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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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## Preface

[*Note to the Working Group: The Working Group may wish to note that, for reasons of consistency with the Guide, the former section A of the Introduction has been shortened and is being presented as a preface to the draft Supplement.*]

The Supplement to the *UNCITRAL Legislative Guide on Secured Transactions* (the "*Guide*") was prepared by the United Nations Commission on International Trade Law (UNCITRAL).

At its thirty-ninth session, in 2006, the Commission considered and approved in principle the substance of the recommendations of the *Guide*. At that session, the Commission also considered its future work on secured financing law. Noting that the recommendations of the *Guide* generally applied to security rights in intellectual property rights, the Commission requested the Secretariat to prepare, in cooperation with relevant organizations and in particular World Intellectual Property Organization (WIPO), a note for submission to the Commission at its fortieth session, in 2007, discussing the scope of future work on intellectual property financing in a supplement (initially called annex) to the *Guide*. 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.[1]

Pursuant to that decision of the Commission, the Secretariat organized in cooperation with WIPO a colloquium on security rights in intellectual property rights (Vienna, 18 and 19 January 2007). The colloquium was attended by experts on secured financing and intellectual property law, including representatives of Governments and national and international, governmental and non-governmental organizations. At the colloquium, several suggestions were made with respect to adjustments that would need to be made to the *Guide* to address issues specific to intellectual property financing.[2]

At the first part of its fortieth session, in June 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 law and law relating to intellectual property, the Commission decided to entrust Working Group VI (Security Interests) with the preparation of a supplement to the *Guide* specific to security rights in intellectual property rights.[3] At its resumed fortieth session, in December 2007, the Commission finalized and adopted the *Guide* on the understanding that a supplement to the *Guide* specific to security rights in intellectual property rights would subsequently be prepared.[4]

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[1] *Official Records of the General Assembly, Sixty-first Session, Supplement No. 17* (A/61/17), paras. 81, 82 and 86.

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

[3] *Official Records of the General Assembly, Sixty-second Session, Supplement No. 17* (A/62/17 (Part I)), paras. 156, 157 and 162.

[4] Ibid., *Sixty-second Session, Supplement No. 17* (A/62/17 (Part II)), paras. 99 and 100.

The work of Working Group VI was developed through 5 one-week sessions, the final session taking place in February 2010.[5] At its fourteenth, fifteenth and sixteenth sessions, the Working Group referred certain insolvency-related matters to Working Group V (Insolvency Law),[6] which Working Group V considered at its thirty-fifth, thirty-sixth and […] sessions.[7] In addition, the Working Group cooperated with WIPO and other intellectual property organizations from the public and the private sector to ensure that the Supplement would be sufficiently coordinated with law relating to intellectual property. Moreover, the Working Group closely cooperated with the Permanent Bureau of the Hague Conference in the preparation of the chapter of the Supplement on conflict of laws.[8]

[At its forty-third session, in 2010, the Commission considered and approved the Supplement. Subsequently, the General Assembly adopted resolution …].

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[5] The reports of the Working Group on its work during these 5 sessions are contained in documents A/CN.9/649, A/CN.9/667, A/CN.9/670, A/CN.9/685 and A/CN.9/689. During these sessions, the Working Group considered A/CN.9/WG.VI/WP.33 and Add.1, A/CN.9/WG.VI/WP.35 and Add.1, A/CN.9/WG.VI/WP.37 and Add.1-4, A/CN.9/WG.VI/WP.39 and Add.1-7, and A/CN.9/WG.VI/WP.42 and Add.1-7.

[6] A/CN.9/667, paras. 129-140 and, A/CN.9/670, paras. 116-122, and A/CN.9/685, para. 95.

[7] A/CN.9/666, paras. 112-117, A/CN.9/WG.V/WP.87, A/CN.9/671, paras. 125-127, and [A/CN.9/…, paras. …].

[8] At its sixteenth session, the Working Group considered a proposal by the Permanent Bureau of the Hague Conference on Private International Law (A/CN.9/WG.VI/WP.40).

# Introduction[1]

## A. Purpose of the draft Supplement

[*Note to the Working Group: For paras. 1-7, see A/CN.9/WG.VI/WP.39, paras. 13-18, A/CN.9/685, para. 21, 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.*]

1. The overall objective of the *Guide* is to promote low-cost credit by enhancing the availability of secured credit (see recommendation 1, subparagraph (a)). In line with this objective, the draft Supplement is intended to make credit more available and at lower cost to intellectual property owners and other intellectual property rights holders, thus enhancing the value of intellectual property rights. The draft Supplement, however, seeks to achieve this objective without interfering with fundamental policies of law relating to intellectual property (see section E below).

[*Note to the Working Group: The Working Group may wish to note that new section A, Purpose of the draft Supplement has been added for reasons of consistency of the draft Supplement with the Guide and for the ease of understanding of the purpose of the Guide by the reader.*]

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

2. With only limited exceptions, the law recommended in the *Guide* applies to security rights in all types of movable asset, including intellectual property (see recommendations 2 and 4-7). However, 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)).

3. Recommendation 4, subparagraph (b), sets out the basic principle with respect to the interaction of secured transactions and law relating to intellectual property. The meaning given to the term "intellectual property" is intended to ensure consistency of the *Guide* with laws and treaties relating to intellectual property. As used in the *Guide*, the term "intellectual property" means any asset considered to be intellectual property under law relating to intellectual property. In addition, references in the *Guide* to "intellectual property" are to be understood as references to "intellectual property rights" (see paras. 18-20 below). The term "law relating to intellectual property" is used in the draft 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,

[1] For the easy reference of the reader, the draft Supplement follows the order in which the issues are discussed in the *Guide* (that is, Introduction with purpose, terminology, examples and key objectives and fundamental polices, Scope, Creation of a security right, etc.). In each section, the draft Supplement summarizes briefly the general considerations of the *Guide* and then goes on to discuss how they apply to an intellectual property context. Therefore, the draft Supplement has to be read together with the *Guide*.

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. 22 below). The term 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 various conventions administered by the World Intellectual Property Organization (WIPO) or the Agreement on Trade Related Aspects of Intellectual Property Rights (the "TRIPS Agreement")), as provided in those treaties.

4. 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.42/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, enforcement of and law applicable to 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 intellectual-property-specific rule against being overridden inadvertently as a result of adoption by a State of the law recommended in the *Guide*.

5. 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 law recommended in the *Guide* (for example, pledges, mortgages and transfers or trusts of intellectual property for security purposes). For this reason, States that adopt the law recommended in 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.

6. The draft 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 draft Supplement discusses how the commentary and recommendations 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 draft Supplement, a security right in intellectual property may be created, be made effective against third parties, have priority, be enforced and be made subject to applicable law as provided in the general recommendations of the *Guide*.

7. A State enacting the law recommended in the *Guide* with a view to making credit more available and at lower cost to owners of assets such as goods and receivables will most likely wish to make the benefits of such modernization available also to the owners of intellectual property, thereby enhancing the value of the intellectual property. This may have an impact on law relating to intellectual property. While it is not the purpose of the draft Supplement to make any recommendations for changes to a State's law relating to intellectual property, as already mentioned, it may have an impact on that law. The draft 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. Thus, recommendation 4, subparagraph (b), is intended to foreclose only inadvertent change to law relating to intellectual property, not all change after careful consideration by a State enacting the law recommended in the *Guide*.

## C. Terminology

[*Note to the Working Group: For paras. 8-32, see A/CN.9/WG.VI/WP.39, paras. 19-39, A/CN.9/685, para. 22, 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, 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) Acquisition security right

8. As used in the *Guide*, the term "acquisition security right" means a security right in a tangible asset (other than a negotiable instrument or negotiable document) that secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or credit otherwise provided to enable the grantor to acquire the asset. An acquisition security right need not be denominated as such. Under the unitary approach, the term includes a right that is a retention-of-title right or a financial lease right (see the term "acquisition security right", Introduction to the *Guide*, section B on terminology and interpretation).

9. For the purposes of the draft Supplement, the term includes a security right in intellectual property or a licence of intellectual property, provided that the security right secures the obligation to pay any unpaid portion of the acquisition price of the encumbered asset or an obligation incurred or credit otherwise provided to enable the grantor to acquire the encumbered asset.

### (b) Consumer goods

10. The *Guide* uses the term "consumer goods" to refer to goods that a grantor uses or intends to use for personal, family or household purposes (see the term "consumer goods", Introduction to the *Guide*, section B on terminology and

interpretation). For the purposes of the draft Supplement, the term includes intellectual property or a licence of intellectual property used or intended by the grantor to be used for personal, family or household purposes.

**(c) Competing claimant**

11. 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 the term "competing claimant", Introduction to the *Guide*, section B on terminology and interpretation). Thus, the *Guide* uses the term "competing claimant" in the sense of a claimant that competes with a secured creditor (that is, the claimant 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 from the same grantor before the other secured creditor but failed to register a notice of its security right.

12. In law relating to intellectual property, however, the notion of a "competing claimant" is not used, and priority conflicts typically refer to conflicts among intellectual property transferees and licensees, even if no conflict with a secured creditor is involved (infringers are not competing claimants and, if an alleged infringer proves that it has a legitimate claim, it is a transferee or licensee, and not an infringer). 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 that 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 a transferee for security purposes of intellectual property rights and an outright transferee of the same intellectual property rights would, subject to the limitation of recommendation 4, subparagraph (b), be covered by the *Guide* (see recommendations 78 and 79).

**(d) Encumbered asset**

13. The *Guide* uses the term "encumbered asset" to denote an asset that is subject to a security right (see the term "encumbered asset", Introduction to the *Guide*, section B on terminology and interpretation). 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".

14. 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, if they are transferable under law relating to intellectual property.

15. 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, the right to sue infringers 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.

16. Typically, under law relating to intellectual property 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 to terminate the licence agreement. Similarly, the rights of a licensee include the authorization given to the licensee 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 (see the term "licence", paras. 23-25 below). 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.

**(e) Grantor**

17. The *Guide* uses the term "grantor" to denote the person creating a security right to secure either its own obligation or that of another person (see the term "grantor", Introduction to the *Guide*, section B on terminology and interpretation). As already mentioned, in a secured transaction relating to intellectual property, the encumbered asset may be the 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.

**(f) Intellectual property**

18. As used in the *Guide* (see the term "intellectual property", Introduction to the *Guide*, section B on terminology and interpretation), 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[2] or plant varieties). Furthermore, 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.[3] As a result, 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.

19. 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, for example, 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 might be treated as part of the intellectual property right of the licensor (for the treatment of receivables under secured transactions law and law relating to intellectual property, see A/CN.9/WG.VI/42/Add.2, paras. 21-29).

20. 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.42/Add.5, para. 1).

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[2] 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 of 26 October 1961. Additional protections are accorded to certain performers and phonogram producers in the WIPO Performances and Phonograms Treaty of 20 December 1996.

[3] See footnote 24 of the Introduction to the *Guide*.

**(g) Inventory**

21. As used in the *Guide*, the term "inventory" means tangible assets held for sale or lease in the ordinary course of a grantor's business, as well as raw and semi-processed materials (work-in-process) (see the term "inventory", Introduction to the *Guide*, section B on terminology and interpretation). For the purposes of the draft Supplement, the term includes intellectual property or a licence of intellectual property used or intended by the grantor to be used for sale or licence in the ordinary course of the grantor's business.

**(h) Law and law relating to intellectual property**

22. As already mentioned (see para. 3 above), the commentary of the *Guide* also clarifies that references to the term "law" throughout the *Guide* include both statutory and non-statutory law. In addition, the commentary o 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, directly 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, as a result, may govern security rights in intellectual property. An example of a "law relating to intellectual property" might be law that applies specifically to pledges or mortgages of copyrights in software, assuming that it is part of the law relating to intellectual property and is not simply the application of a State's general law of pledges or mortgages in an intellectual property context.

**(i) Licence**

23. The *Guide* also uses the term "licence" (which includes a sub-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.

24. 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)[4] and the Singapore Treaty on the Law of Trademarks (2006)).[5] In particular, a security right in rights under a licence agreement does not affect the terms and conditions of the licence agreement (in the

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

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

same way that a security right in a sales receivable does not affect the terms and conditions of the sales contract). This means, inter alia, that the secured creditor does not acquire more rights than its grantor (see recommendation 13). For example, 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. As a result, an exclusive licence to exercise the "theatrical rights" in Film A in Country X for "10 years starting 1 January 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 January 2008".

25. In addition, the *Guide* does not affect in any way the particular characterization of rights under a licence agreement given by law relating to intellectual property. For example, the *Guide* does not affect the nature of rights created under an exclusive licence agreement as rights in rem or the nature of an exclusive licence as a transfer, as is the case under some laws relating to intellectual property. Moreover, the *Guide* does not affect any limitations included in the licence agreement as to the transferability of licensed rights (see A/CN.9/WG.VI/WP.42/Add.2, para. 31, A/CN.9/WG.VI/WP.42/Add.3, paras. 40-41, and A/CN.9/WG.VI/WP.42/Add.4, paras. 15 and 24-25).

**(j) Receivable and assignment**

26. The term "receivable" is used in the *Guide* (see the term "receivable", Introduction to the *Guide*, section B on terminology and interpretation) and in the United Nations Convention on the Assignment of Receivables in International Trade (hereinafter referred to as the "United Nations Assignment Convention"; see article 2)[6] to reflect a right to payment of a monetary obligation. Thus, for the purposes of the *Guide*, the term 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. 29-30 below; for a discussion of the distinction between a secured creditor and an intellectual property owner, see A/CN.9/WG.VI/WP.42/Add.2, paras. 10-12).

27. 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 (as the term "assignment" is used in law relating to intellectual property), the term "transfer" (rather than the term "assignment") is used in the draft Supplement to denote the transfer of the rights of an intellectual property owner. While the law recommended in the *Guide* applies to all types of assignment of

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

receivables, it does not apply to outright transfers of any right other than a receivable (see recommendations 2, subparagraph (d), and 3; see also A/CN.9/WG.VI/WP.42/Add.1, paras. 5-7). 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.

**(k) Owner**

28. 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 paras. 29-30 below and A/CN.9/WG.VI/WP.42/Add.2, paras. 10-12).

**(l) Secured creditor**

29. 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 (see recommendation 13). Thus, in the *Guide*, the term "secured creditor" (which includes a transferee by way of security) is used to denote a person that has a security right and not an outright transferee or an owner (although, for convenience of reference, the term includes an outright assignee of receivables; see the term "secured creditor", Introduction to the *Guide*, section B on terminology and interpretation). 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 a secured creditor to 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). It should also be noted that, even 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 grantor, the debtor and any other affected person; see recommendations 157-158), or acquires the grantor's ownership rights by purchasing the asset at a sale in the context of an enforcement, will the secured creditor ever become an owner.

30. For the purposes of secured transactions law, this characterization of a security agreement and the rights of a secured creditor applies also 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, licensor or licensee and the secured creditor may have the rights of an owner, licensor or 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 (see recommendation 10 and A/CN.9/WG.VI/WP.42/Add.5, para. 1). 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, enforcement of and law applicable to 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 (for the distinction between a secured creditor and an owner with respect to intellectual property, see also A/CN.9/WG.VI/WP.42/Add.2, paras. 10-12).

**(m) Security right**

31. 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 the term "security right", Introduction to the *Guide*, section B on terminology and interpretation, and recommendations 2, subparagraph (d), and 8). Thus, the term "security right" would cover the right of a pledge or mortgagee of intellectual property, as well as of a transferee in a transfer for security purposes. States that adopt the law recommended in 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*.

**(n) Transfer**

32. 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. 2-7 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 (for a discussion of outright transfers of intellectual property, see A/CN.9/WG.VI/WP.42/Add.1, paras. 5-7).

## D. Valuation of intellectual property to be encumbered

[*Note to the Working Group: For paras. 33-45, see A/CN.9/WG.VI/WP.39, paras. 40-52, A/CN.9/685, para. 23, 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.*]

33. 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 may be harder at least to the extent that 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.

34. Secured transactions law cannot answer this question. Still, 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

35. Secured transactions relating to intellectual property can usefully be divided into two 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.

36. The second category of transaction involves financing transactions that involve intellectual property in combination with other movable assets, such as equipment, inventory or receivables. An illustration of this type of transaction is found in Example 5, which involves a credit facility to a manufacturer, secured by a security right covering substantially all of the manufacturer's assets, including its intellectual property rights.

37. Each of the examples illustrates how owners, licensors and licensees of intellectual property 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 assets, but also presents different legal issues for a prospective lender or other credit provider.[7]

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

38. 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.

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[7] Some of these questions might be addressed in asset-specific intellectual property legislation. For example, article 19 of the Council Regulation (EC) No. 40/94 on the Community Trademark provides that a security right may be created in a community trademark and, on request of one of the parties, such a right may be registered in the community trademark registry.

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

39. 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)**

40. Company C, a motion picture company, wishes to produce a motion picture. Company C sets up a separate company to undertake the production and hire the individual writers, producers, directors and actors. The production company obtains a loan from Bank C secured by the copyright, service contracts and all revenues to be earned from the exploitation of the motion picture in the future. The production company then enters into licence agreements with distributors in multiple countries who agree to pay "advance guarantees" against royalties upon completion and delivery of the picture. For each licence, the production Company C, Bank C and the distributor/licensee enter into an "acknowledgement and assignment" agreement under which the licensee acknowledges the prior security right of Bank C and the assignment of its royalty payments to Bank C, while Bank C agrees that, in case of enforcement of its security right in the licensor's rights, it will not terminate the licence so long as the licensee makes payments and otherwise abides by the terms of the licence agreement.

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

41. 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 (security right in all assets of an enterprise)**

42. Company E, a manufacturer and distributor of cosmetics, wishes to obtain a €200 million credit facility to provide ongoing working capital for its business. Bank E is considering extending this facility, provided that the facility is secured by a so called "enterprise mortgage", "floating charge" or all asset-security right granting to the bank a security right in substantially all of Company E's existing and

future assets, including all existing and future intellectual property rights that it owns or licenses from third parties.

43. Apart from the transactions mentioned above, there are transactions in which assets other than intellectual property, such as inventory or equipment, serve as security for credit, while 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 6 and 7 below. As discussed in the draft Supplement (see A/CN.9/WG.VI/WP.42/Add.2, paras. 32-36), a security right in a tangible asset does not automatically extend to the intellectual property used with respect to that asset. If a secured creditor wishes to take a security right in such intellectual property, the intellectual property has to be described in the security agreement as part of the encumbered asset.

**Example 6 (rights of a manufacturer of trademarked inventory)**

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

**Example 7 (rights of a distributor of trademarked inventory)**

45. Company G, one of Company F's distributors (see example 6), wishes to borrow money from Bank G secured in part by its inventory of designer jeans and other clothing that it purchases from Company F, a significant portion of which bears well-known trademarks licensed by Company G from third parties. Company G provides Bank G with invoices from Company F evidencing that it acquired the jeans in an authorized sale, or copies of the agreements with Company F evidencing that the jeans distributed by Company G are genuine. Bank G extends credit to Company G against the value of the inventory.

## F. Key objectives and fundamental policies

[*Note to the Working Group: For paras. 46-52, see A/CN.9/WG.VI/WP.39, paras. 53-59, A/CN.9/685, para. 25, 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.*]

46. As already mentioned (see para. 1 above), 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).

47. 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, without 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)).

48. 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. 2-7 above and A/CN.9/WG.VI/WP.42/Add.1, section II, A.4).

49. 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.

50. 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 by the owner or the secured creditor (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).

51. In addition, in the case of products or services associated with marks, this key objective means 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.

52. 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.