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

Note by the Secretariat

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II. Scope of application and party autonomy

[*Note to the Working Group: For paras. 1-24, see A/CN.9/WG.VI/WP.35, paras. 46-67, A/CN.9/667, paras. 29-31, A/CN.9/WG.VI/WP.33, paras. 82-108, and A/CN.9/649, paras. 81-87.*]

A. Broad scope of application

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

1. Encumbered assets covered

2. The question of characterization of types of intellectual property and the question of whether each type of intellectual property is transferable and may thus be encumbered are matters of law relating to intellectual property. However, the *Guide* and the Annex are based on the general assumption that a security right may be created in a patent, a trademark and the economic rights under a copyright (but not in the moral rights of an author, if not permitted under law relating to intellectual property). The *Guide* and the Annex are also based on the assumption that the encumbered asset may be various exclusive rights of an owner, the rights of a licensor, the rights of a licensee or the rights in intellectual property used with respect to a tangible asset.

3. However, there is an important qualification to the scope of the *Guide* and the Annex as just set out. In line with general rules of property law, the right to be encumbered has to be transferable under general property law and law relating to intellectual property law. It should be noted that, with the exception of statutory limitations to the assignability of future receivables and receivables assigned in bulk, the law recommended in the *Guide* does not override provisions of any other law (including law relating to intellectual property) to the extent that they limit the creation or enforcement of a security right in or the transferability of specific types of asset, including intellectual property (see recommendation 18).

2. Transactions covered

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

3. Outright transfers of intellectual property

5. The *Guide* applies to the outright transfer (i.e. a transfer of ownership) of receivables (see recommendation 3). As the *Guide* treats royalties payable by the

licensee of intellectual property as receivables, it applies to the outright transfer of the right to receive royalties. The inclusion of outright transfers of receivables in the scope of the *Guide* reflects the fact that such transfers are usually seen as financing transactions and are often difficult in practice to distinguish from loans against the receivables.

6. The *Guide* also applies to transfers of all movable assets for security purposes, which it treats as security devices (see recommendation 2, subparagraph (d)). Thus, if a State enacts the recommendations of the *Guide*, a transfer of intellectual property rights (whether full title or rights limited in scope, time or territory) for security purposes would be treated as a secured transaction. Accordingly, parties will be able to simply create a security right in intellectual property using the methods provided in the law recommended in the *Guide* without the need to adopt other formalities of a “transfer”. This result will not affect licence practices as, under the *Guide*, a licence agreement does not create a security right and the right to terminate a licence agreement is not a security right.

7. However, the *Guide* does not apply to outright transfers of any other movable asset, including intellectual property, except to the extent that there is a priority conflict between an outright transferee of the asset and a secured creditor with a security right in the asset. The reason for the exclusion of outright transfers of any other movable asset, including intellectual property, is that they are sufficiently covered by other law, including law relating to intellectual property and, in the case of some types of intellectual property, made subject to specialized registration.

4. Limitations on scope

8. The *Guide* assumes that, in order to facilitate access to financing based on intellectual property, States enacting the recommendations of the *Guide* will include rules on security rights in intellectual property in their modern secured transactions regime. Accordingly, States enacting the recommendations of the *Guide* may wish to review their laws relating to intellectual property with a view to replacing all devices by way of which a security right is created in intellectual property (including fictional assignments) with a general security right. However, the *Guide* also recognizes that this must be done in a manner that is consistent with the policies and infrastructure of law relating to intellectual property of each enacting State (see recommendation 4, subparagraph (b)).

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

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

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

11. In the context of intellectual property financing, it follows that the *Guide* does not affect, and does not purport to affect, issues relating to the existence, validity, enforceability and content of a grantor's intellectual property rights. These issues are determined solely by law relating to intellectual property. Of course, the secured creditor will need to pay attention to those rules in order to assess the existence and quality of the assets to be encumbered, but this would apply to any other asset. What follows is an indicative, non-exhaustive list of issues that may be addressed by law relating to intellectual property relevant to that assessment. Law relating to intellectual property may, of course, deal with issues not included in the list that follows.

Copyright:

- (a) The determination of who is the author or joint author;
- (b) The duration of copyright protection;
- (c) The economic rights granted under the law and limitations on and exceptions to protection;
- (d) The nature of the protected subject matter (expression embodied in the work, as opposed to the idea behind it, and the dividing line between these);
- (e) The transferability of economic rights as a matter of law;
- (f) The possibilities to terminate transfers and licences and other provisions regulating transfers or licences of rights;
- (g) The scope and non-transferability of moral rights;
- (h) Presumptions relating to the exercise and transfer of rights and limitations relating to who may exercise rights;
- (i) Attribution of original ownership in the case of commissioned works and works created by an employee within the scope of employment.

Patents:

- (a) The determination of who is the inventor or co-inventor;
- (b) The validity of a patent and in which country it is to be applied for (or filed) and registered;
- (c) The limitations on and exceptions to protection;
- (d) Scope and duration of protection;
- (e) The grounds for invalidity challenges (obviousness or lack of novelty);

- (f) Whether certain prior publication precludes patentability;
- (g) Whether protection is granted to a person who uses the patent first or to a person who files an application first.

Trademarks and service marks:

- (a) The determination of who is the first user or the owner of the mark;
- (b) Whether protection of the mark is granted to a person that uses the mark first or to a person that files an application first;
- (c) Whether ex ante use is a prerequisite to registration in a mark registry or whether the right is secured by initial registration and maintained by later use;
- (d) The basis of protection of the right (distinctiveness);
- (e) The basis for losing protection (holder's failure to ensure that mark retains its association with the owner's goods in the marketplace), as in the case of:
 - (i) Licensing without the licensor directly or indirectly controlling the quality or character of the goods or services associated with the mark (so called "naked licensing"); and
 - (ii) Altering the mark so its appearance does not match the mark as registered;
- (f) Whether the mark may be transferred with or without goodwill.

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

12. The issues just addressed do not create any necessity for deference to law relating to intellectual property, since the *Guide* does not purport to address these issues in the first instance. In other words, they are not issues where the principle of recommendation 4, subparagraph (b), has any application. The deference issue arises when the law relating to intellectual property of the enacting State provides an intellectual-property-specific rule on an issue falling within the scope of the *Guide*, namely, an issue relating to the creation, third-party effectiveness, priority, enforcement of or law applicable to a security right in intellectual property.

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

Example 1

14. Some States, in which security rights are created by a transfer of title to the encumbered asset, do not permit security rights to be created in a trademark, owing to concerns that the secured creditor's title would impair the quality control required of the trademark holder. Adoption of the recommendations of the *Guide* by such a State would make transfers unnecessary and eliminate the rationale for this prohibition, since the grantor retains ownership of encumbered assets under the

Guide's concept of security right (whether the secured creditor substitutes the owner or lesser rights holder in its rights for the purposes of law relating to intellectual property is a different matter). Nonetheless, adoption of the recommendations of the *Guide* would not automatically eliminate the prohibition. The requirement for deference means that a specific amendment to relevant intellectual-property-specific legislation would be needed.

Example 2

15. In a few States, as a matter of law relating to intellectual property, registration of a transfer of or a security right in intellectual property in a specialized intellectual property registry is a mandatory prerequisite to either the creation or the third-party effectiveness either of outright transfers only or both of outright transfers and security rights in the category of intellectual property subject to that registry. In view of the principle of deference to law relating to intellectual property embodied in recommendation 4, subparagraph (b), adoption of the *Guide's* recommendations would not affect the operation of such a rule and such specialized registration will continue to be required. However, deference to law relating to intellectual property will not be sufficient to address the issue of coordination between the general security rights registry and intellectual property registries (see A/CN.9/WG.VI/WP.37/Add.2, paras. 15-19) or the question whether a security right may be created in and a notice may refer to a future intellectual property right (see paras. 60-63 below and A/CN.9/WG.VI/WP.37/Add.2, paras. 20-22).

Example 3

16. In some States, law relating to intellectual property provides for registration of both outright transfers and security rights in their intellectual property registries, but registration is not mandatory in the sense of being an absolute precondition to creation or third-party effectiveness. However, registration has priority consequences in that an unregistered transaction can be defeated by a registered transaction. In the case of such a State, recommendation 4, subparagraph (b), would preserve that rule of law relating to intellectual property of the State and, accordingly, a secured creditor desiring optimal protection may need to both register a notice of its security right in the general security rights registry and the security agreement or a notice thereof in the intellectual property registry (although, if the intellectual property registry permits registration of security rights, registration there would be sufficient for all purposes). This is because: (a) registration in the general security rights registry is a necessary prerequisite to third-party effectiveness under secured transactions law; and (b) registration in the intellectual property registry will be necessary to protect the secured creditor against the risk of finding its security right defeated by the registration of a competing outright transfer or security right in the intellectual property registry under the intellectual-property-specific priority rules.

17. In some States, registration of transfers and security rights in the relevant intellectual property registry only provides protection against a prior unregistered transfer or security right only if the person with the registered right took without notice of the unregistered right (e.g. if the person is a bona fide purchaser). In States, in which this rule is a rule of law relating to intellectual property to which the *Guide* defers pursuant to recommendation 4, subparagraph (b) (as opposed to a

general rule of secured transactions law present throughout the State's legal system), adoption of the *Guide*'s recommendation will raise the further question as to whether registration of a notice of a security right in intellectual property in the general security rights registry constitutes constructive notice to a subsequent secured creditor that registers its security right in the intellectual property registry. If so, under the law of a State that has such a bona fide purchaser rule, it would be unnecessary for a secured creditor that has registered a notice of its security right in the general security rights registry to also register a document or notice thereof in the intellectual property registry in order to prevail as against subsequent transferees and secured creditors. Otherwise, under the law of that State, registration of a document or notice of the security right in the intellectual property registry may be required to gain priority over subsequent bona fide purchasers.

Example 4

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

Example 5

19. As a matter of law relating to intellectual property, in some States, registration of a document or notice of a transfer and a security right in an intellectual property registry is purely permissive and intended only to facilitate identification of the current owner. Failure to register neither invalidates the transaction nor affects its priority (although it might create evidentiary presumptions). In States that adopt this approach, the position is essentially the same as when no specialized registry exists at all, as is often the case for copyright. Where these issues are dealt with by law relating to intellectual property, the *Guide* defers to it. Where, however, these issues are left to be determined by general property law, no issue of deference arises since the pre-*Guide* rules were not derived from the law relating to intellectual property but rather from property law generally. Thus, adoption of the *Guide* will replace the existing rules on creation, third-party effectiveness, priority and so forth for security rights in intellectual property. Of course, the old rules on these issues will continue to apply to outright transfers of intellectual property since the *Guide* only covers security rights in intellectual property. Consequently, the secured creditor will need to verify the quality of any outright transfers of intellectual property to its grantor. But this type of risk management is no different from that necessary for any other type of encumbered asset for which a specialized registry does not exist.

Example 6

20. The question of who is the intellectual property owner in a chain of transferees of intellectual property is a matter of law relating to intellectual property. At the same time, the question of whether a transfer is an outright transfer or a transfer for security purposes is a matter of general property and secured transactions law. Finally, the legal nature of a licence under a licence agreement is a matter of law relating to intellectual property and contract law.

Example 7

21. If law relating to intellectual property has specialized rules governing specifically the enforcement of a security right in intellectual property, these rules will prevail over the enforcement regime of the *Guide*. However, if there is no specific rule of law relating to intellectual property on the matter and the enforcement of security rights in intellectual property is a matter left to general civil procedure law, the enforcement regime for security rights elaborated in the *Guide* would take precedence. Similarly, if there is no specific rule of law relating to intellectual property on extrajudicial enforcement, the relevant regime of the *Guide* on extrajudicial enforcement of security rights would apply (see A/CN.9/WG.VI/WP.37/Add.3, chapter on enforcement).

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

22. The *Guide* generally recognizes the principle of party autonomy, although it does elaborate a number of exceptions (see recommendations 10 and 111-112). This principle applies equally to security rights in intellectual property to the extent that law relating to intellectual property does not limit party autonomy (see A/CN.9/WG.VI/WP.37/Add.3, paras. 23-25). It should be noted that recommendations 111-113 apply only to tangible assets, as they refer to the possession of encumbered assets and intangible assets are by definition not subject to possession.

23. A special expression of the principle of party autonomy in secured transactions relating to intellectual property would be the following: a grantor and a secured creditor may agree that the secured creditor may acquire certain of the rights of an owner or lesser rights holder under law relating to intellectual property and thus become an owner or lesser rights holder entitled, for example, to register or renew registrations, as well as to sue infringers. This agreement could take the form of a special clause in the security agreement or a separate agreement between the grantor and the secured creditor, since, under the *Guide*, a secured creditor does not, by the mere fact of obtaining a security right, become an owner.

24. It should also be noted that damages received as a result of infringement of intellectual property rights would fall under the definition of “proceeds” (“whatever is received in respect of encumbered assets”), to which the security right in the original encumbered intellectual property would be extended. However, the right to pursue infringement claims (as opposed to the right to receive payment of damages for infringement) is a different matter. This right would not constitute proceeds as it would not fall under the words “whatever is received in respect of encumbered

assets” in the definition that qualify the indicative (i.e. non-exhaustive) list of items contained in the definition (“including ... and claims arising from defects in, damage or loss of an encumbered asset”).

III. Creation of a security right in intellectual property

[*Note to the Working Group: For paras. 25-64, see A/CN.9/WG.VI/WP.35, paras. 68-102, A/CN.9/667, paras. 32-54, A/CN.9/WG.VI/WP.33, paras. 112-133, and A/CN.9/649, paras. 16-28.*]

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

A. The concepts of creation and third-party effectiveness

26. With respect to all types of encumbered asset (including intellectual property), the *Guide* draws a distinction between the creation of a security right (its effectiveness as between the parties) and its effectiveness against third parties, providing different requirements to achieve each of these outcomes. In effect, this means that the requirements for the creation of a security right can be kept to a minimum, while any additional requirements are aimed at addressing the rights of third parties. The main reason for this distinction is to achieve three of the key objectives of the law recommended in the *Guide*, namely, establishing a security right in a simple and efficient way, while at the same time enhancing certainty and transparency and establishing clear priority rules (see recommendation 1, subparagraphs (c), (f) and (g)).

27. Under the *Guide*, a security right may be created by an agreement between the grantor and the secured creditor (see recommendation 13). For the security right to be effective against third parties, an additional step is required. For intangible assets this step is notice to third parties of the possible existence of the security right, which establishes an objective criterion for determining priority between a secured creditor and a competing claimant has not taken place (see recommendation 29). Accordingly, if a security right has been created in accordance with the requirements set out in the *Guide*, the security right is effective between the grantor and the secured creditor even if the additional steps necessary to make the security right effective against third parties have not been taken (see recommendation 30). As a result, the secured creditor may enforce the security right in accordance with the procedures set out in Chapter IX of the *Guide*, subject of course to the rights of competing claimants in accordance with the priority rules set out in chapter V.

28. This distinction applies equally to security rights in intellectual property. Thus, under the *Guide* a security right in intellectual property can be effective between the grantor and the secured creditor even if it is not effective against third parties. In some States, law relating to intellectual property draws such a distinction. In other States, however, such a distinction is not drawn in law relating to intellectual property, which provides that the same actions are required for both the creation of a security right and its effectiveness against third parties. In such a case, as required

by recommendation 4, subparagraph (b), the *Guide* defers to that law. To ensure better coordination between secured transactions law and law relating to intellectual property, States enacting the recommendations of the *Guide* may wish to consider reviewing their law relating to intellectual property. Such a review should make it possible for States to determine whether: (a) the fact that law relating to intellectual property does not draw a distinction between creation and third-party effectiveness of a security right in intellectual property serves specific policy objectives of law relating to intellectual property (rather than other law, such as general property law, contract law or secured transactions law) and should be retained; or (b) the distinction should be introduced in law relating to intellectual property so as to harmonize it with the relevant approach of the law recommended in the *Guide*.

B. Unitary concept of a security right

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

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

30. Under the *Guide*, the creation of a security right in an intangible asset requires a written agreement. In addition, the grantor must have rights in the asset to be encumbered or the power to encumber it. The agreement must reflect the intent of the parties to create a security right, identify the secured creditor and the grantor, and describe the secured obligation and the encumbered assets (see recommendations 13-15). As already mentioned, no additional step is required for the creation of a security right in an intangible asset. The additional steps (e.g. registration of a notice in a general security rights registry) required for third-party effectiveness of that security right are not required for the security right to be created effectively as between the grantor and the secured creditor.

31. However, law relating to intellectual property in many States impose different requirements for the creation of a security right in intellectual property. For example, registration of a document or notice of a security right in intellectual property (e.g. a transfer for security purposes, a mortgage or pledge of intellectual property) in the relevant intellectual property registry may be required for the

creation of the security right. In addition, under law relating to intellectual property, the intellectual property to be encumbered may need to be described specifically in a security agreement. Thus, a sufficient description under the *Guide* (e.g. one that embraces “all intellectual property”) may not be sufficient under intellectual property law. All depends on the particular provisions of the relevant law relating to intellectual property. Similarly, as some intellectual property registries index registered transactions by the specific intellectual property to which they relate, and not the grantor’s name or other identifier, registration of a document that merely states “all intellectual property of the grantor” would not be sufficient to create a security right. It would instead be necessary to identify each intellectual property right in the security agreement or in any other document to be registered in the intellectual property registry for the purposes of creating the security right.

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

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

33. As already mentioned, a grantor of a security right must have rights in the asset to be encumbered or the power to encumber it (see recommendation 13). This is a principle of secured transactions law that applies equally to intellectual property. A grantor may encumber its full rights or only limited rights. So, an intellectual property owner or lesser rights holder may encumber its full rights or rights limited in time, scope or territory. In addition, as a matter of general property law, a grantor may encumber its assets only to the extent that the assets are transferable under general property law. This principle also applies to secured transactions relating to intellectual property. So, an owner or lesser rights holder may only encumber its rights to the extent these rights are transferable under law relating to intellectual property.

E. Distinction between a secured creditor and an owner with respect to intellectual property

34. For the purposes of secured transactions law under the *Guide*, the creation of a security right does not change the owner (or lesser rights holder) of the encumbered intellectual property (in other words, who is the owner or rights holder) and the secured creditor does not become an owner (or lesser rights holder) on the sole ground that it acquired a security right in intellectual property.

35. However, under the enforcement chapter of the *Guide*, upon default of the grantor the secured creditor may exercise its security right by disposing of the

encumbered asset (the right of an intellectual property owner or lesser rights holder) or may propose to retain it in satisfaction of the secured obligation (see recommendations 156-157). In certain circumstances, the secured creditor may later be the buyer at a disposition that it conducts (see recommendations 141 and 148). Thus, while the *Guide* does not provide that the creation of a security right in intellectual property changes the owner (or lesser rights holder) of the encumbered intellectual property rights, the exercise of the secured creditor's rights upon default of the grantor will often result in the grantor's encumbered intellectual property rights being transferred (and, thus, the identity of the owner or lesser rights holder, as determined by law relating to intellectual property, might change). In situations in which the enforcement of the security right in the intellectual property results in a disposition to the secured creditor or retention of the intellectual property in satisfaction of the secured obligation, at that time, the secured creditor may become the owner or lesser rights holder, depending on the rights of the grantor.

36. In any case, the question of who is the owner (or lesser rights holder) with respect to intellectual property and whether the parties may determine it for themselves is a matter of law relating to intellectual property. Under law relating to intellectual property, a secured creditor may be treated as an owner (and may, for example, renew registrations or pursue infringers) or may be entitled to agree with the owner that the secured creditor will become the owner.

F. Types of encumbered asset in an intellectual property context

37. Under the *Guide*, a security right may be created not only in the rights of an intellectual property owner but also in the rights of a lesser rights holder, such as a licensor or a licensee under a licence agreement. In addition, a security right may be created in a tangible asset with respect to which intellectual property is used (e.g. designer watches or clothes bearing a trademark). As already mentioned, the intellectual property to be encumbered needs to be described in the security agreement (a general description is sufficient; see recommendation 14, subparagraph (d)).

38. It should be noted that the *Guide* (with the exception of legal limitations to the assignability of future receivables as future receivables, or of receivables assigned in bulk; see recommendation 23) does not override any provisions of law relating to intellectual property (or other law) that limit the creation or enforcement of a security right or the transferability of an intellectual property (or other) asset (see recommendation 18). Similarly, the *Guide* does not affect contractual limitations to the transferability of intellectual property rights (but does affect contractual limitations to the assignability of receivables; see recommendation 24). As a result, if, under law relating to intellectual property, a security right may not be created or enforced in an intellectual property right or if that intellectual property right is non-transferable, the law recommended in the *Guide* will not interfere with these limitations.

1. Rights of an owner

39. The *Guide* applies to secured transactions in which the encumbered assets are the rights of an owner. Typically the essence of the rights of an owner is the right to

enjoy its intellectual property, the right to prevent unauthorized use of its intellectual property and to sue infringers, the right to register intellectual property and the right to authorize others to use the intellectual property in return for royalties.

40. If, under law relating to intellectual property, a security right may be created and enforced in these rights or these rights are transferable, the owner may encumber all or some of them with a security right under the law recommended in the *Guide* and that law will apply to such a security right. If these rights may not be encumbered or transferred under law relating to intellectual property, they may not be encumbered by a security right under the law recommended in the *Guide*, since, as already mentioned, the *Guide* does not affect legal provisions that limit the creation or enforcement of a security right, or the transferability of assets, with the exceptions of provisions relating to the assignability of future receivables and receivables assigned in bulk (see recommendation 18).

41. Similarly, whether the right of an owner to sue infringers and obtain compensation, which is incidental to the rights of the owner, may be used as an encumbered asset separately from the other rights of the owner is a matter for law relating to intellectual property. In particular, with respect to the right of the owner to sue infringers and obtain compensation, whether it is part of the original encumbered rights of an owner, the security right extends to any compensation as proceeds or a transferee of the encumbered intellectual property right may continue a pending lawsuit and obtain any compensation would depend on the circumstances.

42. Accordingly, if, at the time a security right is created in the rights of an owner, an infringement has been committed, the owner has sued infringers and infringers have paid compensation to the owner, the amount paid prior to the creation of a security right would not be part of the encumbered rights of the owner and the secured creditor could not claim it in the case of default as part of the original encumbered asset. However, if the compensation is paid to the owner after the creation of the security right (for an infringement that occurred before or after the creation of the security right), the secured creditor may claim it but only as proceeds of the original encumbered asset. If the compensation has not been paid, the receivable could be part of the original encumbered intellectual property, if it is included in the description of the original encumbered assets in the security agreement; otherwise, in the case of default, the secured creditor could claim the receivable as proceeds of the original encumbered assets. Finally, if the lawsuit is still pending at the time of creation of the security right, a person that bought the intellectual property in an enforcement sale should be able to take over the lawsuit and obtain any compensation granted (again, if permitted under law relating to intellectual property).

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

2. Rights of a licensor

44. Under the *Guide*, a security right may be created in a licensor's rights under a licence agreement. If a licensor is an owner, it can create a security right in (all or part of) its rights as mentioned above. If a licensor is not an owner but a licensee that grants a sub-licence, typically, it may create a security right in its right to receive payment of royalties owed under the sub-licence agreement (for the licensee's rights, see paras. 53-54 below). Such a licensor may also create a security right in other contractual rights of value that the licensor might have under the licence agreement and the relevant law. These other contractual rights might include, for example, the licensor's right to compel the licensee to advertise the licensed intellectual property or product with respect to which the intellectual property is used, or the right to compel the licensee to market the licensed intellectual property only in a particular manner, as well as the right to terminate the licence agreement on account of the licensee's breach.

45. Following the approach taken in most legal systems and reflected in the United Nations Assignment Convention, the *Guide* treats rights to receive payment of royalties arising from the transfer or licence of intellectual property as proceeds of intellectual property in the form of receivables. This means that the general discussion and recommendations dealing with security rights in proceeds, as modified by the receivables-specific discussion and recommendations, apply to rights to payment of royalties. Thus, under the *Guide*, statutory prohibitions that relate to the assignment of future receivables or receivables assigned in bulk or partial assignments are rendered unenforceable (see recommendation 23). However, other statutory prohibitions or limitations are not affected (see recommendation 18). In addition, a licensee could raise against an assignee of the royalties all defences or rights of set-off arising from the licence agreement or any other agreement that was part of the same transaction (see recommendation 120).

46. In this context, it is important to note that the statutory prohibitions set aside refer to future receivables only as future receivables. They do not affect statutory prohibitions based on the nature of receivables, for example, as wages or royalties that may by law be payable directly only to authors or collecting societies. Many countries have "author-protective" or similar legislation that designates a certain portion of income earned from exploitation of the intellectual property rights as "equitable remuneration" or the like which must be paid to authors or other entitled parties or their collecting societies. These laws often make such payment rights expressly non-assignable. The *Guide's* recommendations with respect to limitations to the assignment of receivables do not apply to these or other legal limitations.

47. Furthermore, it is important to note that the treatment of the right to receive payment of royalties for the purposes of secured transactions law as proceeds of intellectual property in the form of receivables does not affect the different treatment of this right to royalties under law relating to intellectual property. Such laws would include, in particular, international accounting rules as to how or when royalties are earned (e.g. International Accounting Standard No. 38 of the International Accounting Standards Board). Thus, the parties to a licence agreement and to a security agreement creating a security right in the licensor's right to receive such royalties should take these rules into account.

48. Finally, it is equally important to note that the treatment of rights to receive payment of royalties in the same way as any other receivable does not affect 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.

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

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

51. It is equally important to note that recommendation 24 applies only to an agreement between a creditor of a receivable and the debtor of the receivable that the receivable owed to the creditor by the debtor may not be assigned. It does not apply to an agreement between a creditor of a receivable and the debtor of the receivable that the debtor may not assign receivables that may be owed to the debtor by third parties. Thus, recommendation 24 does not apply to an agreement between a licensor and a licensee that the licensee will not assign its right to receive payment of sub-licence royalties from third-party sub-licensees. Such an agreement may exist, for example, where the licensor and the licensee agree that sub-licence royalties will be used by the licensee to further develop the licensed intellectual property. Thus, recommendation 24 does not affect the right of the licensor to negotiate the licence agreement with the licensee so as to control by agreement who can use the intellectual property or the flow of royalties from the licensee and sub-licensees. However, a licensor cannot control by agreement the flow of royalties in situations where the licensee in its capacity as a sub-licensor creates a security right in its right to receive payment of sub-royalties (unless, of course, the licensor prohibits sub-licences). In addition, if the licensee becomes insolvent, the licensor would be treated as an unsecured creditor, unless it obtained a security right in the right to receive payment of the royalties.

52. In addition, recommendation 24 does not apply to an agreement between a licensor and a licensee that the licensor will terminate the licence agreement if the licensee violates the agreement not to assign royalties payable to the licensee by sub-licensees. In this context, it should be noted that the right of the licensor to terminate the licence agreement if the licensee breaches this agreement gives the

sub-licensees a strong incentive to make sure that the licensor gets paid. Moreover, recommendation 24 does not affect the right of the licensor to: (a) agree with the licensee that part of the licensee's royalties (representing a source for the payment of the royalties the licensee owes to the licensor) be paid by sub-licensees to an account in the name of the licensor; or (b) obtain a security right in the licensee's future royalties to be paid by sub-licensees, register a notice in that regard in the general security rights registry (or the relevant intellectual property registry) and thus obtain a security right with priority over the licensee's other creditors (subject to the rules of the *Guide* for obtaining third-party effectiveness and priority of security rights).

3. "Rights" of a licensee

53. Typically, a licensee is authorized to use the licensed intellectual property in line with the terms of the licence agreement. A licensee may also have the right to grant sub-licences and to receive as a sub-licensor the payment of any royalties flowing from a sub-licence agreement, unless the licence agreement or law relating to intellectual property provides otherwise. The discussion above with respect to the rights of a licensor would apply equally to the rights of a licensee as a sub-licensor.

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

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

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

56. Where intellectual property is used in connection with a tangible asset, two different types of asset are involved. One is the intellectual property; another is the tangible asset. These assets are separate. Law relating to intellectual property allows an owner the ability to control many but not all uses of the tangible asset. For example, law relating to copyright allows an author (or other rights holder) to prevent unauthorized duplication of a book, but not to prevent an authorized bookstore that bought the book in an authorized sale to re-sell it or the end-buyer to make notes in the margin while reading. As such, a security right in intellectual property does not extend to the tangible asset with respect to which intellectual property is used, and a security right in a tangible asset does not extend to the intellectual property used with respect to the tangible asset.

57. Of course, the parties to the security agreement may agree that a security right is granted both in a tangible asset and in intellectual property used with respect to that asset. For example, a security right may be taken in inventory of trademarked jeans and in the trademark giving the right to the secured creditor in the case of default of the grantor to sell both the encumbered trademarked jeans and the right to produce other jeans bearing the encumbered trademark. In other words, the extent of the security right depends on the description of the encumbered asset in the security agreement. In this regard, the question arises as to whether the description of the encumbered tangible assets should be specific (e.g. “my entire inventory with all associated intellectual property rights and other rights”) or whether a general description (“my entire inventory”) would suffice. It would seem that a general description would be in line with the principles of the *Guide* and the reasonable expectations of the parties, with the realization that separate assets are involved. At the same time, key principles of law relating to intellectual property with respect to the description of intellectual property to be encumbered in a security agreement should be respected.

58. As already mentioned, a security right in a tangible asset, in connection with which an intellectual property right is used, does not extend to the intellectual property used with respect to the tangible asset, but does apply to the tangible asset itself, including those characteristics of the asset that use the intellectual property (e.g. the security right applies to a television set as a functioning television set). Thus, a security right in such an asset does not give the secured creditor the right to manufacture additional assets using the intellectual property. Upon default, however, the secured creditor with a security right in the tangible assets could exercise the remedies recognized under secured transactions law, provided that such exercise of remedies did not interfere with rights existing under law relating to intellectual property. It may be that, under applicable law relating to intellectual property, the concept of “exhaustion” (or similar concepts) might apply to the enforcement of the security right (for a discussion of enforcement issues, see A/CN.9/WG.VI/WP.37/Add.3).

59. The above-mentioned remarks may be reflected in the following recommendation:

“The law should provide that, in the case of a security right in a tangible asset with respect to which intellectual property is used, unless otherwise specified in the security agreement, a security right in intellectual property does not extend to the tangible assets with respect to which it is used, and a security right in such tangible assets does not extend to the intellectual property. However, nothing in this recommendation limits the remedies that a secured creditor with a security right in such intellectual property has with respect to the tangible assets to the extent permitted by law relating to intellectual property, nor does it limit the enforcement remedies that a secured creditor with a security right in the tangible assets has with respect to the tangible assets to the extent permitted by law relating to intellectual property.”

G. Security rights in future intellectual property

60. The *Guide* provides that grantors may grant security rights in future assets, namely assets created or acquired by the grantor after the creation of a security right (see recommendation 17). This recommendation applies to intellectual property, except in so far as it is inconsistent with law relating to intellectual property (see recommendation 4, subparagraph (b)). Accordingly, under the *Guide*, a security right could be created in future intellectual property (as to legislative limitations in that regard, see recommendation 18 and paras. 65-66 below). This approach is justified by the commercial utility in allowing a security right to extend to future intellectual property.

61. Many laws relating to intellectual property follow the same approach, allowing owners to obtain financing useful in the development of new works, provided of course that their value can be reasonably estimated in advance. For example, in some States it is possible to create a security right in a patent application before the patent is issued. Similarly, it is common practice to fund the production of motion pictures or software to be produced in the future.

62. However, in certain cases, law relating to intellectual property may limit the transferability of various types of future intellectual property to achieve specific policy goals. For example, in some cases, a transfer of rights in new media or technological uses that are unknown at the time of the transfer may not be effective in view of the need to protect authors. In other cases, transfers of future rights may be subject to a statutory right of cancellation after a certain period. In other cases, the notion of “future intellectual property” may include registrable rights created but not yet registered. Statutory prohibitions may also take the form of a requirement for a specific description of intellectual property. Finally, as is the case with assets other than intellectual property, statutory prohibitions may be the result of the *nemo dat* principle, in accordance with which a creditor obtaining a security right does not obtain any rights greater than the rights of the grantor. In this connection, it should be noted that, if the grantor were a licensee, the licensee could not give anything more than the right granted to the licensee from the licensor.

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

64. If law relating to intellectual property limits the transferability of future intellectual property, the law recommended in the *Guide* does not apply to this matter in so far as it is inconsistent law relating to intellectual property (see recommendation 4, subparagraph (b)). Otherwise, the *Guide* applies and permits the creation of a security right in future assets (see recommendation 17). Where law relating to intellectual property includes limitations to the transferability of future intellectual property, these limitations are often intended to protect the owner. Again, States enacting the *Guide* may wish to review their law relating to intellectual property with a view to establishing whether the benefits from these limitations (e.g. protection of the owner) outweigh the benefits from the use of such assets as security for credit (e.g. the financing of research and development activities).

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

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

66. The only limitations on the transferability of certain assets that the *Guide* may affect are the legislative limitations on the transferability of future receivables, receivables assigned in bulk and parts of or undivided interests in receivables, as well as to contractual limitations on the assignment of receivables arising for the sale or licence of intellectual property rights (see article 8 of the United Nations Assignment Convention and recommendations 23-25). In addition, the *Guide* may affect contractual limitations, but only with respect to receivables (not intellectual property) and only in a certain context, that is, in an agreement between the creditor of a receivable and the debtor of that receivable (see paras. 60-64 above).