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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

**Addendum**

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# I. Scope of application and party autonomy

[*Note to the Commission: For paras. 1-24, see A/CN.9/WG.VI/WP.42/Add.1, paras. 1-24; A/CN.9/689, para. 22; A/CN.9/WG.VI/WP.39/Add.1, paras. 1-24; A/CN.9/685, paras. 26 and 27, A/CN.9/WG.VI/WP.37/Add.1, paras. 1-24; A/CN.9/670, paras. 28-34; A/CN.9/WG.VI/WP.35, paras. 46-67; A/CN.9/667, paras. 29-31; A/CN.9/WG.VI/WP.33, paras. 82-108; and A/CN.9/649, paras. 81-87.*]

## A. Broad scope of application

1. The law recommended in the *Guide* applies to security rights in all types of movable asset, including intellectual property (for the meaning of the term "intellectual property", see A/CN.9/700, paras. 18-20). Under the law recommended in the *Guide*, a legal or natural person may create or acquire a security right, and a security right may secure any type of obligation (see recommendation 2). The law recommended in the *Guide* applies to all transactions serving security purposes, regardless of the form of the transaction or the terminology used by the parties (see recommendations 2, subpara. (d), and 8). The draft Supplement has an equally broad scope with respect to security rights in intellectual property.

### 1. Encumbered assets covered

2. The characterization of different types of intellectual property and the question of whether each type of intellectual property is transferable and may thus be encumbered are matters of law relating to intellectual property. However, the *Guide* and the draft Supplement are based on the general assumption that a security right may be created in any type of intellectual property, such as a patent, a trademark or a copyright. The *Guide* and the draft Supplement are also based on the assumption that the encumbered asset may be any of the various exclusive rights of an owner, the rights of a licensor, the rights of a licensee or the rights in intellectual property used with respect to a tangible asset.

3. However, there is an important limitation to the scope of the *Guide* and the draft Supplement. In line with general rules of property law, for a security right to be created in an asset, including intellectual property, the asset has to be transferable under property law, including law relating to intellectual property. For example, in many States, under law relating to intellectual property, only the economic rights under a copyright may be transferred (and thus encumbered), but not the moral rights of an author. The law recommended in the *Guide* does not affect such limitations. More specifically, the law recommended in the *Guide* does not override provisions of any other law (including law relating to intellectual property) to the extent that they limit the creation or enforcement of a security right in or the transferability of specific types of asset, including intellectual property (see recommendation 18). The only exception to this rule relates to statutory limitations to the assignability of future receivables and receivables assigned in bulk, which would be removed or overridden by a rule or law enacting the relevant recommendation of the *Guide* (see recommendation 23).

### 2. Transactions covered

4. As already mentioned (see para. 1 above), the law recommended in the *Guide* applies to all transactions serving security purposes, regardless of how they are denominated by the parties or by law relating to intellectual property. In other words, even if law relating to intellectual property characterizes a transfer of intellectual property to a creditor for security purposes as a conditional transfer or even as an "outright" transfer, the law recommended in the *Guide* treats this transaction as giving rise to a security right and thus applies to it as long as it serves security purposes (see recommendations 2, subpara. (d), and 8).

### 3. Outright transfers of intellectual property

5. To some extent, the law recommended in the *Guide* applies to an outright transfer (that is, a transfer of ownership) of a receivable (see recommendation 3). As the law recommended in the *Guide* treats royalties payable by the licensee of intellectual property to its licensor as receivables of the licensor (see the term "receivable" in the introduction to the *Guide*, sect. B), it applies, to some extent, to the outright transfer of the right to the payment of 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 inclusion of outright transfers of receivables in the scope of the law recommended in the *Guide* reflects the fact that such transfers are usually seen as financing transactions and are often difficult in practice to distinguish from loans against the receivables. However, simply because certain recommendations of the *Guide* would generally apply to outright transfers of receivables, this does not mean that the law re-characterizes an outright transfer of a receivable as a secured transaction. An important reason for not re-characterizing outright transfers of receivables as secured transactions is to avoid negatively affecting important receivables financing practices, such as factoring (for outright transfers of receivables, see the *Guide*, chap. I, paras. 25-31; for an example of a factoring transaction, see the introduction to the *Guide*, paras. 31-34).

6. The law recommended in the *Guide* also applies to transfers of all movable assets for security purposes, which it treats as transactions giving rise to a security right (see recommendations 2, subpara. (d), and 8). Thus, if a State enacts the recommendations of the *Guide*, a transfer of intellectual property (whether of full title or rights limited in scope, time or territory) for security purposes would be treated as a secured transaction. This approach of the law recommended in the *Guide* is based on the principle that, in determining whether a transaction is a secured transaction or not, substance prevails over form. Accordingly, parties will be able to create a security right in intellectual property simply by using the methods provided in the law recommended in the *Guide* without the need to adopt other formalities of a "transfer". This result will not affect licensing practices as, under the law recommended in the *Guide*, a licence agreement does not in itself create a security right and a licence with the right to terminate the licence agreement is not a security right (see A/CN.9/700, paras. 23-25).

7. The law recommended in the *Guide* does not apply to outright transfers of any movable asset other than receivables, including intellectual property (the term "assignment" is used in the *Guide* only with respect to receivables to avoid any implication that the recommendations that apply to the assignment of receivables

apply more generally to security rights in intellectual property; see the introduction to the *Guide*, footnote 24; see also A/CN.9/700, paras. 27 and 28). The law recommended in the *Guide* may, however, affect the rights of an outright transferee of an encumbered asset to the extent that there is a priority conflict between the rights of that transferee and the rights of a secured creditor with a security right in the asset. The reason for the exclusion of outright transfers of any movable asset other than receivables, including intellectual property, is that they are normally subject to and sufficiently covered by other law, including law relating to intellectual property.

### 4. Limitations on scope

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

9. The potential points of intersection between secured transactions law and law relating to intellectual property are dealt with in detail in the introduction (see A/CN.9/700, paras. 2-7) and in various chapters of the draft Supplement. As noted, the basic principle is set forth in recommendation 4, subparagraph (b), which provides that the law recommended in the *Guide* does not apply to "intellectual property in so far as the provisions of the law are inconsistent with national law or international agreements, to which the state is a party, relating to intellectual property." To provide a context for this more detailed discussion of the implications of recommendation 4, subparagraph (b), it is helpful at this point to delineate: (a) issues that are clearly the province of law relating to intellectual property and are not intended to be affected in any way by the *Guide*; and (b) issues on which the rules set out in the *Guide* may be pre-empted or supplemented by a rule of the law relating to intellectual property that regulates the same issue in a different manner from the *Guide*.

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

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

11. In the context of intellectual property financing, it follows that the law recommended in the *Guide* does not affect and does not purport to affect issues relating to the existence, validity, enforceability and content of a grantor's

intellectual property rights. These issues are determined solely by law relating to intellectual property. The secured creditor will need to pay attention to those rules in order to assess the existence and quality of the assets to be encumbered, but this would be the case with any type of encumbered asset (for example, whether a right to payment of funds credited to a bank account exists, its exact content and enforceability are matters for law other than secured transactions law). What follows is an indicative, non-exhaustive list of issues that may be addressed by law relating to intellectual property relevant to that assessment. Law relating to intellectual property may also deal with issues not included in the following list.

*Copyright*

(a) The determination of who is the author, joint author or right holder;

(b) The duration of copyright protection;

(c) The economic rights granted under the law and limitations on and exceptions to protection;

(d) The nature of the protected subject matter (expression embodied in the work, as opposed to the idea behind it, and the dividing line between these);

(e) The transferability of economic rights as a matter of law and the right to grant a licence;

(f) The possibility of terminating a transfer or licence of copyright, or otherwise regulating a transfer or licence;

(g) The scope and non-transferability of moral rights;

(h) Presumptions relating to the exercise and transfer of rights and limitations relating to who may exercise rights; and

(i) Attribution of original ownership in the case of commissioned works and works created by an employee within the scope of employment.

*Neighbouring (allied or related) rights*

(a) The meaning and extent of neighbouring rights, including whether a State may recognize certain neighbouring rights within copyright or other law;

(b) The persons entitled to claim neighbouring rights;

(c) The type of protected expression;

(d) The relationship between holders of neighbouring rights and holders of copyright;

(e) The extent of exclusive rights or rights of equitable remuneration with respect to neighbouring rights;

(f) Any connecting factors or formalities for protection, such as fixation, publication or notice;

(g) Any limitations and exceptions to protection for neighbouring rights;

(h) The duration of protection for neighbouring rights;

(i) The transferability of any neighbouring rights as a matter of law and the right to grant licences;

(j) The possibility of terminating a transfer or licence of neighbouring rights, or otherwise regulating a transfer or licence; and

(k) The scope, duration and non-transferability of any related moral rights.

*Patents*

(a) The determination of who is the patent owner or co-owner;

(b) The validity of a patent;

(c) The limitations on and exceptions to protection;

(d) Scope and duration of protection;

(e) The grounds for invalidity challenges (obviousness or lack of novelty);

(f) Whether certain prior publication is excluded from prior art and thus may not preclude patentability; and

(g) Whether protection is granted to a person who first invented the patent or to a person who first filed an application.

*Trademarks and service marks*

(a) The determination of who is the first user or the owner of the mark;

(b) Whether protection of the mark is granted to a person that uses the mark first or to a person that files an application first and whether protection is granted to a subsequently registered mark if it conflicts with a previously registered mark;

(c) Whether *ex ante* use is a prerequisite to registration in a mark registry or whether the right is secured by initial registration and maintained by later use;

(d) The basis of protection of the right (distinctiveness);

(e) The basis for losing protection (holder's failure to ensure that the mark retains its association with the owner's products in the marketplace), as in the case of:

(i) Licensing without the licensor directly or indirectly controlling the quality or character of the products or services associated with the mark (so called "naked licensing"); and

(ii) Altering the mark so its appearance does not match the mark as registered; and

(f) Whether the mark may be transferred with or without goodwill.

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

12. The issues just addressed do not create any necessity for deference to law relating to intellectual property, since the law recommended in the *Guide* does not purport to address these issues. In other words, they are not issues where the principle of recommendation 4, subparagraph (b), has any application.

The deference issue arises when the law relating to intellectual property of the State enacting the law recommended in the *Guide* provides an intellectual-property-specific rule on an issue falling within the scope of the law recommended in the *Guide*, namely, an issue relating to the creation, third-party effectiveness, priority, enforcement of or law applicable to a security right in intellectual property (see A/CN.9/700, paras. 2-7).

13. The precise scope and implications of deference to law relating to intellectual property cannot be stated in the abstract since there is great variation among States on the extent to which intellectual-property-specific rules have been established, and indeed even within the same State depending on which category of intellectual property is at issue. In addition, the harmonization and modernization of the secured financing law achieved through the law recommended in the *Guide* has its limitations, since that law addresses issues of secured transactions law only and, under certain conditions, defers to law relating to intellectual property (see recommendation 4, subpara. (b)). Another fact that limits the impact of the law recommended in the *Guide* is that law relating to intellectual property in the various States does not address all secured transactions law issues in a comprehensive or coordinated way. For this reason, optimal results can only be obtained if the harmonization and modernization of secured transactions law achieved through the law recommended in the *Guide* is accompanied by a review of intellectual property financing law to ensure compatibility and coordination with the secured transactions law recommended in the *Guide*. The examples set forth below illustrate some typically encountered patterns.

*Example 1*

14. In some States where security rights are created by a transfer of title to the encumbered asset, a security right may not be created in a trademark. The reason is a concern that the secured creditor's title would impair the quality control required of the trademark holder. Adoption of the law recommended in the *Guide* by such a State would make transfers of title unnecessary to create a security right in a trademark and eliminate the rationale for this prohibition, since the grantor retains ownership of the encumbered trademark under the concept of security right of the law recommended in the *Guide*. Whether the secured creditor may become the owner, licensor or licensee of rights in the trademark for the purposes of law relating to intellectual property is a different matter (for purposes of secured transactions law, a secured creditor does not become the owner, licensor or licensee). Nonetheless, adoption of the law recommended in the *Guide* would not automatically eliminate the prohibition, because, to the extent that it is inconsistent with law relating to intellectual property, the law recommended in the *Guide* defers to that law. As a result, a specific amendment to the relevant law relating to intellectual property may be needed to harmonize it with the law recommended in the *Guide*.

*Example 2*

15. In some States, only transfers of intellectual property (whether outright or for security purposes) may be registered in a specialized intellectual property registry and such registration is mandatory for the effectiveness of a transfer. In other States, a security right in intellectual property may also be registered and such registration

has constitutive or third-party effects. In view of the principle of deference to law relating to intellectual property embodied in recommendation 4, subparagraph (b), adoption of the law recommended in the *Guide* would not affect the operation of such a rule and such specialized registration will continue to be required. However, deference to law relating to intellectual property will not always be sufficient to address the issue of coordination between the general security rights registry and intellectual property registries (see A/CN.9/700/Add.3, paras. 15-20) or the question whether a security right may be created in and a notice may refer to a future intellectual property right (see A/CN.9/700/Add.2, paras. 37-42, and A/CN.9/700/Add.3, paras. 21-23).

*Example 3*

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

17. In some States, registration of transfers and security rights in the relevant intellectual property registry provides protection only against a prior unregistered transfer or security right and only if the person with the registered right took its rights without notice of the prior unregistered right (the law recommended in the *Guide* would defer to this rule as it is a rule of law relating to intellectual property rather than a general rule of secured transactions law present throughout the State's legal system; see recommendation 4, subpara. (b)). In those States, adoption of the law recommended in the *Guide* will raise the further question as to whether registration of a notice of a security right in intellectual property in the general security rights registry constitutes constructive notice to a subsequent transferee or secured creditor that registers its transfer or security right in the intellectual property registry. If so, under the law of such a State, it would be unnecessary for a secured creditor that has registered a notice of its security right in the general security rights registry to also register a document or notice thereof in the intellectual property registry in order to prevail as against subsequent transferees and secured creditors. Otherwise, under the law of that State, registration of a

document or notice of the security right in the intellectual property registry may be required to gain priority over subsequent transferees and secured creditors.

*Example 4*

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

*Example 5*

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

*Example 6*

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

Finally, the rights and obligations flowing from a licence agreement is a matter of law relating to intellectual property and contract law. If a State adopts the law recommended in the *Guide*, transfers for security purposes will be treated as secured transactions.

*Example 7*

21. If law relating to intellectual property has specialized rules governing specifically the enforcement of a security right in intellectual property, these rules will prevail over the enforcement regime recommended in the *Guide*. However, if there is no specific rule of law relating to intellectual property on the matter and the enforcement of security rights in intellectual property is a matter left to general civil procedure law, the enforcement regime for security rights recommended in the *Guide* would take precedence. Similarly, if there is no specific rule of law relating to intellectual property on extrajudicial enforcement, the relevant regime recommended in the *Guide* on extrajudicial enforcement of security rights would apply (see A/CN.9/700/Add.5, chap. VIII).

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

22. The law recommended in the *Guide* generally recognizes the principle of party autonomy, although it does set forth a number of exceptions (see recommendations 10 and 111-113). This principle applies equally to security rights in intellectual property to the extent that law relating to intellectual property does not limit party autonomy (see A/CN.9/700/Add.5, para. 1). It should be noted that recommendations 111-113 apply only to tangible assets, as they refer to possession, a notion which in the *Guide* means "actual" possession and thus is not applicable to intangible assets (see the term "possession" in the introduction of the *Guide*, sect. B).

23. An example of the application of the principle of party autonomy in secured transactions relating to intellectual property would be the following: if not prohibited by law relating to intellectual property, under secured transactions law, a grantor and a secured creditor may agree that the secured creditor may acquire certain rights of an owner, licensor or licensee and thus become an owner, licensor or licensee entitled to deal with public authorities (for example, to register or renew registrations), as well as to pursue infringers, make further transfers or grant licences. This agreement could take the form of a special clause in the security agreement or a separate agreement between the grantor and the secured creditor, since, under the *Guide*, a secured creditor does not, by the mere fact of obtaining a security right, become an owner, licensor or licensee (see A/CN.9/700, paras. 26, 29 and 30, and A/CN.9/700/Add.2, paras. 10-12).

24. Another example of the application of the principle of party autonomy would be the following: if not prohibited by law relating to intellectual property, under secured transactions law, a grantor and a secured creditor may agree that damages for infringement, as well as for lost profits and devaluation of the encumbered intellectual property, are included in the original encumbered assets. In the absence of such an agreement, such damages may still be treated as proceeds under the law

recommended in the *Guide*, provided that that treatment is not inconsistent with law relating to intellectual property (see recommendation 4, subpara. (b)). However, the right to pursue infringement claims (as opposed to the right to the payment of damages for infringement) is a different matter. Typically, under law relating to intellectual property, this right cannot be used as security for credit. In addition, under the law recommended in the *Guide*, this right would not constitute proceeds as it would not fall under the scope of "whatever is received in respect of encumbered assets" (see the term "proceeds" in the introduction to the *Guide*, sect. B).