, whether national law or law flowing from treaties (see Introduction to the *Guide*, footnote 24). An enacting State may add to the list mentioned above or remove from it types of intellectual property so that it conforms to national law.[10] That is, the *Guide* treats as "intellectual property", for the purposes of the *Guide*, whatever an enacting State considers to be intellectual property in conformity with its national law and compliance with its international obligations.

27. 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. Under the *Guide* these income streams are characterized as "receivables" and could be the original encumbered asset, if described as such in the security agreement, or proceeds of intellectual property, if the original encumbered asset is intellectual property. However, this treatment of these income streams in the *Guide* does not preclude a different treatment for purposes of law relating to intellectual property. For example, for the purposes of law relating to intellectual property, a right of a licensor to payment of equitable remuneration could be treated as part of the intellectual property right of the licensor.

28. It is also important to note that a licence agreement relating to intellectual property is not a secured transaction and a licence with a right to terminate the licence agreement is not 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, licensor's or licensee's ability to limit the transferability of its intellectual property rights remains unaffected. In any case, it should be noted that, while the question whether an intellectual property owner may grant a licence is a matter of law relating to intellectual property, the question whether the owner's secured creditor may prohibit by agreement the owner from granting a licence is a matter of secured transactions law addressed in the draft Supplement (see A/CN.9/WG.VI/WP.39/Add.6, para. 1).

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[9] Closely related to "copyright" are "neighbouring rights", also called allied or related rights. These are rights that are said to be "in the neighbourhood" of copyright. The term typically covers the rights of performers, producers of phonograms and broadcasting organizations, but in some countries it can also include the rights of film producers, or rights in photographs. Sometimes these are called Diritti Conessi ("connected rights") or Verwandte Schutzrechte ("related rights") or Droits Voisins ("neighbouring rights"), but the common term is the English "neighbouring rights." Internationally, neighbouring rights are generally protected under the Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations done Oct. 26, 1961. Additional protections are accorded to certain performers and phonogram producers in the WIPO Performances and Phonograms Treaty done December 20, 1996.

[10] See footnote 32 of the Introduction to the *Guide*.

(e) Law and law relating to intellectual property

29. 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 (see Introduction to the *Guide*, para. 19). In particular, the expression "law relating to intellectual property" means national law or law flowing from international agreements, to which a State is a party, relating to intellectual property 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 a "law relating to intellectual property" might be intellectual property law that applies specifically to pledges or mortgages of copyrights in software, assuming of course that the specific law in question arises as a matter of law relating to intellectual property and is not simply the application of a State's general law of pledges or mortgages to the intellectual property context.

(f) Licence

30. The *Guide* also uses the term "licence" as a general concept, while recognizing that, under law relating to intellectual property, a distinction may often be drawn: (a) between contractual licences (whether express or implied) and compulsory or statutory licences, in which a licence is not the result of an agreement; (b) between a licence agreement and the licence that is granted by the agreement (for example, the authorization to use or exploit the licensed intellectual property); and (c) between exclusive licences (which, under law relating to intellectual property in some States, may be treated as transfers) and non-exclusive licences. In addition, under the *Guide*, a licence agreement does not in itself create a security right and a licence with a right to terminate the licence agreement is not a security right.

31. 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)[11] and the Singapore Treaty on the Law of Trademarks (2006)).[12] 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".

32. 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

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

property. Moreover, the *Guide* does not affect any limitations included in the licence agreement as to the transferability of licensed rights.

(g) Receivable and assignment

33. The term "receivable" is used in the *Guide* and in the United Nations Convention on the Assignment of Receivables in International Trade (hereinafter referred to as the "United Nations Assignment Convention")[13] 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 not) or a licensee/sub-licensor to obtain payment of licence royalties (without affecting the terms and conditions of the licence agreement, such as an agreement between the licensor and the licensee that the licensee will not create a security right in its right to payment of sub-royalties). The exact meaning and scope of licence royalties are subject to the 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 (for a discussion of the term "secured creditor", see paras. 35-37 below; for a discussion of the distinction between a secured creditor and an intellectual property owner, see A/CN.9/WG.VI/WP.39/Add.2, paras. 10-12).

34. The term "assignment" is used in the *Guide* with respect to receivables to denote not only outright assignments but also assignments for security purposes (treated under the *Guide* as secured transactions) 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 Supplement to denote the transfer of the rights of an intellectual property owner. While the *Guide* applies to all types of assignment of receivables, it does not apply to outright transfers of any right other than a receivable (see recommendations 2, subparagraph (d), and 3). It should also be noted that, while what is a "transfer" or a "licence" is left to the relevant property or contract law, the term "transfer" is not used in the *Guide* to denote a licence agreement.

(h) Owner

35. The *Guide* does not explain the term "owner" of an encumbered asset, whether that asset is intellectual property or not. This is a matter of the relevant property law. Accordingly, the *Guide* uses the term "intellectual property owner" referring to the understanding of this term under law relating to intellectual property, generally denoting the person that is entitled to enforce the exclusive rights flowing from intellectual property or its transferee, that is, the creator, author or inventor or their successor in title (as to whether a secured creditor may exercise the rights of an intellectual property owner, see para. 37).

(i) Secured creditor

36. 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,

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[13] United Nations publication Sales No. E.04.V.14.

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 in the context of an enforcement, will the secured creditor ever become an owner.

37. 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, a licensor or a licensee), such as the right to preserve the encumbered intellectual property and thus to deal with State authorities, grant licences or pursue infringers. So, for example, nothing in secured transactions law prevents a secured creditor from agreeing with the grantor/owner, licensor or licensee to become an owner, licensor or licensee 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, licensor or licensee, the term "secured creditor" may denote an owner, licensor or licensee 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 (subject to the limitation of recommendation 4, subparagraph (b)); 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 pursuing infringers.

(j) Security right

38. 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 (see definition of the term "security right" in the Introduction to the *Guide*, para. 20 and

recommendations 2, subparagraph (d), and 8). Thus, the term "security right" would cover the right of a pledgee or mortgagee of intellectual property, as well as of a transferee in a transfer for security purposes. States that adopt the recommendations 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*.

(k) Transfer

39. While the *Guide* uses the term "outright transfer" to denote transfer of ownership (see chapter I of the *Guide* on scope, para. 25), the exact meaning of this term is a matter of property law. The *Guide* also uses the term "transfer for security purposes" to refer to a transaction that is in name only a transfer but functionally a secured transaction. In view of the functional, integrated and comprehensive approach it takes to secured transactions (see recommendations 2, subparagraph (d), and 8), for the purposes of secured transactions law, the *Guide* treats a transfer for security purposes as a secured transaction. To the extent that a different characterization of a transfer for security purposes in other law would apply to all assets, this is not an issue with respect to which the *Guide* would defer to law relating to intellectual property (see recommendation 4, subparagraph (b), and paras. 12-17 above). However, this approach does not affect a different characterization of a transfer other than an outright transfer for the purposes of law relating to intellectual property. For example, under intellectual property law, the expression "transfer other than an outright transfer" may denote a transfer of parts of exclusive rights from a licensor to a licensee where the licensor retains some rights.

D. Valuation of intellectual property to be encumbered

[*Note to the Working Group: For paras. 40-52, see A/CN.9/WG.VI/WP.37, paras. 33-46, A/CN.9/670, paras. 21-26, A/CN.9/WG.V/WP.35, paras. 22-41, A/CN.9/667, paras. 23 and 24, A/CN.9/WG.VI/WP.33, paras. 8-21, and A/CN.9/649, para. 108*.]

40. The valuation of assets to be encumbered is an issue that any prudent grantor and secured creditor have to address irrespective of the type of asset to be encumbered. However, valuation of intellectual property is harder at least to the extent it raises the issue whether intellectual property is an asset that 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.

41. 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, one issue is that, 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 making this calculation. However, 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. In addition, parties in some States may be able to rely on valuation methodologies developed by national institutions, such as bank associations. Moreover, parties may be able to rely on training for valuation of intellectual property in general or for the purpose of licence agreements in particular provided by international organizations, such as WIPO. Parties may also be able to rely on standards for the valuation of intellectual property as assets that can be used as security for credit developed by other international organizations, such as the Organization for Economic Cooperation and Development.

E. Examples of financing practices relating to intellectual property

42. Secured transactions relating to intellectual property 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 (that is, 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 example 1, the encumbered assets are the rights of an owner. In examples 2 and 3, the encumbered assets are the rights of a licensor, and, in example 4, the encumbered assets are the rights of a licensee.

43. The second category of transactions involves situations in which assets other than intellectual property, such as inventory or equipment, serve as security for credit, but the value of these assets is based to some extent upon the intellectual property with which they are associated. This category of transactions is illustrated by examples 5 and 6.

44. 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.

45. Each of the examples illustrates how owners, licensors and licensees of intellectual property, or owners of assets, the value of which depends significantly on associated 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.[14]

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

46. 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 registry (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 registry reflecting its security right in the new patent.

Example 2 (rights of a licensor in royalties from the licence of visual art)

47. 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 appropriate party (for example, Company B, Bank B or an escrow account) until further notice.

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

48. 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

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[14] 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.

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 or exploit licensed software)

49. 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-licenses 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 agreement.

Example 5 (rights of a manufacturer of trademarked inventory)

50. 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 and its obligations to the trademark owner. Bank E extends credit to Company E against the value of the inventory.

Example 6 (rights of a distributor of trademarked inventory)

51. 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 E 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)

52. 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 G 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.

F. Key objectives and fundamental policies

[*Note to the Working Group: For paras. 53-59, see A/CN.9/WG.VI/WP.37, paras. 47-53, A/CN.9/670, para. 27, 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*.]

53. 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 to the *Guide*, section D.2). 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 to the *Guide*, section D.3).

54. 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, as well as under 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)).

55. A general policy objective of law relating to intellectual property law is to prevent unauthorized use of intellectual property or to protect the value of intellectual property and thus to encourage further innovation and creativity. To accomplish this general policy objective, law relating to intellectual property accords certain exclusive rights to intellectual property owners, 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 paras. 13-18 above and A/CN.9/WG.VI/WP.39/Add.1, section II, A.4).

56. 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, licensor or licensee may exercise or impede their rights to preserve the value of their intellectual property rights by preventing their unauthorized use. Thus, the key objective of promoting secured credit with respect to intellectual property will 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.

57. Similarly, this key objective of promoting secured credit without 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, the creation of a security right in intellectual property should not be misinterpreted as constituting an inadvertent abandonment of intellectual property (for example, failure to use a trademark properly, to use it on all products 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.

58. In addition, this key objective means, in the case of products or services associated with marks, that secured transactions law should avoid causing consumer confusion as to the source of products or services. For example, if a secured creditor replaces the manufacturer's name and address on the products with a sticker bearing its name and address or retains the trademark and sells the products in a jurisdiction where the trademark is owned by a different person, confusion as to the source of the products is bound to arise.

59. Finally, this key objective means that secured transactions law should not provide that a security right in the rights of a licensee that are non-transferable without the consent of the licensor may be created without the consent of the licensor.