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

**Note by the Secretariat**

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## VI. Priority of a security right in intellectual property (continued)

### G. Rights of licensees in general

1. 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 receive royalties) may be used by the licensor as security for credit. Similarly, the licensee's authorization to use the intellectual property or the licensee's right to grant sub-licences and receive royalties (in both cases according to the terms of the licence agreement) may be used by the licensee as security for credit.

2. Where the intellectual property owner has created a security right in favour of a secured creditor and the security right is made effective against third parties, the owner may still grant a licence in the encumbered intellectual property as long as it remains the intellectual property owner. However, under general principles of law relating to intellectual property, the owner may not grant a licence in its encumbered intellectual property if: (a) the secured creditor becomes the owner; (b) to the extent permitted under law relating to intellectual property, the owner and the secured creditor have agreed that the secured creditor will be or will act as an owner; (c) the owner and the secured creditor have agreed that any licences granted by the owner would terminate upon the secured creditor's enforcement of its security right. In the first two situations, a licence granted by the original owner would be under law relating to intellectual property an unauthorized licence and a secured creditor acquiring a security right in that licence would obtain nothing based on the *nemo dat* principle.

3. In the last situation mentioned in the preceding paragraph, the owner may theoretically grant a licence, but the result would normally be the same as in the first two situations, because 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 licensor's secured creditor could enforce its security right by selling the licensed intellectual property or granting 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 licensor's secured creditor (see recommendations 79 and 161-163). Alternatively, the secured creditor of the licensor could seek to collect the royalties owed by the licensee to the licensor (as proceeds of the encumbered intellectual property; see recommendations 19, 39, 40, 100 and 168), as licence royalties are treated as any other receivable. Of course, if the licensee took the licensed intellectual property free of the security right granted by the owner/licensor in the intellectual property (that is, if the secured creditor authorized the granting of the licence or the licence is a non-exclusive licence granted by the licensor in its ordinary course of business, the licensee could retain its licence and the secured creditor could only seek to collect the royalties owed by the licensee to the licensor (see recommendations 80, subparagraph (b), and 81, subparagraph (c)).

4. If the licensee also creates a security right in its rights under the licence agreement (i.e. mainly the authorization to use the licensed intellectual property),

that security right would be in a different asset (i.e. not in the licensor's rights to claim the payment of royalties) and, in effect, be subject to the security right created by the licensor, as the licensee would have taken its rights subject to that security right (see recommendation 79) and the licensee could not have given to its secured creditor more rights than the licensee has (based on the *nemo dat* principle). So, if the secured creditor of the licensor enforced its security right, it could dispose of the encumbered intellectual property free of the licence. Thus, the licence would terminate upon that disposition and the licensee's encumbered asset would cease to exist. Likewise, whether or not the licensor had granted a security right to one of its creditors, if the licensee defaults on the licence agreement, the 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.

5. The rights of the licensor and the licensee under the licence agreement and the relevant law relating to intellectual property would remain unaffected by secured transactions law. So, if the licensee defaults on the licence agreement, the licensor can terminate it and the licensee's secured creditor would be again 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 its claims to royalties owed by sub-licensors to the licensee.

6. As already mentioned, there are two exceptions to the rule that a licensee of encumbered intellectual property takes the licence subject to a pre-existing security right. The first exception arises where the secured creditor authorizes the licence free of the security right (see recommendation 80, subparagraph (b)). The second exception relates to a non-exclusive licence in the ordinary course of the licensor's business (see recommendation 81, subparagraph (c), and paras. 7-10 below).

## **H. Rights of certain licensees**

7. To the extent that law relating to intellectual property addresses this matter and provides that a licensee of encumbered intellectual property takes the licence subject to a security right created by the licensor, unless the secured creditor authorized the granting of the licence free of the security right, the law recommended in the *Guide* (that is, in this case, recommendation 81, subparagraph (c)) does not apply (see recommendation 4, subparagraph (b)). As a result, unless the secured creditor authorized the granting of licences unaffected by the security right (which will typically be the case as the grantor/licensor will rely on its royalty income to pay the secured obligation), the licensee would take the licence subject to the security right. Thus, in the case of the grantor's/licensor's default, the secured creditor of the licensor would be able to enforce its security right in the licensed intellectual property and sell or licence it free of the licence granted by the grantor/licensor. 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 to give.

8. If law relating to intellectual property does not address this matter at all or does not address it inconsistently with recommendation 81, subparagraph (c), recommendation 81, subparagraph (c), will apply (see recommendation 4,

subparagraph (b)). Under recommendation 81, subparagraph (c), a non-exclusive licensee that takes a licence in the ordinary course of business of the licensor without knowledge that the licence violated a security right in the licensed intellectual property, takes its rights under the licence agreement unaffected by a security right previously granted by the licensor. 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, the secured creditor could collect any royalties owed by the licensee to the licensor, but not sell the licensed intellectual property or grant another licence in with the effect of terminating the rights of the existing licensee as long as the licensee performed the terms of the licence agreement. This rule is intended to protect everyday, legitimate transactions, such as off-the-shelf purchases of copies of copyrighted software with end-user licence agreements. In such transactions, purchasers should not have to do a search in a registry or acquire the software subject to security rights created by the software developer or its distributors.

9. Recommendation 81, subparagraph (c), is based on the assumption that the grantor retains ownership of the encumbered intellectual property and does not authorize the granting of licences by a grantor that is no longer the intellectual property owner or the holder of that right. In addition, it 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 (nor does it affect limitations in the licence agreement on the licensee entering into sub-licence agreements). Moreover, this recommendation or the *Guide* does 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.

10. The secured creditor may elect to avoid extending any credit until it has an opportunity to review and approve the terms of the sub-licences to ensure, for example, that expected royalties are paid upfront, termination be permitted in the case of non-payment of royalties and assignment of sub-royalties be prohibited. 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 borrower (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 grant 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, of course, 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 borrower to use the fees paid under those licence agreements to pay the secured obligation.

*[Note to the Working Group: With respect to security rights in intellectual property, the Working Group may wish to consider modifying recommendation 81,*

subparagraph (c), to the extent that it applies to security rights to intellectual property (but not to other intangible assets), by one of the following alternative asset-specific recommendations:

**Alternative A**

The law should provide that the rights of a licensee of intellectual property to use the licensed intellectual property pursuant to the terms of the licence agreement are not affected by a security right in the intellectual property granted by the licensor, provided that:

(a) The licence is non-exclusive;

(b) The owner of the encumbered intellectual property is generally in the business of granting non-exclusive licences in that intellectual property under substantially the same terms as those of the licensee's licence agreement without customization of the intellectual property for the licensee; and

(c) At the time of the conclusion of the licence agreement, the licensee does not have knowledge that the licence violates the rights of the secured creditor.

**Alternative B**

[The law should provide that a licensee of encumbered intellectual property takes its licence subject to a security right granted by the licensor, unless the secured creditor acting as an owner has authorized the granting of the licence free of the security right.] If the security agreement does not address the matter, the secured creditor acting as an owner is deemed to have authorized the licence free of the security right.

The Working Group may wish to note that: alternatives A and B appear within square brackets as they have not been approved by the Working Group yet; and that the first sentence of alternative B is within additional square brackets as it repeats the rule embodied in recommendation 80, subparagraph (b). They are proposed by the Secretariat in an effort to assist the Working Group to reach an agreement on this matter (see A/CN.9/667, paras. 97-100). The other alternative would be to explain how recommendation 81, subparagraph (c), would apply in an intellectual property context along the lines of paragraphs 7-10 above (see also A/CN.9/WG.VI/WP.35/Add.1, paras. 49-55), and leave the matter to the principle of deference to intellectual property law embodied in recommendation 4, subparagraph (b). As a result, recommendation 81, subparagraph (c), would not apply in so far as it would be inconsistent with law relating to intellectual property. Thus, law relating to intellectual property law would not be interfered with.

In addition, the Working Group may wish to note that both alternatives A and B are based on the assumption that the security right is effective against third parties (under the Guide, no priority issue can arise if a security right is not effective against third parties). Moreover, the Working Group may wish to note that: alternative A is a reformulation of the principle embodied in recommendation 81, subparagraph (c); and alternative B reiterates and elaborates further on the principle embodied in recommendation 80, subparagraph (b).

The following example may assist the Working Group in considering the results of the application of alternative A or B.

*Video distributor A normally obtains exclusive licences from movie producers for the reproduction and sale of movie videos and is in the business of granting non-exclusive sub-licences under substantially the same terms without customization. A grants under these terms non-exclusive sub-licences to B, C and D for the reproduction and sale of these movie videos. Video distributor A agrees to pay the producers a royalty of 25% of its net income from royalties for exploiting the video rights. Video distributor A also agrees with its non-exclusive sub-licensees B, C and D that they would pay royalties equal to 50% of their royalty income. Video distributor A obtains a line of credit from secured creditor E and grants secured creditor E a security right in its rights under the video licences and its expected royalty income. Non-exclusive sub-licensees B, C and D operate video store chains, selling and renting video tapes to customers while granting to them in effect non-exclusive sub-licences under the same terms without customization. B, C and D obtain lines of credit from secured creditor F secured from their licence rights and royalties.*

*Even without alternative A or B, the rights of a licensee would not be affected by a security right of a secured creditor of the licensor, if the secured creditor authorized the licensor to grant the licence unaffected by the security right see recommendation 80, subparagraph (b).*

*Under alternative A, non-exclusive licensees B, C and D licence rights would not be affected by the security right created by video distributor A (that in its normal course of business grants non-exclusive licences on substantially the same terms without customization) in favour of secured creditor E, if, at the time of the conclusion of the licence agreement B, C and D did not know that the licences violated the rights of secured creditor E (see recommendation 81, subparagraph (c) and alternative A). Similarly, the customers of B, C and D buying or renting video tapes would not be affected by any security right granted by B, C and D, if, as would normally be the case, they did not know that the licences they received violated the rights of secured creditor F. In fact, in both situations, the secured creditor would have no interest in disrupting the stream of royalty payments to their borrowers.*

*Under alternative B, non-exclusive sub-licensees B, C and D would take their licence rights unaffected by the security right created by video distributor A in favour of secured creditor E, if the security agreement did not address the matter (if secured creditor E authorized the granting of the licences by video distributor A to non-exclusive sub-licensees B, C and D unaffected by the security right, recommendation 80, subparagraph (b), would apply). The same would apply to the customers of B, C and D if the security agreements with secured creditor F did not address the matter.]*

## **I. Priority of a security right granted by a licensor as against a security right granted by a licensee**

11. The licensor's right to the payment of the royalties owed to the licensor by the licensee under a licence agreement is not affected by any security right granted by the licensee in any royalties due to the licensee under any sub-licence agreement. Such a security right, though, can have an impact on the licensee's ability to pay the

licensor if the licensee is in default with respect to its secured creditor inasmuch as that secured creditor may seek to collect the sub-royalties itself.

12. The following example may be useful in illustrating the problem. Intellectual property owner A grants a licence to licensee B under a licence agreement permitting B to grant sub-licences. B grants a sub-licence to C and creates a security right in its sub-royalties in favour of secured creditor SC1 who registers a notice of its security right in the general security rights registry. Intellectual property owner A then creates a security right in favour of SC2 in its intellectual property ownership rights and the right to receive payment of royalties. Secured creditor SC2 then registers a notice of its security right in the general security rights registry. Licensee's B secured creditor SC1 will prevail over the owner's secured creditor SC2, unless the licensee's secured creditor SC1 registered a notice of its security right in the general security rights registry, while the licensor's secured creditor SC2 registered a document or notice of its security right in the relevant intellectual property registry. Where the encumbered intellectual property is not registrable in a specialized registry, priority will be determined by the order of registration of a notice of the security right in the general security rights registry (see recommendations 76-78).

13. However, the licensor has numerous ways to protect itself in this circumstance. For example, the licensor could protect its rights by: (a) prohibiting the licensee from assigning or granting a security right in its claim against sub-licensees for the payment of royalties owed under sub-licence agreements; (b) terminating the licence in cases where the licensee assigned its royalty claims against sub-licensees in breach of such a prohibition; (c) agreeing that any sub-licencee pay its sub-royalties directly to the licensor; or (d) requiring the secured creditor of the licensee to enter into a subordination agreement with the licensor's secured creditor. The *Guide* does not interfere with these provisions if they are effective under law relating to intellectual property and the law of obligations.

14. In addition, the licensor could insist that the licensee grant to the licensor a security right in royalty claims of the licensee against sub-licensees. However, the priority of the security right of the licensor as against another security right granted by the licensor in those royalty claims would be subject to the general priority rules. This means that the security right that was first made effective against third parties or the subject of a notice registered in the general security rights registry (or a document or notice registered in a specialized registry, if applicable) would have priority.

15. In situations where the encumbered asset is a tangible asset with respect to which intellectual property is used, in certain circumstances, a security right may qualify as an acquisition security right. This means that a secured creditor of an owner/lessor may obtain priority over a secured creditor of a lessee of tangible assets, even if the owner's/lessor's secured creditor registers second. However, as discussed in the chapter on enforcement, that right encumbers the tangible asset and not the intellectual property. The right of the acquisition secured creditor to dispose of the encumbered assets as they are (i.e. including the application of the intellectual property in that specific encumbered asset) is treated as a matter of enforcement and, as discussed below, is subject either to the exhaustion of the rights of the owner of the intellectual property used in the specific tangible encumbered

assets or to the authorization given to the secured creditor by the owner to dispose of the encumbered assets as they are (see paras. 40-43 below).

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

16. Under the *Guide*, a security right that was made effective against third parties before a judgement creditor obtained rights in the encumbered asset has 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).

17. This recommendation applies equally to security rights in intellectual property. 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 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* and law relating to intellectual property, the transferee of encumbered intellectual property will take the encumbered intellectual property free of the security right (see also recommendation 79).

## **K. Subordination**

18. The *Guide* recognizes the principle of subordination (see recommendation 94). The principle applies equally to security rights in intellectual property. 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. This is important for intellectual property in view of the divisibility of intellectual property rights.

## **VII. Rights and obligations of the parties to a security agreement relating to intellectual property**

[*Note to the Working Group: For paras. 19-22, see A/CN.9/WG.VI/WP.35/Add.1, paras. 62-63, A/CN.9/667, paras. 104-108, A/CN.9/WG.VI/WP.33/Add.1, paras. 26-30, and A/CN.9/649, paras. 57-59.*]

### **A. Application of the principle of party autonomy**

19. With few exceptions, the *Guide* generally recognizes the freedom of the parties to the security agreement to tailor their agreement so as to meet their practical needs (see recommendation 10). The principle of party autonomy applies equally to security rights in intellectual property, subject to any limitations specifically introduced by law relating to intellectual property. For example, where the rights of

an owner are encumbered, the right to sue infringers may not be part of the encumbered asset, if law relating to intellectual property provides that only an owner may exercise, transfer or encumber that right.

## **B. Right of the secured creditor to pursue infringers or renew registrations**

20. Under secured transactions law, the secured creditor should be able to agree with the intellectual property owner that the secured creditor would be entitled to pursue infringers and renew registrations, provided that this is permitted under law relating to intellectual property. Otherwise, the encumbered asset could lose its value, if the owner of the encumbered intellectual property failed to exercise this right in a timely fashion. This result could negatively affect the use of intellectual property as security for credit. This approach would not interfere with the rights of the owner as its consent would be necessary. Similarly, this approach would not interfere with law relating to intellectual property because such an agreement would be null and void, if it were concluded in violation of law relating to intellectual property. Of course, States enacting the recommendations of the *Guide* may wish to consider their law relating to intellectual property so as to determine whether such agreements should be permitted, as this could facilitate the use of intellectual property as security for credit.

21. Similarly, unless prohibited by law relating to intellectual property, the secured creditor should be able to protect the value of the encumbered intellectual property, for example, by renewing registration and suing infringers if the owner failed to do so within a reasonable period of time after being asked by the secured creditor. Otherwise, the value of the encumbered intellectual property could diminish, a result that could negatively affect the use of intellectual property as security for credit. Again, this result would not interfere with law relating to intellectual property as recommendation 4, subparagraph (b) would defer to that law in case of any inconsistency.

22. The following two new asset-specific recommendations could be added to the *Guide*:

“The law should provide that[, unless prohibited by law relating to intellectual property,] the grantor and the secured creditor may agree as to who may pursue infringers or renew registrations of the encumbered intellectual property.

[The law should provide that[, unless prohibited by law relating to intellectual property,] the secured creditor should be entitled to pursue infringers and renew registrations if the owner fails to exercise these rights within a reasonable period of time.]”

*[Note to the Working Group: The Working Group may wish to consider that the bracketed wording in both recommendations is not necessary as: (a) recommendation 4, subparagraph (b), would be sufficient in deferring to law relating to intellectual property with respect to any matter that is addressed in the Guide in a way that is inconsistent with law relating to intellectual property; and (b) recommendation 18 already preserves that any statutory limitations to the transferability of certain types of asset.]*

## VIII. Rights and obligations of third-party obligors in intellectual property financing transactions

[*Note to the Working Group: For para. 23, see A/CN.9/WG.VI/WP.35/Add.1, para. 64, A/CN.9/667, para. 109, A/CN.9/WG.VI/WP.33/Add.1, paras. 32, and A/CN.9/649, para. 60.*]

23. Where a licensor assigns its claim against a licensee for the payment of royalties under a licence agreement, the licensee (as the debtor of the assigned receivable) would be a third-party obligor under the *Guide* and its rights and obligations would be the rights and obligations of a debtor of a receivable. Similarly, where a licensee assigned its claim against a sub-licensee for the payment of royalties under a sub-licence agreement, the sub-licensee would be a third-party obligor in the sense of the *Guide*.

## IX. Enforcement of a security right in intellectual property

[*Note to the Working Group: For paras. 24-48, see A/CN.9/WG.VI/WP.35/Add.1, paras. 65-89, A/CN.9/667, paras. 110-123, A/CN.9/WG.VI/WP.33/Add.1, paras. 35-44, and A/CN.9/649, paras. 61-73.*]

### A. Intersection of secured transactions law and law relating to intellectual property

24. States typically do not provide for specific enforcement remedies for security rights in intellectual property in their laws relating to intellectual property. The general law of secured transactions normally applies to the enforcement of security rights in intellectual property. To the extent that law relating to intellectual property in some States actually does address the enforcement of security rights in different types of intellectual property, it merely engrafts existing secured transactions enforcement regimes onto the regime governing intellectual property. As a consequence, States that enact the *Guide*'s recommendations will normally be simply substituting the *Guide*'s recommended enforcement regime for the prior enforcement regime derived from, for example, a civil code and code of civil procedure, the common law of floating and fixed charges, a mortgage act or some other general law of enforcement, as the case may be.

25. This approach to the enforcement of security rights applies not only to intellectual property (for example, a patent, a copyright or a trademark), but also to other rights that are derived from these types of intellectual property. Hence, consistently with the United Nations Assignment Convention, assets, such as royalties and licence fees, are treated as receivables and are subject to the enforcement regime recommended in the *Guide* for assignments (i.e. outright transfers, security transfers and security rights) in receivables. Likewise, a licensor's or sub-licensor's other contractual rights as against a licensee or sub-licensee will also be governed by a State's general law of obligations, and security rights in these contractual rights will be enforced under a State's general secured transactions law. And again, a licensee's or sub-licensee's rights of use are treated in the same way as a lessee's or purchaser's rights, and are governed by a

State's general law of obligations, except as regards questions of registration (where specifically mentioned in law relating to intellectual property).

26. On occasion, States incorporate special procedural controls on the enforcement of security rights in intellectual property into law relating to intellectual property. In addition, the general procedural norms of secured transactions law in a State may be given a specific content in the context of enforcement of security rights in intellectual property. So, for example, the determination of what is commercially reasonable where the encumbered asset is intellectual property may depend on law and practice relating to intellectual property. This standard of commercial reasonableness may well vary from State to State, as well as from intellectual property regime to intellectual property regime. The *Guide* recognizes this procedural specificity and, in so far as any procedural rules apply specifically to security rights in intellectual property and impose greater obligations on parties than those of the enforcement regime set out in the recommendations of the *Guide*, they will, under the principle set out in recommendation 4, subparagraph (b), displace the general recommendations of the *Guide*. Of course, if these procedural rules and definitional specifications apply to security rights in assets other than intellectual property as well, they will be displaced by the recommendations of the *Guide* in States that enact them.

27. As for substantive enforcement rights of secured creditors, once a State adopts the *Guide*'s recommendations, there is no reason to develop different or unusual remedial principles to govern enforcement of security rights in intellectual property serving as encumbered assets. The *Guide* merely recommends a more efficient, transparent and effective enforcement regime of a secured creditor's rights, without in any way limiting the rights that the owner of intellectual property may exercise to protect its rights against infringement or to collect royalties from a licensee or sub-licensee. As pointed out in the section of this Annex on creation of a security right (see A/CN.9/WG.VI/WP.37/Add.1, paras. 30 and 33), the secured creditor can never acquire security in more rights than the rights with which the grantor is vested at the time enforcement occurs.

## **B. Enforcement of a security right in different types of intellectual property**

28. The *Guide* elaborates a detailed regime governing the enforcement of security rights in different types of encumbered asset. Its basic assumption is that enforcement remedies must be tailored to ensure the most effective and efficient enforcement while ensuring appropriate protection of the rights of the grantor and third parties. This assumption and approach of the *Guide* should apply equally to the enforcement of security rights in the various categories of intellectual property. Currently, the law of most States recognizes a wide variety of rights relating to intellectual property, including:

- (a) The intellectual property in itself;
- (b) Receivables arising under a licence agreement;
- (c) The licensor's other contractual rights under a licence agreement;
- (d) The licensee's rights under a licence agreement;

(e) The owner's, licensor's and licensee's rights in tangible assets with respect to which intellectual property is used.

29. The enforcement regime recommended in the *Guide*, and applicable to each of these different rights in intellectual property, will be discussed separately in the following sections.

### **C. Taking “possession” of encumbered intellectual property**

30. The right of the secured creditor to take possession of the encumbered asset as set out in recommendations 146 and 147 of the *Guide* is normally not relevant if the encumbered asset is an intangible asset such as intellectual property (as the term “possession”, as defined in the *Guide*, means *actual* possession). These two recommendations deal only with the taking of possession of tangible assets. However, consistently with the general principle of extrajudicial enforcement, the secured creditor should be entitled to take possession of any documents necessary for the enforcement of its security right where the encumbered asset is intellectual property. Such a right will normally be provided for in the security agreement. In the event that the documents are accessory to the encumbered intellectual property, the creditor should be able to obtain possession whether or not those documents were specifically mentioned as encumbered assets in the security agreement.

31. It may be thought that, where a secured creditor takes possession of a tangible asset that is produced using intellectual property or in which a chip containing a programme produced using an intellectual property is included, the secured creditor is also taking possession of the encumbered intellectual property. This is not the case. It is important to distinguish properly the asset encumbered by the security right. Even though many tangible assets, whether equipment or inventory, may be produced through the application of intellectual property such as a patent, the creditor's security lies upon the tangible asset and does not, absent specific language in the security agreement purporting to encumber the intellectual property itself, encumber the intellectual property with the use of which the asset was produced. So, for example, the secured creditor may take possession of a tangible asset, such as a compact disc or a digital video disc, and may exercise its enforcement remedies against the discs under the *Guide*'s recommendations. In cases where the secured creditor also wishes to obtain a security right in the intellectual property itself (including, to the extent the grantor has the right to sell or otherwise dispose of, or license the intellectual property, the right to sell or otherwise dispose of, or license), it would be necessary for the secured creditor to specifically mention such intellectual property as encumbered assets in the security agreement with the owner of such intellectual property.

### **D. Disposition of encumbered intellectual property**

32. Under the *Guide*, the secured creditor has the right upon the grantor's default to dispose of or grant a licence with respect to intellectual property encumbered by its security right, but always within the limits of the rights of the grantor. As a result, if the grantor is the owner, the secured creditor should, in principle, have the right to sell or otherwise dispose of, or license the intellectual property in which it has

obtained a security right. However, if the grantor had previously granted an exclusive licence to a third party free of the security right, upon default, the secured creditor will be unable to grant another licence, as the grantor had no such right at the time the secured creditor acquired its security right (*nemo dat quod non habet*).

33. In the above-mentioned situation, under the *Guide*, the enforcing secured creditor does not acquire the intellectual property against which the security right is being enforced. Instead, the secured creditor disposes of the encumbered intellectual property (by assigning, licensing or sub-licensing it) in the name of the grantor. Until the assignee or licensee (as the case may be) that acquires the rights upon a disposition by the enforcing creditor registers a notice (or other document) of its rights in the relevant registry (assuming the rights in question are registrable), the grantor will appear on the registry as the owner of the relevant intellectual property.

#### **E. Rights acquired through disposition of encumbered intellectual property**

34. Under the *Guide*, rights in intellectual property acquired through judicial disposition would be regulated by the relevant law applicable to the enforcement of court judgements. In the case of an extrajudicial disposition in line with the provisions of secured transactions law, the first point to note is that the transferee or licensee takes its rights directly from the grantor. The secured creditor that chooses to enforce its rights in this manner does not become the owner as a result of this enforcement process, unless the secured creditor acquires the encumbered intellectual property in satisfaction of the secured obligation or at an enforcement sale (see, for example, recommendations 148 and 156).

35. The second point is that the transferee or licensee could only take such rights as were actually encumbered by the enforcing creditor's security right. Under the *Guide*, the transferee or licensee would take the intellectual property free of the security right of the enforcing secured creditor and any lower-ranking security rights, but subject to any higher-ranking security rights. The same rule applies to an extrajudicial disposition that is inconsistent with the provisions of the secured transactions law, provided that the transferee or licensee acted in good faith (see recommendations 161-163).

36. As a general principle of secured transactions law, the enforcing secured creditor takes the encumbered asset in the condition it is at the time of enforcement. Thus, a security right in a tangible asset extends to and may be enforced against attachments to that asset (see recommendation 21 and 166). To ensure that the security right also covers assets produced or manufactured from encumbered assets, the security agreement normally provides expressly that the security right extends to such manufactured assets. Where the encumbered asset is intellectual property, it is important to determine whether the asset that is disposed of to the transferee or licensee is simply the intellectual property as it existed at the time the security right became effective against third parties or whether it is that intellectual property including any subsequent enhancements to it (e.g. an improvement to a patent). Generally, laws relating to intellectual property treat such improvements as separate assets and not as integral parts of existing intellectual property. As a result, the prudent secured creditor that wishes to ensure that improvements are encumbered

with the security right should describe the encumbered asset in the security agreement in a manner that ensures that enhancements are directly encumbered by the security right.

#### **F. Proposal by the secured creditor to accept the encumbered intellectual property**

37. Under the enforcement regime recommended in the *Guide*, the secured creditor also has the right to propose to the grantor that it accept the grantor's rights in satisfaction of the secured obligation. If the grantor is the owner of intellectual property, the secured creditor could itself become the owner, provided that the grantor and its creditors do not object (see recommendations 156-159). Should the owner have licensed its intellectual property to a licensee that acquired its rights under the licence agreement free of the rights of the enforcing secured creditor, when the secured creditor accepts the intellectual property from the grantor, it acquires that right subject to the prior-ranking licence under the *nemo dat* principle. Once a secured creditor becomes the owner of intellectual property, its rights and obligations are regulated by the relevant law relating to intellectual property. In particular, the secured creditor should register to enjoy the rights of an owner in the relevant intellectual property registry (assuming that rights in the intellectual property are registrable). Finally, the secured creditor that accepts the encumbered intellectual property in full or partial satisfaction of the secured obligation would take the intellectual property free of the security right of any lower-ranking security rights, but subject to any higher-ranking security rights (see recommendation 161).

#### **G. Collection of royalties and licence fees**

38. Under the *Guide*, where the encumbered asset is the right to receive payment of royalties or other fees under a licence agreement, the secured creditor should be entitled to enforce the security right by simply collecting the royalties and fees upon default and notification to the person that owes the royalties or fees (see recommendation 168). In all these situations, the royalties are, for the purposes of secured transactions laws, receivables, and the rights and obligations of the parties will be governed by the principles pertaining to receivables that are elaborated in the United Nations Assignment Convention and the *Guide* for receivables. Once again, the secured creditor that has taken security over present and future royalty payments is entitled to enforce only such rights to receive payment of royalties as were vested in the grantor (licensor) at the time the security right in the receivable is enforced. In addition, subject to any contrary provision of law relating to intellectual property (see recommendation 4, subparagraph (b)), the secured creditor's rights to collect royalties includes the right to collect or otherwise enforce any personal or property right that secures payment of the royalties (see recommendation 169).

#### **H. Licensor's other contractual rights**

39. In addition to the right to collect receivables, the licensor will normally include a number of other contractual rights in its agreement with the licensee.

These may include, for example, a limitation in the licence agreement on the right of the licensee to grant any sub-licence or a prohibition on the granting of security rights by the licensee in its rights under the licence agreement, including the right to terminate the licence agreement under a set of specified conditions. Merely because the licensor may have granted a security right in its right to collect royalties and this right to collect has become enforceable and is being enforced by the secured creditor has no direct bearing on these other rights of the licensor under its licence agreement or under generally applicable law relating to intellectual property. These rights remain vested in the licensor, unless they themselves have been assigned to a third party or were included in the description of the encumbered asset over which the secured creditor that is enforcing its security right obtained a security right from the grantor.

## **I. Enforcement of security rights in tangible assets related to intellectual property**

40. In principle, except where the so-called “exhaustion doctrine” applies, the intellectual property owner has the right to control the manner and place in which tangible assets, with respect to which intellectual property is used (of course, with the authorization of the owner), are sold. That is, in the event that the relevant intellectual property right has not been exhausted, the secured creditor should be able to dispose of the assets upon default, if there is an authorization from the intellectual property owner. In both these cases, it is assumed that the security agreement does not encumber the intellectual property itself.

41. There is no universal understanding of the “exhaustion doctrine” (often referred to as “exhaustion of rights” or “first sale doctrine”) and the Annex makes reference to the doctrine not as a universal concept, but as it is actually understood in each enacting State. Nonetheless, where the exhaustion doctrine applies under law relating to intellectual property, the basic idea is that an intellectual property owner will lose or “exhaust” certain rights after their first marketing or sale. For example, the ability of a trademark owner to control further sales of a product bearing its mark are generally “exhausted” following the sale of that product. The rule serves to protect a person that resells that product from infringement liability. However, it is important to note that such protection extends only to the point where the products have not been altered so as to be materially different from those originating from the trademark owner. The reseller, for example, under law relating to intellectual property in some States, may not remove or alter the trademark applied to the products by the trademark owner.

42. In situations where a product is produced with the use of intellectual property that has been licensed to the grantor, the licensor may provide that the licensee cannot grant security rights in such products or that a creditor that takes security may only enforce its rights in a manner agreed to by the licensor. In both these cases, the licensor will typically provide in the licence agreement that the licence may be revoked if the grantor or secured creditor is in breach of the licence agreement. As a consequence, to enforce effectively its security right in the product, the secured creditor would need to obtain the consent of the owner-licensor in line with the licence agreement and the relevant law relating to intellectual property and subject in particular to the operation of the exhaustion doctrine.

43. In cases where the secured creditor also wishes to obtain a security right in the intellectual property itself (including, to the extent the grantor has the right to sell or license the intellectual property, the right to sell or license), it would be necessary for the secured creditor to specifically mention such intellectual property as encumbered assets in the security agreement with the intellectual property owner. Here, the encumbered asset is not the product produced using the intellectual property, but rather the intellectual property itself (or the licence to manufacture tangible assets using the intellectual property). A prudent secured creditor will normally take a security right in such intellectual property so as to be able to continue the production of partially completed products.

## **J. Enforcement of a security right in a licensee's rights**

44. In the discussion above, the grantor of the security right has been assumed to be the owner of the relevant intellectual property. The encumbered asset was either the intellectual property itself, the right of the owner-licensor to receive royalties and fees or the right of the owner-licensor to enforce other contractual terms relating to the intellectual property. Only in the discussion of security rights in tangible assets produced by using intellectual property (section I) were the rights of the owner-licensor and the rights of the licensee treated together. However, most of the issues addressed in sections C to H also are relevant in situations where the encumbered asset is not the intellectual property itself but the rights of a licensee (or sub-licensee) arising from a licence (or sub-licence) agreement. In cases where the encumbered asset is merely a licence, the secured creditor obviously may only enforce its security right against the licensee's rights and may do so only in a manner that is consistent with the terms of the licence agreement.

45. In situations where the grantor is a licensee, upon the grantor's default, the secured creditor will have the right to enforce its security right in the licence and to dispose of the licence to a transferee, provided that the licensor consents or the licence is transferable, which is rarely the case. Likewise, the enforcing creditor may grant a sub-licence, provided that the licensor consents or the grantor-licensee had, under the terms of the licence agreement, the right to grant sub-licences. In situations where the secured creditor proposes to a grantor-licensee to accept the licence in full or partial satisfaction of the secured obligation and neither the grantor nor other interested parties (e.g. the licensor) object (and the licence agreement does not prohibit the transfer of the licence), the secured creditor becomes vested with the licence according to the terms of the licence agreement between the licensee and the licensor. As in the case of a transferee or licensee that acquires intellectual property upon a disposition by a secured creditor, the licensee/secured creditor that accepts the licence in full or partial satisfaction of the secured obligation should register to enjoy its rights as a licensee in the relevant intellectual property registry. Assuming that registration of licences is possible under law relating to intellectual property, such registration may be a condition of the effectiveness of the licensee's rights or may simply serve information purposes.

46. Where the encumbered asset is the sub-licensor's right to receive payment of royalties under a sub-licence agreement, the secured creditor is entitled to treat the asset as a receivable. This means that the secured creditor may collect payment of the royalties to the extent that these were vested in the grantor/sub-licensor at the

time when the security right in the receivable is enforced. If enforcement of the security right in the right to receive payment of royalties payable by a sub-licensee constituted a breach of the licence agreement, then the secured creditor would not be able to enforce its security right in any receivables arising after that breach.

47. Where the encumbered asset is another contractual right stipulated in the sub-licence agreement, the secured creditor may enforce its security right in this contractual right as if it were any other encumbered asset, and the fact that the licensor may have revoked the licence for the future, or may have itself claimed a prior right to receive payment of sub-royalties, has no direct bearing on the right of the secured creditor to enforce these other contractual rights set out in the licence agreement.

48. The rights acquired by a transferee of the licence, a sub-licensee upon disposition by the secured creditor or by a secured creditor that accepts the licence in full or partial satisfaction of the secured obligation may be significantly limited by the terms of the licence agreement. For example, a non-exclusive licensee cannot enforce the intellectual property against another non-exclusive licensee or against an infringer of the intellectual property. Only the licensor (or the owner) may do so, although, in some States, exclusive licensees may join the licensor as a party to the proceedings. In addition, depending upon the terms of the licence agreement and the description of the encumbered asset in the security agreement, a transferee of the licence may not have access to information such as a source code. In order to ensure the effectiveness of the licence being transferred or sub-licensed, the security agreement will have to include such rights within the description of the assets encumbered by the grantor/licensee, to the extent that the licence agreement and relevant law permits it to encumber these rights as well.