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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

Contents

	<i>Paragraphs</i>	<i>Page</i>
VI. Priority of a security right in intellectual property (<i>continued</i>).....	1-22	2
G. Rights of licensees in general	1-6	2
H. Rights of certain licensees	7-14	3
I. Priority of a security right in intellectual property granted by a licensor as against a security right granted by a licensee	15-19	9
J. Priority of a security right in intellectual property as against the right of a judgement creditor	20-21	14
K. Subordination	22	15



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 grant further licences or to obtain payment of royalties) may be used by the licensor as security for credit. Similarly, the licensee's authorization to use or exploit the intellectual property or the licensee's right to grant sub-licences and obtain payment of 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/WG.VI/WP.39/Add.2, paras. 13-36).

2. Under the *Guide*, where the intellectual property owner has created a security right in favour of a secured creditor, 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 (with which the *Guide* is consistent), the owner may not grant a licence in its encumbered intellectual property if the secured creditor becomes the owner of the intellectual property with authority to grant licences while the security right is in place. In this situation, a licence granted by the original owner would be an unauthorized licence under law relating to intellectual property and the licensee or its secured creditor would obtain nothing based on the *nemo dat* principle.

3. If the owner 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 result would normally be the same, 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 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 rights, the secured creditor may collect the royalties as proceeds of the encumbered intellectual property (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. In any case, if the licensee took the licensed intellectual property free of the security right granted by the owner 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 owner 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 owner (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 (for example, the authorization 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). If the security right created by the licensee were in the same asset, it would be subject to the security right created by the owner (and made effective against third parties). The reason for this result is that the licensee would have taken its rights 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 licensee's encumbered asset 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.

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 defaulted on the licence agreement, the licensor could exercise any available right to 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 to the licensor the licensee's rights to the payment of royalties owed by sub-licensees to the licensee as sub-licensor.

6. Under the *Guide*, as a matter of secured transactions law, there are two exceptions to the rule that a licensee of encumbered intellectual property takes the licence subject to a pre-existing security right (see recommendation 79). 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. 8-10 below).

H. Rights of certain licensees

7. As already mentioned, the first exception to the principle of the *Guide* that a licensee of an encumbered asset takes the asset subject to the security right (see recommendation 79) arises where the secured creditor approved the granting of licences by the grantor free of the security right (see recommendation 80, subparagraph (b)). Thus, under 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.

8. The second exception to the principle embodied in recommendation 79 is that a non-exclusive licensee that takes a 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, subparagraph (c)). 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 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. 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. 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 the owner's rights to the secured creditor. 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 (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.

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. For example, the secured creditor may wish to ensure that expected royalties are paid upfront, termination is permitted in the case of non-payment of royalties and assignment of sub-royalties is 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 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.

11. 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. First, secured creditors typically 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 normally interested in permitting licensing so that the owner/grantor may repay the secured obligation. Second, 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 copies of copyrighted software or patent pools 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. Such off-the shelf licences may be described without reference to the ordinary-course-of-business concept.

12. 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.

13. However, the concept of ordinary course of business is rarely used in intellectual property law and may create confusion in an intellectual property financing context. In many States, a different rule applies that provides that a licensee of encumbered intellectual property takes the licence subject to a security right created by the licensor, unless the secured creditor (to whom the grantor has given the right to authorize licences) authorized the granting of the licence free of the security right. To the extent that a State has such a rule recommendation 81, subparagraph (c), would not apply (see recommendation 4, subparagraph (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 licence 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 to give.

14. 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 in the limited cases and with the limited impact described above (see recommendation 4, subparagraph (b)).

[Note to the Working Group: At its fifteenth session, the Working Group requested the Secretariat to prepare a revised version of alternative A of this recommendation with appropriate commentary. This revised recommendation and commentary are set out below. The Working Group may wish to consider whether the bracketed language is necessary as it states the obvious. The Working Group may also wish to consider whether subparagraph (d) should be retained as it appears to be too restrictive. If the Working Group decides to delete

subparagraph (d) and considers that it is somehow useful, it could consider including it in the commentary as an explanation.

Recommendation 244¹

Priority of rights of certain licensees of intellectual property

Alternative A

The law should provide that[, in cases that are not covered by recommendation 80, subparagraph (b),] the right of a[n end-user] licensee of intellectual property to use or exploit the licensed intellectual property pursuant to the terms and conditions of the licence agreement is not limited by the enforcement of a security right in the licensed intellectual property created by the licensor before the licence was granted, provided that:

(a) The licence is granted by a party that, under law relating to intellectual property, is authorized to grant a licence in the relevant intellectual property;

(b) The licence is non-exclusive;

(c) The licensed intellectual property and the rights and obligations under the licence agreement are not customized for the licensee;

(d) The licence covers copies of copyrighted software or patent pools used with respect to equipment; and

(e) At the time of the conclusion of the licence agreement:

(i) The licensor is generally in the business of granting non-exclusive licences in the licensed intellectual property;

(ii) The licensor grants licences of the licensed intellectual property on substantially the same terms to any person that agrees to perform in accordance with such terms, and the licence agreement is on such terms; and

(iii) The licensee does not have knowledge that the licence violates the rights of the secured creditor under the security agreement.

Commentary

1. This recommendation does not affect:

(a) The effectiveness of a security right in licensed intellectual property, its priority as against a competing claimant other than a licensee as described in this recommendation or the enforcement remedies of the secured creditor that do not affect the right of the licensee to use or exploit the licensed intellectual property;

(b) Any right that the licensor may have to terminate the licence for non-compliance of the licensee with the licence agreement; or

¹ If this recommendation could be included in the *Guide*, it would be placed in the chapter on the priority of a security right as recommendation 81 bis. As an asset-specific recommendation, this recommendation would modify the general recommendation 81, subparagraph (c), which refers to non-exclusive licensees of intangible assets in general.

(c) The rights of a secured creditor as an owner under law relating to intellectual property.

2. It should also be noted that the rights of the licensee under this recommendation may be derogated from by agreement of the licensee in the licence agreement or otherwise. Like any other recommendation of the Guide, this recommendation is subject to recommendation 4, subparagraph (b).

3. The following examples are mentioned to clarify the situations to which this recommendation would apply and the impact from its application. In each example, it should be assumed that:

(a) O owns intellectual property;

(b) O grants a security right in the intellectual property to SC;

(c) O's security right is effective against third parties either in accordance with the recommendations of the Guide or, pursuant to recommendation 4, subparagraph (b), under the law relating to intellectual property;

(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; and

(e) Except as indicated, the transaction satisfies each provision of recommendation 244.

4. 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 244 against enforcement by SC of its security right because the licence and the transaction satisfy each provision of recommendation 244. However, SC still has whatever rights it may have against L under law relating to intellectual property.

5. 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 S. 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 S is not authorized, the right of S to use the intellectual property is not protected by recommendation 244 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).

6. 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 244 against enforcement by SC of its security right because the licence is exclusive.

7. *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 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 244 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.*

8. *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 recommendation 244 against enforcement by SC of its security right because L had knowledge that the licence agreement would violate SC's rights.*

9. *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 244 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.*

10. *Same facts as under para. 8 above, except that, O does not furnish a copy of the security agreement to L and, as a result, L does not know that the licence would violate the rights of SC. 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 244 against enforcement by SC of its security right because the licence and the transaction satisfy each provision of recommendation 244.*

11 *After SC registers its security right, O grants a non-exclusive licence to a patent pool. The patent pool will grant a non-exclusive licence to any interested person. SC forecloses on the intellectual property. The licence is not discharged as a result of the foreclosure because the licence and the transaction satisfy each provision of recommendation 244.*

Alternative B

The law should provide that, if the security agreement between a licensor and its secured creditor does not address the question whether the licensor may grant licences in the encumbered intellectual property free of the security right, the licensor is deemed to have been authorized by the secured creditor to grant licences free of the security right.]

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

15. 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. 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 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. In such a case, if the assignment of sub-royalties takes place before a licence is granted and a security right is created and made effective by the licensee, the licensee does not have a right in 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 sub-royalties subject to the security right of the licensor's secured creditor. If, however, the assignment takes place after a licence is granted and a security right is created and made effective by the licensee in all its future royalties, the licensor takes the assignment 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).

16. 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 licensee A's secured creditor SC1 security right and licensor B's secured creditor SC1 can have no greater rights than licensor B.

17. If, however, licensee B first creates a security right in its right to the payment of sub-royalties and then assigns to licensor A the right to payment of a percentage of the sub-royalties, SC2 (that is, the licensee's secured creditor) will prevail. The licensor has 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 in the relevant intellectual property registry or requiring the secured creditor of the licensee to enter into a subordination agreement with the licensor's secured creditor

before granting a licence; (b) prohibiting the licensee from granting a security right in its right to the payment of sub-royalties; (c) terminating the licence in cases where the licensee created a security right in its sub-royalties in breach of such a prohibition; or (d) agreeing that any sub-licensee pay its sub-royalties directly to 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 the law of obligations. 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.

18. 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. 15).

19. 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 a lessor may obtain priority over a secured creditor of a lessee, even if the 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 (that is, 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 A/CN.9/WG.VI/WP.39/Add.6, paras. 24-27 below).

[Note to the Working Group: The Working Group may wish to note that, in accordance with historical commercial and legal practices in many States, the discussion of acquisition financing in the Guide is limited to tangible assets (other than negotiable instruments and negotiable documents). The Guide does not address explicitly the question whether an acquisition security right in tangible assets with respect to which software is used extends to the software. However, under the Supplement, that result would be possible under the same conditions under which a security right in tangible assets extends to intellectual property used with respect to those assets (see A/CN.9/WG.VI/WP.39/Add.2, paras. 32-36).

It is argued though that, in modern credit economies, it would be useful to have the same rules apply to security rights securing amounts used for the acquisition (but not the original creation) of intellectual property. It is also argued that this would provide parity in the treatment of tangible assets and intellectual property assets. Thus, the Working Group agreed to consider a proposal that would apply the principles of the Guide on acquisition security rights in tangible assets to security rights in intellectual property securing amounts used for the acquisition of that intellectual property (see A/CN.9/670, paras. 89-93). The following text has

been prepared so as to assist the Working Group in its consideration of that proposal.

In some legal systems, an acquisition security right in software is possible but only if: (a) the security right accompanies a security right in a tangible asset, (b) the software is acquired by the grantor in a transaction integrated with the transaction in which the grantor acquired the tangible asset, and (c) the grantor acquires the software for the principal purpose of using the software in the tangible asset. In other legal systems, it is possible for a secured creditor to obtain an acquisition security right in intangible assets (including intellectual property, whether or not the intellectual property is used in connection with tangible assets). In yet other legal systems, where the law (for example a civil code) does not contain the concept of an acquisition security right, a similar result may be achieved through a reservation of title, a financial lease or a hypothec securing the sale price of a movable asset. In each case, the transaction may relate to an intangible asset, although this is rarely seen. In yet other legal systems, a “mortgage” or “fixed charge” securing the acquisition of intellectual property is possible and it can prevail over a pre-existing “floating charge”.

The existing rules in the Guide with respect to acquisition security rights in tangible assets could be made to apply to similar rights in intellectual property by:

(a) Providing that acquisition security rights can exist in intellectual property, as well as in tangible assets;

(b) In cases in which the intellectual property that is subject to an acquisition security right is held by the grantor for sale, lease or licence in the ordinary course of the grantor’s business, the acquisition security right is treated as an acquisition security right in inventory;

(c) In cases in which the intellectual property subject to an acquisition security right is used or intended by the grantor to be used for personal, family or household purposes, the acquisition security right is treated as an acquisition security right in consumer goods;

(d) In cases in which the intellectual property that is subject to an acquisition security right is not held by the grantor for sale, lease or licence in the ordinary course of the grantor’s business or to be used for personal, family or household purposes, the acquisition security right is treated as an acquisition security right in tangible assets other than inventory or consumer goods;

(e) Deleting references to possession and delivery of the encumbered asset.

Terminology and recommendations

The Working Group may wish to consider terminology (to be added to the terminology part of the Supplement) and recommendations (to be added to a new chapter of the Supplement on acquisition financing) along the following lines:

“Acquisition security right” also includes a security right in intellectual property and a licence in intellectual property, provided that the security right secures the obligation to pay any unpaid portion of the acquisition price of the encumbered asset or an obligation incurred or credit otherwise provided to enable the grantor to acquire the encumbered asset.

“Consumer goods” for the purposes of the Supplement includes intellectual property or a licence used or intended by the grantor to be used for personal, family or household purposes.

“Inventory” for the purposes of the Supplement includes intellectual property or a licence used or intended by the grantor to be used for sale or licence in the ordinary course of the grantor’s business.

- 1. The law should provide that all references to acquisition security rights in tangible assets also refer to an acquisition security right in intellectual property or a licence in intellectual property.*
- 2. The law should provide that, if intellectual property or a licence in intellectual property that is subject to an acquisition security right is held for sale or licence in the ordinary course of the grantor’s business, the acquisition security right is treated as an acquisition security right in inventory.*
- 3. The law should provide that, if intellectual property or a licence in intellectual property that is subject to an acquisition security right is used or intended by the grantor to be used for personal, family or household purposes, the acquisition security right is treated as an acquisition security right in consumer goods.*
- 4. The law should provide that, if intellectual property or a licence in intellectual property is subject to an acquisition security right, any reference in such recommendations to possession of the encumbered asset by the secured creditor does not apply.*
- 5. The law should provide that, if intellectual property or a licence in intellectual property is subject to an acquisition security right, any reference in such recommendations to the time of possession of the encumbered asset by the grantor refers to the time the grantor obtains the encumbered intellectual property or licence.*
- 6. The law should provide that, if intellectual property or a licence in intellectual property is subject to an acquisition security right, any reference in such recommendations to time of the delivery of the encumbered asset to the grantor refers to the time the grantor obtains the encumbered intellectual property or licence.*

Examples

The following examples have been prepared to assist the Working Group in its consideration of the proposal. In all these examples, the owner or a second secured creditor financing the acquisition of intellectual property or a licence in intellectual property has an acquisition security right with special priority under the conditions described in the examples.

Acquisition security right in intellectual property securing the purchase price of the intellectual property (other than inventory or consumer goods)

- 1. B grants a security right in all of its present and future movable assets to SC, who takes the actions necessary to make that security right effective against third parties. Subsequently, B acquires a patent from O to be used in B’s business. Pursuant to the agreement between B and O, B agrees to pay the purchase price to*

O over time and B grants O a security right in the patent to secure B's obligation to pay the purchase price. O makes that security right effective against third parties within a short period of time, such as 20 or 30 days of B obtaining the patent. O's security right is an acquisition security right and has priority over the security right of SC (see recommendation 180, alternative A, subparagraph (a), or alternative B, subparagraph (b)). Whether the priority of O's security right extends to proceeds of the patent in the form of receivables depends on which version of recommendation 185 a State enacts. Under alternative A, the priority of O's security right carries over to the receivables (see recommendation 185, alternative A, subparagraph (a)). Under alternative B, O's security right in the receivables would have only the priority of a non-acquisition security right (see recommendation 185, alternative B).

Acquisition security right in intellectual property securing the purchase price of the intellectual property (inventory)

2. *B grants a security right in all of its present and future movable assets to SC1, who takes the actions necessary to make the security right effective against third parties. Subsequently, B acquires a patent from O for the purpose of licensing it to third parties in the ordinary course of B's business. B obtains the money necessary to pay the purchase price to O by borrowing money from SC2, to whom B grants a security right in the patent to secure B's repayment obligation. Before B obtains the patent, SC2: (a) takes the actions necessary to make its security right effective against third parties, and (b) notifies SC1 that SC2 will have an acquisition security right. SC2's security right is an acquisition security right and has priority over the security right of SC1 (see recommendation 180, alternative A, subparagraph (b), or alternative B, subparagraph (b)). Under alternative A, this result is brought about by recommendation 180, subparagraph (b), which requires all of the facts listed in this example. Under alternative B, the result is the same. Indeed, under alternative B, the security right of SC2 would have priority over the security right of SC1 so long as SC2 takes the actions necessary to make its security right effective against third parties within a short period of time such as 20 or 30 days of B obtaining the patent, and there would be no necessity of notifying SC1. The priority of SC2's security right does not extend to proceeds of the patent in the form of receivables (see recommendation 185). This is the case no matter which alternative version of recommendation 185 a State enacts. Under alternative A, this result is brought about by recommendation 185, subparagraph (b). Under Alternative B, the result is brought about by recommendation 185.*

Acquisition security right in an intellectual property licence securing the purchase price of the licence (other than inventory or consumer goods)

3. *B has granted a security right in all of its present and future movable assets to SC, who has taken the actions necessary for that security right to be effective against third parties. Subsequently, B obtains a licence from O to use a patent owned by O in B's business. B agrees to pay the licence fee to O over time and grants O a security right in B's rights as licensee to secure B's payment obligation. O makes that security right effective against third parties within xx days of B obtaining the licence. O's security right in B's rights under the licence agreement is an acquisition security right and has priority over the security right of SC (see recommendation 180, alternative A, subparagraph (a), or alternative B,*

subparagraph (b)). Whether the priority of O's security right extends to proceeds of B's rights as licensee in the form of receivables depends on which version of recommendation 185 a State enacts. Under alternative A, the priority of O's security right carries over to the receivables (see recommendation 185, alternative A, subparagraph (a)). Under alternative B, O's security right in the receivables would have only the priority of a non-acquisition security right (see recommendation 185, alternative B). It should be noted that O's rights pursuant to its security right are separate from O's rights under the licence agreement to terminate the licence agreement upon B's default in its obligations under the licence agreement.

Acquisition security right in an intellectual property licence securing the purchase price of the licence (inventory)

4. B grants a security right in all of its present and future movable assets to SC1, who takes the actions necessary to make the security right effective against third parties. Subsequently, B obtains a licence from O, the patent owner, for the purpose of sub-licensing the patent to third parties in the ordinary course of B's business. B obtains the money necessary to pay its licence fee by borrowing money from SC2, to whom B grants a security right in B's rights as licensee to secure B's repayment obligation. Before B obtains the licence, SC2: (a) takes the actions necessary to make its security right effective against third parties; and (b) notifies SC1 that SC2 will have an acquisition security right. SC2's security right is an acquisition security right and has priority over the security right of SC1 (see recommendation 180, alternative A, subparagraph (b), or alternative B, subparagraph (b)). The priority of O's security right does not extend to proceeds of the licence in the form of receivables (see recommendation 185, alternative A or alternative B). This is the case no matter which alternative version of recommendation 185 a State enacts. Under alternative A, this result is brought about by recommendation 185, subparagraph (b). Under alternative B, the result is brought about by recommendation 185.]

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

20. The *Guide* recommends that 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).

21. This recommendation applies equally to security rights in intellectual property (subject to the principle embodied in recommendation 4, subparagraph (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 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

22. 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.
