



General Assembly

Distr.: General
22 March 2010

Original: English

**United Nations Commission
on International Trade Law**
Forty-third session
New York, 21 June-9 July 2010

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

Note by the Secretariat

Addendum

Contents

	<i>Paragraphs</i>	<i>Page</i>
V. Priority of a security right in intellectual property	1-49	3
A. The concept of priority	1-2	3
B. Identification of competing claimants	3-4	3
C. Relevance of knowledge of prior transfers or security rights	5-6	4
D. Priority of security rights in intellectual property that are not registered in an intellectual property registry	7-8	5
E. Priority of security rights in intellectual property that are registered in an intellectual property registry	9-11	5
F. Rights of transferees of encumbered intellectual property	12-15	7
G. Rights of licensees in general	16-20	8
H. Rights of certain licensees	21-40	9
I. Priority of a security right in intellectual property granted by a licensor as against a security right granted by a licensee	41-46	14



J. Priority of a security right in intellectual property as against the right of a judgement creditor	47-48	16
K. Subordination	49	16
Recommendation 245		16

V. Priority of a security right in intellectual property

[*Note to the Commission: For paras. 1-49 and recommendation 245, see A/CN.9/WG.VI/WP.42/Add.4, paras. 1-49, and recommendation 245; A/CN.9/689, paras. 30-32; A/CN.9/WG.VI/WP.39/Add.4, paras. 1-15; A/CN.9/WG.VI/WP.42/Add.5, paras. 1-12; A/CN.9/685, paras. 47-72; A/CN.9/WG.VI/WP.37/Add.2, paras. 43-55; A/CN.9/WG.VI/WP.37/Add.3, paras. 1-23; A/CN.9/670, paras. 73-95; A/CN.9/WG.VI/WP.35/Add.1, paras. 33-61; A/CN.9/667, paras. 86-103; A/CN.9/WG.VI/WP.33/Add.1, paras. 1-25; and A/CN.9/649, paras. 41-56.*]

A. The concept of priority

1. As used in the *Guide*, the concept of priority of a security right as against competing claimants refers to the question of whether the secured creditor may derive the economic benefit of its security right in an encumbered asset in preference to a competing claimant (see the term “priority” in the introduction to the *Guide*, sect. B; see also the term “competing claimant” in the introduction to the draft Supplement, A/CN.9/700, paras. 10 and 11, and paras. 3-5 below). It should also be noted that a conflict between two persons, neither of whom is a secured creditor, is not a priority conflict under the law recommended in the *Guide*.

2. By contrast, in law relating to intellectual property, the concept of priority of an intellectual property right may relate to notions of exclusive rights. In most States, once intellectual property is transferred by the owner, a second transfer by the same person will normally transfer no rights to the second transferee (except if the first transferee does not comply with statutory registration requirements or the second transferee is a good faith purchaser; for the relevance of knowledge of prior transfers, see paras. 5 and 6 below). Similarly, if both the first and the second transferee create a security right in their intellectual property rights, there may be no priority conflict under the law recommended in the *Guide* to the extent the second transferee does not have any intellectual property right in which to create a security right. In such a case, the issue of priority in the sense that this term is used in the *Guide* does not arise. Accordingly, the law recommended in the *Guide* would not apply and this matter would be left to law relating to intellectual property, which would typically resolve it by reference to the *nemo dat* principle and principles about good faith acquisition of assets. It should be noted that, under the law recommended in the *Guide*, a party that does not have rights in or the power to encumber an asset at the time of the conclusion of the security agreement, or does not acquire such rights or power later, may not create a security right in the asset (see recommendation 13).

B. Identification of competing claimants

3. The *Guide* uses the term “competing claimant” to refer to another secured creditor with a security right in the same asset (which includes a transferee in a transfer by way of security), an outright transferee, lessee or licensee of the encumbered asset, a judgement creditor with a right in the encumbered asset and an insolvency representative in the insolvency of the grantor (see the term “competing

claimant”, A/CN.9/700, paras. 10 and 11). In particular, the law recommended in the *Guide* applies to priority conflicts: (a) between security rights, notices of which are registered in the general security rights registry (see recommendation 76, subpara. (a)); (b) between a security right, a notice of which is registered in the general security rights registry, and a security right, a document or notice of which is registered in the relevant intellectual property registry (see recommendation 77, subpara. (a)); (c) between security rights, documents or notices of which are registered in the relevant intellectual property registry (see recommendation 77, subpara. (b)); (d) between the rights of a transferee or licensee of intellectual property and a security right in that intellectual property, a notice or document of which may be registered in an intellectual property registry (see recommendation 78); (e) between the rights of a transferee or licensee of intellectual property and a security right in that intellectual property, a notice or document of which may not be registered in an intellectual property registry (see recommendations 79-81); and (f) between two security rights that are both effective against third parties, one of which is created by the grantor and the other is created by the transferee, lessee or licensee of the encumbered asset. The last conflict is addressed in the sense that the transferee, lessee or licensee takes the asset subject to the security right created by the grantor (see recommendations 79 and 82) and the secured creditor of the transferee takes no more rights than the transferee had (see recommendation 31).

4. In an intellectual property context, the notion of “conflicting transferees” is used instead and it includes transferees and licensees competing with each other. If no conflict with a security right in intellectual property (which includes the right of a transferee by way of security) is involved, the law recommended in the *Guide* does not apply and the matter is left to law relating to intellectual property. If a conflict with such a security right is involved, the law recommended in the *Guide* does not apply in so far as its provisions are inconsistent with the enacting State’s law relating to intellectual property (see recommendation 4, subpara. (b)). Furthermore, the law recommended in the *Guide* does not apply to a conflict between a transferee of an encumbered asset that acquired the asset from a secured creditor enforcing its security right and another secured creditor that later received a right in the same asset from the same grantor (that no longer had any rights in the encumbered asset). This is not a priority conflict under the law recommended in the *Guide*, but it may well be a conflict addressed by law relating to intellectual property.

C. Relevance of knowledge of prior transfers or security rights

5. Under the law recommended in the *Guide*, knowledge of the existence of a prior security right on the part of a competing claimant is generally irrelevant for determining priority (see recommendation 93; however, knowledge that a transfer violates the rights of a secured creditor may be relevant; see recommendation 81, subpara. (a)). Thus, a later created but earlier registered security right has priority over an earlier created but later registered security right, even if the holder of the later created security right had knowledge of the existence of the earlier created security right (see recommendation 76, subpara. (a)).

6. By contrast, in many States, law relating to intellectual property provides that a later conflicting transfer or security right may only gain priority if it is registered first and taken without knowledge of a prior conflicting transfer. The deference to law relating to intellectual property under recommendation 4, subparagraph (b), should preserve these knowledge-based priority rules to the extent they apply specifically to security rights in intellectual property.

D. Priority of security rights in intellectual property that are not registered in an intellectual property registry

7. As already mentioned, if law relating to intellectual property has priority rules dealing with the priority of security rights in intellectual property that apply specifically to intellectual property and the priority rules of the law recommended in the *Guide* are inconsistent with those rules, the law recommended in the *Guide* does not apply (see recommendation 4, subpara. (b)). However, if law relating to intellectual property does not have such rules or the priority rules of the law recommended in the *Guide* are not inconsistent with such rules, the priority rules of the law recommended in the *Guide* apply.

8. Under the law recommended in the *Guide*, priority between security rights granted by the same grantor in the same encumbered asset that were made effective against third parties by registration in the general security rights registry is determined by the order of registration of a notice in that registry (see recommendation 76, subpara. (a)). This rule applies if a document or notice of a security right may not be registered or is not registered in a specialized registry. If such a document or notice may be registered and is registered in a specialized registry, different rules apply (see recommendation 77 and paras. 9-11 below). In addition, if a security right is granted by a different grantor (for example, a transferee of the initial grantor), different rules apply (see recommendation 79-83 and paras. 12-29 below). All these rules apply equally to security rights in intellectual property.

E. Priority of security rights in intellectual property that are registered in an intellectual property registry

9. The *Guide* recommends that a security right in an asset that is made effective against third parties by registration in a specialized registry (see recommendation 38) has priority over a security right in the same asset that is made effective against third parties by another method (see recommendation 77, subpara. (a)). It also recommends that a security right in an asset that is made effective against third parties by registration in a specialized registry has priority over a security right that was subsequently registered in the specialized registry (see recommendation 77, subpara. (b)). In addition, the *Guide* recommends that, if an encumbered asset is transferred, leased or licensed and, at the time of the transfer, lease or licence, the security right has been made effective against third parties by registration in a specialized registry, the transferee, lessee or licensee takes its rights subject to the security right. If such a security right has not been registered in a specialized registry, a transferee, lessee or licensee of an encumbered asset takes the asset free of the security right, even if a notice of the security right was registered in

the general security rights registry (see recommendation 78). These rules are subject to certain exceptions (see paras. 12-40 below, as well as recommendations 79-81). In addition, if a transferee, lessee or licensee of an encumbered asset acquires its rights in the asset free of a security right, any person that subsequently acquires rights in the asset acquires its rights free of the security right (see recommendations 31 and 82).

10. These recommendations are equally applicable to security rights in intellectual property. Thus, if there is a conflict between two security rights in intellectual property, one of which is the subject of a notice registered in the general security rights registry and the other is the subject of a document or notice registered in the relevant intellectual property registry, the law recommended in the *Guide* applies and gives priority to the latter security right (see recommendation 77, subpara. (a)). If there is a conflict between security rights registered in the relevant intellectual property registry, the right registered first has priority and the law recommended in the *Guide* confirms that result (see recommendation 77, subpara. (b)). If there is a conflict between the rights of a transferee of intellectual property and a security right which, at the time of the transfer, may be and is registered in the relevant intellectual property registry, the transferee takes the encumbered intellectual property subject to the security right. However, if a security right in intellectual property may be registered but is not registered in the relevant intellectual property registry, the transferee or licensee of the encumbered intellectual property takes the encumbered intellectual property free of the security right, even if the security right was registered in the general security rights registry (see recommendation 78). In some States, under law relating to intellectual property, a secured creditor may have priority in this case, if the transferee is not a good-faith purchaser. Following recommendation 4, subparagraph (b), the law recommended in the *Guide* would defer to that rule if it applied specifically to intellectual property. Finally, if a transferee acquires a right in encumbered intellectual property subject to a security right, any person (for example, a secured creditor) that subsequently acquires a right in the intellectual property from the transferee also takes its right subject to the security right (see recommendations 31 and 82).

11. For example, if A creates a security right in a patent in favour of B, which registers a notice of its security right in the general security rights registry, and then A transfers title to the patent to C, which registers a document or notice of its transfer in the patent registry, under recommendation 78 of the *Guide*, C would take the patent free of the security right of B. If A, instead of making a transfer, creates a second security right in favour of C and C registers a document or notice of the security right in the patent registry, under recommendation 77, subparagraph (a), of the *Guide*, C would prevail. In either case, as registration of a document or notice in the patent registry gives superior rights, under the law recommended in the *Guide*, third-party searchers could rely on a search in that registry and would not need to search in the general security rights registry. In all these examples, the questions of who is a transferee and what are the requirements for a transfer are matters of law relating to intellectual property. It should also be noted that registration in the intellectual property registry would normally refer only to a security right in intellectual property and not to a security right in tangible assets with respect to which intellectual property is used.

F. Rights of transferees of encumbered intellectual property

12. Under the law recommended in the *Guide*, a transferee of an encumbered asset (including intellectual property) normally takes the asset subject to a security right that was effective against third parties at the time of the transfer. There are two exceptions to this rule (recommendation 79). The first exception arises where the secured creditor authorizes the sale or other disposition free of the security right (see recommendation 80, subpara. (a)). The second exception relates to a transfer in the ordinary course of the seller's business where the buyer has no knowledge that the sale or other disposition violates the rights of the secured creditor under the security agreement (see recommendation 81, subpara. (a)). If a security right may be registered (whether registered or not) in an intellectual property registry, as already mentioned (see paras. 9-11 above), a different rule applies (see recommendation 78).

13. Recommendation 79 applies equally to security rights in intellectual property that may not be registered in an intellectual property registry and recommendation 78 applies to security rights in intellectual property that may be registered (whether registered or not) in an intellectual property registry. Thus, if a notice in respect of a security right is registered in the general security rights registry, a transferee or licensee of intellectual property will take the encumbered intellectual property subject to the security right, unless one of the exceptions set out in recommendations 80-82 applies (with respect to recommendation 81, subpara. (c), see paras. 21-40). These recommendations do not apply, under recommendation 4, subparagraph (b), if they are inconsistent with the priority rules of the law relating to intellectual property that apply specifically to intellectual property.

14. The preceding analysis deals with a priority conflict between a security right and the rights of a subsequent transferee. The situation is different where intellectual property is transferred before the creation of a security right, as no priority conflict arises here under the law recommended in the *Guide*. In this case, as a result of the *nemo dat* principle, the secured creditor will have no security right in the intellectual property at all. As already mentioned, the *Guide* does not interfere with the application of the *nemo dat* principle. To the contrary, this approach is reflected in the general rule in the law recommended in the *Guide* that a grantor can create a security right only in an asset in which the grantor has rights or the power to create a security right (see recommendation 13). This rule would be displaced though by a rule of law relating to intellectual property giving priority to a secured creditor that took a security right in intellectual property without knowledge of a prior transfer of the intellectual property by the grantor (see recommendation 4, subpara. (b)).

15. It is also important to note that, as already mentioned (see A/CN.9/700, paras. 23-25, and A/CN.9/700/Add.3, paras. 38 and 39), under the *Guide*, a licence of intellectual property is not a transfer of the licensed intellectual property. Thus, the rules of the law recommended in the *Guide* that apply to transfers of encumbered assets do not apply to licences. However, the law recommended in the *Guide* would defer to law relating to intellectual property treating certain licences (in particular, exclusive licences) as transfers (see recommendation 4, subpara. (b)).

G. Rights of licensees in general

16. Intellectual property is routinely licensed. In such cases, the retained rights of a licensor, such as the ownership right, rights associated with ownership and the rights of a licensor under a licence agreement (such as the right to grant further licences or to obtain payment of royalties), may be used by the licensor as security for credit. Similarly, the licensor's authorization for the licensee to use or exploit the intellectual property or the licensee's right to grant sub-licences and obtain payment of sub-royalties (in both cases according to the terms of the licence agreement) may be used by the licensee as security for credit (as to the types of encumbered asset in an intellectual property context, see A/CN.9/700/Add.2, paras. 13-36).

17. Typically, under secured transactions law, including the law recommended in the *Guide*, a secured creditor does not become an owner of the encumbered asset, unless, upon default, the secured creditor enforces its security right and acquires the asset in an enforcement sale or in satisfaction of the secured obligation (see A/CN.9/700, paras. 29 and 30; A/CN.9/700/Add.2, paras. 10-12; and A/CN.9/700/Add.5, paras. 16, 17 and 21). The question whether the intellectual property owner that has created a security right in its intellectual property is still the owner for purposes of law relating to intellectual property and may, for example, grant a licence in the encumbered intellectual property is a matter to be determined by law relating to intellectual property. Under general principles of law relating to intellectual property (with which the law recommended in the *Guide* is consistent), the grantor who is no longer the owner (or is not entitled to exercise the rights of the owner) may not grant a licence in its encumbered intellectual property if, under law relating to intellectual property, the secured creditor becomes the owner (or may exercise the rights of an owner) of the intellectual property with authority to grant licences while the security right is in place (see A/CN.9/700/Add.5, para. 1). In this situation, a licence granted by the original owner would be an unauthorized licence under law relating to intellectual property and the licensee would obtain nothing based on the *nemo dat* principle. It also follows that, because the secured creditor only obtains a security right in the rights that the grantor has, in this situation there is no asset which the security right of the secured creditor of the licensee can encumber (see recommendation 13).

18. If the owner, after creating a security right in its intellectual property, remains the owner but its ability to grant licences is limited by agreement with the secured creditor (to the extent such agreement is permitted under law relating to intellectual property), the owner may theoretically grant a licence, but the granting of a licence by the owner in breach of its agreement with the secured creditor would be an event of default. As a result, the owner's secured creditor could enforce its security right and, exercising the rights of the owner, sell the licensed intellectual property or grant another licence free of the pre-existing licence (and any security right granted by the licensee), as that licensee would normally have taken its licence subject to the security right of the owner's secured creditor (see recommendations 79 and 161-163). Alternatively, the owner's secured creditor could enforce its security right upon default by collecting the royalties owed by the licensee to the owner as licensor. If the encumbered asset is the owner's intellectual property rights, the secured creditor may collect the royalties as proceeds of the encumbered asset (see

recommendations 19, 39, 40, 100 and 168). If the encumbered asset is the right of the owner as licensor to the payment of royalties, the secured creditor may collect the royalties as the original encumbered asset. In either case, the secured creditor may collect royalties even before default, but only if there is an agreement to that effect between the owner and its secured creditor (see recommendation 168). In any case, if the licensee took the licensed intellectual property free of the security right granted by the owner in the intellectual property, the licensee could retain its licence and the secured creditor could only seek to collect the royalties owed by the licensee to the owner (see recommendations 80, subpara. (b), and 245).

19. If the licensee also creates a security right in its rights under the licence agreement (for example, the right to use or exploit the licensed intellectual property), that security right would be in a different asset (that is, not in the owner's rights). The reason for this result is that the licensee would have taken its rights under the licence agreement subject to the security right created by the owner (see recommendation 79) and the licensee could not have given to its secured creditor more rights than the licensee had (based on the *nemo dat* principle). So, if the secured creditor of the owner enforced its security right and disposed of the encumbered intellectual property free of the licence, the licence would terminate upon that disposition and the asset encumbered by the licensee would cease to exist. Likewise, whether or not the owner had granted a security right to one of its creditors, if the licensee defaults on the licence agreement, the owner as licensor can terminate it to the extent permitted under law relating to intellectual property and the licensee's secured creditor would be again left without an asset encumbered by its security right.

20. As already mentioned (see A/CN.9/700, paras. 23-25, A/CN.9/700/Add.3, paras. 38 and 39, and para. 15 above), the rights of the licensor and the licensee under the licence agreement and the law relating to intellectual property would remain unaffected by secured transactions law. So, if the licensee defaulted on the licence agreement, the licensor could exercise any available right to terminate it and the licensee's secured creditor would again be left without security. Similarly, secured transactions law would not affect an agreement between the licensor and the licensee prohibiting the licensee from granting sub-licences or assigning to the licensor the licensee's rights to the payment of royalties owed by sub-licensees to the licensee as sub-licensor (see A/CN.9/700/Add.2, paras. 26-28).

H. Rights of certain licensees

21. As already mentioned (see para. 12 above), as a matter of secured transactions law, there are two exceptions to the rule recommended in the *Guide* that a licensee of encumbered intellectual property takes the licence subject to a pre-existing security right (see recommendation 79).

22. The first exception arises where the secured creditor authorizes the granting of a licence by the licensor free of the security right (see recommendation 80, subpara. (b)). Thus, under the law recommended in the *Guide*, in the case of the grantor's default, the secured creditor could collect any royalties owed by the licensee to the grantor as licensor, but not sell the licensed intellectual property free of the rights of the existing licensee or grant another licence with the effect of

terminating the rights of the existing licensee as long as the licensee performs the terms of the licence agreement.

23. The second exception to the principle embodied in recommendation 79 is that a licensee that takes a non-exclusive licence in the ordinary course of business of the licensor without knowledge that the licence violated the rights of the secured creditor in the licensed intellectual property, takes its rights under the licence agreement unaffected by a security right previously granted by the licensor (see recommendation 81, subpara. (c), which applies to intangible assets generally, but only if a security right has been created and made effective against third parties before conclusion of a licence agreement). The result of this rule is that, in the case of enforcement of the security right in the licensed intellectual property by the secured creditor of the licensor under the enforcement rules of the law recommended in the *Guide*, the secured creditor could collect any royalties owed by the licensee to the licensor, but not sell the licensed intellectual property free of the rights of the existing licensee or grant another licence with the effect of interfering with the rights of the existing licensee as long as the licensee performs the terms of the licence agreement. This rule is intended to protect everyday, legitimate transactions, such as off-the-shelf purchases of copyrighted software with end-user licence agreements by limiting the enforcement remedies of a secured creditor under the enforcement rules of the law recommended in the *Guide*. In such transactions, the essence of the protection meant here is that purchasers should not have to do a search in a registry or acquire the copyrighted software subject to security rights created by the software developer or its distributors.

24. Recommendation 81, subparagraph (c), is based on the assumption that the grantor retains ownership of the encumbered intellectual property. This means that recommendation 81, subparagraph (c), does not apply if, under law relating to intellectual property, the grantor is no longer authorized to grant a licence because it has transferred its rights as an owner to the secured creditor (which is not the effect of secured transactions law). In addition, recommendation 81, subparagraph (c), does not affect the relationship between the licensor and the licensee and does not mean that the licensee would obtain a licence free of the terms and conditions of the licence agreement and the law applicable to it (for example, free of a clause in the licence agreement that the licence will terminate upon default); nor does it affect limitations in the licence agreement on the licensee entering into sub-licence agreements. Moreover, this recommendation and the *Guide* as a whole do not interfere with the enforcement of provisions as between the secured creditor and the grantor/licensor (or between the licensor and its licensee) that the grantor/licensor place in all of the non-exclusive ordinary course-of-business licences a provision that the licence will terminate if the licensor's secured creditor enforces its security right.

25. The secured creditor may elect to avoid extending any credit until it has an opportunity to review and approve the terms and conditions of any licence or sub-licence agreement. For example, the secured creditor may include terms in the security agreement to ensure that expected royalties are paid up front, to provide for termination of any licence agreement in the case of non-payment of royalties and to prohibit the assignment of any royalties or sub-royalties. In addition, if the secured creditor of the licensor does not want to encourage non-exclusive licences, it can, in its security agreement (or elsewhere), require the grantor (the licensor) to place in

all of the non-exclusive licences a provision that the licence will terminate if the licensor's secured creditor enforces its security right. Similarly, if the licensor does not want its licensee to grant any sub-licences, it can include in the licence agreement a provision that the granting of a sub-licence by the licensee is an event of default under the licence agreement that would entitle the licensor to terminate the licence. Nothing in the *Guide* would interfere with the enforcement of such provisions as between the secured creditor and its borrower (or as between the licensor and its licensee). Ordinarily, the secured creditor will have no interest in doing that, since the licensor (and any licensee) is in the business of granting non-exclusive licences and the secured creditor expects the grantor to use the fees paid under those licence agreements to pay the secured obligation.

26. From the discussion above it becomes clear that the scope of application of recommendation 81, subparagraph (c), is very limited for a number of reasons. Firstly, secured creditors often have no interest in limiting the ability of an owner/grantor to grant licences in its intellectual property and collect royalties. As a matter of fact, a secured creditor is in many cases interested in permitting licensing so that the owner/grantor may repay the secured obligation. Secondly, by its wording, recommendation 81, subparagraph (c), applies only where there is a non-exclusive licence, one that includes a legitimate "off-the-shelf" purchase of licences of mainly copyrighted software used with respect to equipment and only where the licensee had no knowledge that the licence violated the rights of the secured creditor under the security agreement.

27. In addition, the impact of the application of recommendation 81, subparagraph (c), is very limited. The effectiveness, priority and enforceability of the security right against competing claimants (other than the specific licensee) under secured transactions law are not affected. At the same time, if the secured creditor has other rights under law relating to intellectual property law (for example, the rights of an owner), these rights are not affected by recommendation 81, subparagraph (c). The extent of such rights or remedies is a matter of law relating to intellectual property.

28. However, as the concept of "ordinary course of business" is a concept of commercial law and is not drawn from law relating to intellectual property law, it may create confusion in an intellectual property financing context. Typically, law relating to intellectual property does not distinguish in this respect between exclusive and non-exclusive licences and focuses rather on the issue whether a licence has been authorized or not. Accordingly, if a licence has been authorized (that is, the grantor of a security right has, under law relating to intellectual property, a right to grant licences in its encumbered intellectual property), the secured creditor of the licensee takes its right in the licence free of a security right created by the licensor.

29. To the contrary, if a licence has not been authorized, the licensee takes the licence subject to a security right created by the licensor. To the extent that a State has such a rule in its law relating to intellectual property, recommendation 81, subparagraph (c), would not apply (see recommendation 4, subpara. (b)). As a result, unless the secured creditor authorized the grantor to grant licences unaffected by the security right (which will typically be the case as the grantor will rely on its royalty income to pay the secured obligation), the licensee would take the licence subject to the security right. Thus, if the grantor defaults, the secured creditor would

be able to enforce its security right in the licensed intellectual property and sell or license it free of the licence. In addition, a person obtaining a security right from the licensee will not obtain an effective security right as the licensee would have received an unauthorized licence and would have no right in which to create a security right.

30. If law relating to intellectual property does not address this matter at all or addresses it consistently with the way in which it is addressed in recommendation 81, subparagraph (c), recommendation 81, subparagraph (c), will apply in the limited cases and with the limited impact described above (see recommendation 4, subpara. (b)).

31. However, in order to avoid any possible inconsistency between the law recommended in the *Guide* and law relating to intellectual property, a different approach could be followed (see recommendation 245 below). Under this approach, recommendation 81, subparagraph (c), generally applies to rights of a secured creditor under the secured transactions law recommended in the *Guide* (without affecting the effectiveness of a security right in licensed intellectual property, its priority as against a competing claimant other than a non-exclusive licensee or the enforcement remedies of the secured creditor under secured transactions law that do not affect the rights of the licensee). However, recommendation 81, subparagraph (c), does not affect the rights of a secured creditor if the secured creditor is an owner under law relating to intellectual property (for example, as already mentioned, the law recommended in the *Guide* does not affect any right that the licensor may have to terminate the licence for non-compliance of the licensee with the licence agreement; see A/CN.9/700, paras. 23-25, and para. 24 above).

32. It should be noted that, like any other approach recommended in the *Guide* with respect to security rights in intellectual property, this approach also would be subject to recommendation 4, subparagraph (b). In addition, it should be noted that: (a) references in the *Guide* and the draft Supplement to a security right in a priority context refer to a security right that is effective against third parties (otherwise no priority dispute can arise under the *Guide*); and (b) references in the *Guide* and the draft Supplement to an intellectual property licence refer to a licence granted by a person that is authorized to grant a licence in that intellectual property under the law relating to intellectual property.

33. The following examples are designed to clarify the situations to which this approach would apply and the impact of its application. In each example, it should be assumed that: (a) O owns intellectual property; (b) O creates a security right in the intellectual property in favour of SC; (c) O's security right is effective against third parties either in accordance with the recommendations of the *Guide* or, if the law recommended in the *Guide* does not apply, in accordance with recommendation 4, subparagraph (b), under the law relating to intellectual property; and (d) SC has not agreed, in the security agreement or otherwise, that any licensee of the intellectual property from O will enjoy its rights free of SC's security right.

34. After SC takes the steps necessary to make its security right effective against third parties, O, who is in the business of granting non-exclusive licences of the intellectual property on substantially the same terms to any person who agrees to perform in accordance with such terms, offers to license the intellectual property to L. L enters into a licence agreement with O on those terms. O defaults on the

obligation secured by the security right and SC sets out to enforce its security right. The right of L to use the intellectual property is protected by recommendation 245 against enforcement by SC of its security right because the licence and the transaction satisfy each provision of recommendation 245. However, SC still has whatever rights it may have against L under law relating to intellectual property and contract law.

35. After SC takes the steps necessary to make its security right effective against third parties, O grants a licence in the intellectual property to L. The licence agreement provides that L may grant sub-licences in the intellectual property only for educational markets. L grants a sub-licence in a commercial market to SL. O defaults on the obligation secured by the security right, and SC sets out to enforce its security right. If, under the law relating to intellectual property, the sub-licence to SL is not authorized, the right of SL to use the intellectual property is not protected by recommendation 245 against enforcement by SC of its security right (and, as rights and obligations under the licence agreement go together, L is no longer bound by the obligations set out in the licence agreement).

36. After SC takes the steps necessary to make its security right effective against third parties, O grants a licence in the intellectual property to L. The licence agreement provides that L has exclusive rights to use the intellectual property in State Z. O defaults on the obligation secured by the security right, and SC sets out to enforce its security right. The right of L to use the intellectual property is not protected by recommendation 81, subparagraph (c), or 245 against enforcement by SC of its security right because the licence is exclusive.

37. After SC takes the steps necessary to make its security right effective against third parties, O, who is in the business of granting non-exclusive licences of the intellectual property on substantially the same terms to any person who agrees to perform in accordance with such terms, offers to license the intellectual property to L on such terms. L declines to enter into a licence agreement with O on those terms. Instead, O grants a licence in the intellectual property to L, pursuant to which L has substantially greater rights in the intellectual property than under the licences generally offered to others. O defaults on the obligation secured by the security right, and SC sets out to enforce its security right. The right of L to use the intellectual property is not protected by recommendation 81, subparagraph (c), or 245 against enforcement by SC of its security right because the licence is not on substantially the same terms as other licences of the same intellectual property.

38. Before O and L enter into the licence agreement, L discovers the notice filed to make SC's security right effective against third parties and, accordingly, asks to see a copy of the security agreement relating to that notice. The security agreement is furnished to L by O. Upon reading the security agreement, L discovers that the licence to it would violate the rights of SC. Nonetheless, L enters into the licence agreement with O. O defaults on the obligation secured by the security right, and SC sets out to enforce its security right. The right of L to use the intellectual property is not protected by recommendations 81, subparagraph (c), or 245 against enforcement by SC of its security right because L had knowledge that the licence agreement would violate SC's rights.

39. However, if O does not furnish a copy of the security agreement to L and, as a result, although L knows of the existence of the security right, L does not know that

the licence would violate the rights of SC, the right of L to use the intellectual property is protected by recommendations 81, subparagraph (c), and 245 against enforcement by SC of its security right.

40. After SC takes the steps to make its security right effective against third parties, O offers to license the intellectual property but only to parties who have experience in using this type of intellectual property. O grants a licence to L, who has that experience. O defaults on the obligation secured by the security right, and SC sets out to enforce its security right. The right of L to use the intellectual property is not protected by recommendation 81, subparagraph (c), or 245 against enforcement by SC of its security right because O did not make a licence of the intellectual property available on substantially the same terms to any person who agreed to perform the obligations of the licensee under the licence agreement in accordance with such terms.

I. Priority of a security right in intellectual property granted by a licensor as against a security right granted by a licensee

41. Under the law recommended in the *Guide*, with limited exceptions (see recommendations 80, subpara. (b), 81, subpara. (c), and 245), a licensee takes its rights subject to a security right previously granted by the licensor in its rights and made effective against third parties (see recommendation 79). As already explained (see paras. 22 and 23 above), this means that, upon default, the secured creditor may enforce its security right and sell or licence the grantor's rights in the intellectual property. If the licensee also grants a security right in its rights as a sub-licensor against the sub-licensee, no priority conflict arises under the law recommended in the *Guide* between the two security rights because they encumber different assets. The licensor's secured creditor has a security right in the licensor's right to the payment of the royalties owed to the licensor by the licensee under the licence agreement, while the licensee's secured creditor has a security right in any sub-royalties due to the licensee (as sub-licensor) by a sub-licensee under a sub-licence agreement.

42. However, a security right in sub-royalties created by a licensee as a sub-licensor can have an impact on the licensee's ability to pay royalties to the licensor if the licensee is in default with respect to its obligations to its secured creditor inasmuch as that secured creditor may seek to collect the sub-royalties itself. In addition, if the licensee, in payment of royalties owed by the licensee to the licensor, assigns to the licensor the right to the payment of a percentage of the sub-royalties that the licensee will obtain as a sub-licensor from sub-licensees, then a priority conflict may arise between a secured creditor of the licensor and a secured creditor of the licensee under the law recommended in the *Guide*. In such a case, if the assignment of the right to payment of sub-royalties takes place before a security right is created and made effective by the licensee, the licensee does not have a right in the right to payment of the assigned sub-royalties at the time it creates a security right and thus a secured creditor of the licensee takes its security right in the right to payment of sub-royalties subject to the security right of the licensor's secured creditor. If, however, the assignment of the right to payment of sub-royalties by the licensee to the licensor takes place after a security right is created and made effective by the licensee in its right to payment of sub-royalties, the licensor takes

its rights to payment of sub-royalties subject to the security right of the licensee's secured creditor and thus the licensor's secured creditor takes its security right also subject to the security right of the licensee's secured creditor (see recommendations 13 and 31).

43. The following example may be useful in illustrating the problem. A creates a security right in all its future assets or royalties in favour of secured creditor SC1. A then takes an intellectual property licence from licensor B and, in payment of royalties owed to B, licensee A assigns to licensor B the right to payment of a percentage of the sub-royalties payable to licensee A as a sub-licensor. Licensor B creates and makes effective against third parties a security right in these royalties in favour of secured creditor SC2. Licensee A's secured creditor SC1 will prevail as licensor B took the assignment of the sub-royalties subject to security right of licensee A's secured creditor SC1 and licensor B's secured creditor SC2 can have no greater rights than licensor B.

44. In this regard, it should be noted that the licensor has, under the law recommended in the *Guide*, numerous ways to protect itself in this circumstance. For example, the licensor can protect its rights by: (a) ensuring that its secured creditor registers first a notice of its security right in the general security rights registry; (b) ensuring that its secured creditor registers first a document or notice in the relevant intellectual property registry; (c) requiring the secured creditor of the licensee to enter into a subordination agreement with the licensor's secured creditor before granting a licence; (d) prohibiting the licensee from granting a security right in its right to the payment of sub-royalties; (e) terminating the licence in cases where the licensee created a security right in its sub-royalties in breach of such a prohibition; or (f) prior to the licensee as sub-licensor granting a security right to its secured creditor, granting a security right in its right to payment of a percentage of the sub-royalties and agreeing that any sub-licensee pay its sub-royalties directly to an account of the licensor. The *Guide* does not interfere with any agreements of this kind between licensor and licensee, if they are effective under law relating to intellectual property and contract law. In addition, the licensor could insist that the licensee grant to the licensor a security right in its right to the payment of sub-royalties and take as a secured creditor the steps just mentioned.

45. However, these steps may protect the licensor to a certain extent only, because, for example, rights in the encumbered intellectual property may not be subject to registration in an intellectual property registry or it may not be commercially practicable for the licensor to prohibit sub-licensing, terminate the licence agreement or obtain a subordination agreement. In addition, the priority of a security right created by the licensor as against another security right created by the licensee in its right to the payment of sub-royalties would be subject to the general rules explained above (see para. 41).

46. It should be noted that a secured creditor financing the acquisition of an intellectual property right or an intellectual property licence may have the special priority status of an acquisition secured creditor (see A/CN.9/700/Add.5, ch. IX). However, this priority status will be relevant only if there is a priority dispute between security rights created by the same grantor in the same asset. Thus, this priority status does not apply to a priority dispute between a security right created by a licensor and a security right created by a licensee.

J. Priority of a security right in intellectual property as against the right of a judgement creditor

47. The *Guide* recommends that a security right that was made effective against third parties before a judgement creditor obtained rights in the encumbered asset have priority as against the right of the judgement creditor. However, if an unsecured creditor obtained a judgement against the grantor and took the steps necessary under the law governing the enforcement of judgements to acquire rights in the encumbered assets before the security right became effective against third parties, the right of the judgement creditor has priority (see recommendation 84).

48. This recommendation applies equally to security rights in intellectual property (subject to the principle embodied in recommendation 4, subpara. (b)). In such a case, under law relating to intellectual property, the judgement creditor may have to obtain a transfer of the intellectual property and a document or notice thereof may have to be registered in an intellectual property registry in order for the judgement creditor to obtain priority. If this transfer takes place before a security right was made effective against third parties, both under the law recommended in the *Guide* (see recommendation 13) and law relating to intellectual property (*nemo dat*), the transferee of encumbered intellectual property will take the encumbered intellectual property free of the security right.

K. Subordination

49. The law recommended in the *Guide* recognizes the principle of subordination (see recommendation 94). The essence of this principle is that, as long as the rights of third parties are not affected, competing claimants may alter by agreement the priority of their competing claims in an encumbered asset. The principle applies equally to security rights in intellectual property.

Recommendation 245¹

Priority of rights of certain licensees of intellectual property

The law should provide that the rule in recommendation 81, subparagraph (c), applies to the rights of a secured creditor under this law and does not affect the rights the secured creditor may have under the law relating to intellectual property.

¹ If it could be included in the *Guide*, this recommendation would be placed in chapter V, Priority of a security right, as recommendation 81 bis. As an asset-specific recommendation, this recommendation would replace the general recommendation 81, subpara. (c), to the extent that it applies to the priority of the rights of a non-exclusive licensee of intellectual property as against the rights of a secured creditor of the licensor.