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

Proposal by the Permanent Bureau of the Hague Conference on Private International Law

Note by the Secretariat

1. The Annex to this note contains a proposal submitted by the Permanent Bureau of the Hague Conference on Private International Law (the "Hague Conference") with respect to the law applicable to security rights in intellectual property in chapter X on conflict of laws of the Draft Supplement to the *UNCITRAL Legislative Guide on Secured Transactions* (the "*Guide*") dealing with security rights in intellectual property.

2. The Hague Conference is an intergovernmental organization with 69 Member States. Its origins date back to 1893. The Organization's core mission is the "progressive unification of the rules of private international law" (see Art. 1 of the Hague Conference Statute). To this effect, the Hague Conference has adopted 38 multilateral treaties (mostly Conventions), including several Conventions on international commercial and finance law.

3. In line with the mandate of the Hague Conference and its field of expertise, the Permanent Bureau welcomes the opportunity to comment on uniform rules of private international law developed under the auspices of other international organizations. It should be noted that the Permanent Bureau participated in the development and supported the adoption of the *Guide*, the conflict-of-law recommendations of which were prepared in close cooperation with the Permanent Bureau.

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Annex

Proposal by the Permanent Bureau of the Hague Conference on Private International Law

I. Relevance and function of conflict-of-law recommendations in the Draft Supplement

1. As a preliminary remark, the Permanent Bureau wishes to underscore the importance of including conflict-of-law recommendations in the Draft Supplement to the UNCITRAL Legislative Guide on Secured Transactions (the "*Guide*") dealing with security rights in intellectual property (the "Draft Supplement"). Its subject matter, that is, security rights in intellectual property, is a very specific and generally unaddressed topic in private international law. Therefore, guidance from a future UNCITRAL legislative instrument is in every respect an important development.

2. However, it must be noted that conflict-of-law recommendations serve a different purpose to that of the Draft Supplement's substantive recommendations. While the adoption of the latter would address the possible inconsistencies between secured financing and intellectual property law by introducing unifying or harmonizing solutions for the interested States, conflict-of-law recommendations, by their very nature, cannot produce the same unifying or harmonizing effect on national laws. Their effect is limited to the law selection level. In other words, any conflict-of-law recommendation can result only in the use of a uniform criterion (or "connecting factor") to be applied, which in turn leads to the application of a particular law. No unifying or harmonizing effect on the substantive level can be achieved by means of conflict-of-law recommendations.

3. On the structure of chapter X of the Draft Supplement on conflict of laws, the Permanent Bureau fully concurs with the distinction that the Draft Supplement makes between the law applicable to property matters and the law applicable to contractual matters. This distinction is fundamental in conflicts of laws because the degree of party autonomy accepted for contractual matters generally is greater than the party autonomy accepted for property matters. For this reason, the Permanent Bureau does not support the second version of Alternative B in brackets, as it enables the application of a law chosen by the parties to the "creation" of a security right in intellectual property.

II. Law applicable to property matters

4. The Permanent Bureau applauds the attempts to unify the conflict-of-law rules applicable to the property aspects of secured transactions in intellectual property rights. As such, guidance from the Draft Supplement is to be welcomed, especially since specific consideration of this question in national or international law is very limited.

A. International conventions protecting intellectual property

5. At the outset, it may be considered that the principle of national treatment embodied in international conventions protecting intellectual property implicitly imposes a universal rule in favour of the *lex loci protectionis* ("*lex protectionis*"). Provisions such as Article 2(1) of the Paris Industrial Property Convention or Article 5(2) of the Berne Intellectual Property Convention appear to leave no room for a connecting factor other than the place of protection of the relevant intellectual property right. In other words, no law other than the law of the protecting State could be applied. Such an approach suggests that Contracting States to any of these international conventions have chosen to set aside the possibility of freely determining their conflict-of-law rules in reciprocal relationships.

6. The Permanent Bureau stresses that it is highly controversial to confer such an extensive effect on international intellectual property conventions with respect to the issue of the applicable law. Even assuming that these international conventions can impose a given conflict-of-law rule, it would still be questionable whether the scope of application of that rule covers all property effects contemplated by the Draft Supplement, that is, the creation, effectiveness against third parties, priority as against the rights of competing claimants and enforcement of a security right.

7. Accordingly, recommendations on the governing law of security rights in intellectual property will at the very least perform a gap-filling function with regard to any possible conflict-of-law consequences resulting from existing international intellectual property conventions. More likely however, the formulation of conflict-of-law rules in the Draft Supplement will be a welcome development since international intellectual property conventions do not provide for the determination of the applicable law in international cases dealing with security rights in intellectual property.

B. Which conflict-of-law rules for the Draft Supplement?

8. Fully acknowledging the desirability of conflict-of-law rules in the Draft Supplement, the Permanent Bureau now considers how these rules should be best drafted. In this regard, it is noted that the Draft Supplement sets out four alternatives. Each of them offers a combination of the law of the State in which the intellectual property is protected and the law of the place where the grantor is located.

9. In light of the general objectives of the Draft Supplement, the Permanent Bureau supports the idea of a comparative assessment of these connecting factors for each and every one of the proprietary issues addressed in the Draft Supplement, that is, the creation, effectiveness against third parties, priority as against the rights of competing claimants and the enforcement of a security right.

10. As a preliminary remark, it must be stressed that the law governing the intellectual property as such provides whether a security right can be vested in that intellectual property. This is in line with recommendation 4, subparagraph (b), of the *Guide*. Therefore, none of the recommendations contemplated in the Draft Supplement can override the application of the law governing the intellectual property to the preliminary issue of the viability of a security right in intellectual property.

11. Example: a copyright cannot be pledged under the law of State X. Therefore, even if the recommendations of the Draft Supplement are adopted in State X, they cannot override the application of the law of State X prohibiting the pledge on a copyright.

C. A balanced conflict-of-law rule

12. The Permanent Bureau favours the adoption of a recommendation which combines an application of the law of the State in which the grantor is located with the law of the State in which the intellectual property is protected.

13. We respectfully submit the following proposal for the consideration of the Working Group:

> "Within the limits of the law governing the transferability of an intellectual property, the law should provide that the law applicable to the creation, effectiveness against third parties, priority as against competing claimants and enforcement of a security in intellectual property is the law of the State in which the grantor is located. However, the law applicable to the third-party effectiveness and the priority of a security right in intellectual property as against the right of a transferee or a licensee of the encumbered intellectual property is the law of the State in which the intellectual property is protected."

14. We note that this proposal follows Alternative D of the Draft Supplement to a large extent. This proposal preserves the predominant application of a single connecting factor (that is, the law of the State in which the grantor is located), in line with the recommendations adopted in the *Guide*. Insofar as possible, a single law would govern the effectiveness of the security right between the parties and as to third parties, a priority conflict between two secured creditors etc. Simplicity, certainty and predictability are hence enhanced.

D. Limitations to the application of the law of the State in which the grantor is located

15. The application of the law of the State in which the grantor is located is nevertheless subject to two important limitations. First, as stated above, the transferability of the intellectual property right is a preliminary issue to be addressed before the creation of a security in intellectual property. Accordingly, it is important to reiterate the importance of the law governing the intellectual property as the legal framework for the creation of a security right in intellectual property.

16. Second, we suggest the introduction of an exception in favour of the *lex protectionis* where a conflict arises between a secured creditor and an outright transferee or licensee. In these cases, the *lex protectionis* is to be considered the proper law in adjudicating third-party effectiveness and priority, taking into consideration the legitimate expectations of a transferee or licensee.

17. It follows that the secured creditor must fulfil the requirements of (each) *lex protectionis* to ensure that the security right will prevail in case of a licence or transfer. This may appear cumbersome for secured creditors but is to be considered a balanced solution for the evident conflict of interests between these secured creditors and the transferees or licensees.

18. Example: Grantor A, located in State X, holds a patent in State Y. It grants a security right in that patent to a secured creditor in State Y. Grantor A subsequently assigns the same patent to transferee B.

19. If the proposed recommendation is followed, it is for the law of State Y (*lex protectionis*) and not for the law of State X (the law of the grantor's location) to apply to third-party effectiveness and priority between the secured creditor and the outright transferee. In case the law of State Y (*lex protectionis*) stipulates that the security right is enforceable against B, the enforcement of the security right will take place in conformity with the law of State X (the law of the grantor's location).

III. Law applicable to contractual matters

20. Party autonomy is the key to addressing the question of what is the appropriate applicable law to contractual matters. It is acknowledged the grantor and the secured creditor may decide which law applies to the security agreement. From the Permanent Bureau's perspective, the reference to party autonomy is very positive in view of our ongoing work on the promotion of party autonomy in the field of international commercial contracts. The specific reference to the Hague Conference's future instrument in the Draft Supplement is very much appreciated; it shows how various international instruments from different organizations are carefully drafted to work together and to support each other.

21. The Permanent Bureau of the Hague Conference stands ready to further collaborate in the consideration and discussion of chapter X of the Draft Supplement. We remain at the Working Group's disposal for any further information.