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

Note by the Secretariat

Addendum

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II. Creation of a security right in intellectual property

[*Note to the Commission: For paras. 1-44 and recommendation 243, see A/CN.9/WG.VI/WP.42/Add.2, paras. 1-44, and recommendation 243; A/CN.9/689, paras. 23-25; A/CN.9/WG.VI/WP.39/Add.2, paras. 1-43; A/CN.9/685, paras. 28-35; A/CN.9/WG.VI/WP.37/Add.1, paras. 25-64; A/CN.9/670, paras. 35-55; A/CN.9/WG.VI/WP.35, paras. 68-102; A/CN.9/667, paras. 32-54; A/CN.9/WG.VI/WP.33, paras. 112-133; and A/CN.9/649, paras. 16-28.*]

A. The concepts of creation and third-party effectiveness

1. With respect to all types of encumbered asset (including intellectual property), the law recommended in the *Guide* draws a distinction between the creation of a security right (its effectiveness as between the parties) and its effectiveness against third parties, providing distinct requirements to achieve each of these outcomes. In effect, this means that the requirements for the creation of a security right can be kept to a minimum, while any additional requirements are aimed at addressing the rights of third parties. The main reason for this distinction is to achieve three of the key objectives of the law recommended in the *Guide*, namely, to establish a security right in a simple and efficient way, to enhance certainty and transparency, and to establish clear priority rules (see recommendation 1, subparas. (c), (f) and (g)).

2. Under the law recommended in the *Guide*, a security right in intellectual property may be created by written agreement between the grantor and the secured creditor (see recommendation 13 and paras. 5-8 below). For the security right to be effective against third parties, under the general rule recommended in the *Guide*, an additional step is required (see recommendation 29; for exceptions, see recommendations 34, subpara. (b), 39-41, and 43-45). For most intangible assets, this step is registration of a notice about the possible existence of the security right in a public registry, which also establishes an objective criterion for determining priority between a secured creditor and a competing claimant (see recommendations 32 and 33; for the term “competing claimant”, see A/CN.9/700, paras. 10 and 11). Accordingly, if a security right has been created in accordance with the requirements set out in the law recommended in the *Guide*, the security right is effective between the grantor and the secured creditor even if the additional steps necessary to make the security right effective against third parties have not yet been taken (see recommendation 30). As a result, the secured creditor may enforce the security right in accordance with the enforcement procedures set forth in chapter VIII of the law recommended in the *Guide*, subject to the rights of competing claimants in accordance with the priority rules set forth in chapter V.

3. This distinction between creation and effectiveness against third parties applies equally to security rights in intellectual property. Thus, under the law recommended in the *Guide*, a security right in intellectual property can be effective between the grantor and the secured creditor even if it is not effective against third parties. In some States, law relating to intellectual property draws such a distinction. In other States, however, such a distinction is not drawn in law relating to intellectual property, which provides that the same actions are required for both the creation of a security right and its effectiveness against third parties. In such a case, as required by recommendation 4, subparagraph (b), the law recommended in the

Guide defers to that law. To ensure better coordination between secured transactions law and law relating to intellectual property, States enacting the law recommended in the *Guide* may wish to consider reviewing their law relating to intellectual property. Such a review should make it possible for States to determine whether: (a) the fact that law relating to intellectual property does not draw a distinction between creation and third-party effectiveness of a security right in intellectual property serves specific policy objectives of law relating to intellectual property (rather than other law, such as general property law, contract law or secured transactions law) and should be retained; or (b) the distinction should be introduced in law relating to intellectual property so as to harmonize it with the relevant approach of the law recommended in the *Guide*.

B. Functional, integrated and unitary concept of a security right

4. To the extent that law relating to intellectual property permits the creation of a security right in intellectual property, it may do so by referring to outright or conditional transfers of intellectual property, mortgages, pledges, trusts or similar terms. The *Guide* uses the term “security right” to refer to property rights in movable assets that are created by agreement and secure payment or other performance of an obligation, regardless of whether the parties have denominated it as a security right (thus, transfers for security purposes are covered as security devices; see the term “security right” in the introduction to the *Guide*, sect. B). This approach is referred to as the “functional, integrated and comprehensive approach” to secured transactions (see the *Guide*, chap. I, paras. 101-112, and recommendation 8). The *Guide* contemplates, by exception, that States may adopt a non-unitary approach in the limited context of acquisition financing and may retain transactions denominated as retention of title or financial lease of tangible assets (see the *Guide*, chap. IX). A similar approach may be followed with respect to: (a) conditional transfers of an intellectual property right or of a licence of an intellectual property right in which the transferor is the secured creditor and the transfer of the intellectual property right or of the licence does not take place until the transferee pays any unpaid portion of the purchase price or meets any obligation incurred or re-pays any credit provided to enable the transferee to acquire the intellectual property right or the licence; (b) outright transfers of an intellectual property right or of a licence in which the transferee obtains the intellectual property right or the licence on credit and creates a security right in favour of the transferor to secure any unpaid portion of the purchase price or any obligation incurred or credit provided to enable the transferee to acquire the intellectual property or the licence; (c) retention-of-title transactions with respect to an intellectual property right or a licence in which the seller is the secured creditor and the buyer does not obtain the intellectual property right or the licence until the buyer pays any unpaid portion of the purchase price or meets any obligation incurred or re-pays any credit provided to enable the buyer to acquire the intellectual property right or the licence; or (d) financial lease kind of transactions with respect to an intellectual property right or a licence in which the lessor is the secured creditor and the lessee may exploit the intellectual property right or the license only as long as the lessee pays lease instalments or meets any obligation incurred or re-pays any credit provided to enable the lessee to acquire the right to exploit the intellectual property right or the licence (see the term “acquisition security right” in the

introduction to the *Guide*, sect. B, as well as A/CN.9/700/Add.5, chap. IX). Thus, States enacting the law recommended in the *Guide* may wish to review their law relating to intellectual property with a view to: (a) replacing all terms used to refer to the right of a secured creditor with the term “security right”; or (b) providing that, whatever the term used, rights performing security functions are treated in the same way and that such a way is not inconsistent with the treatment of security rights in the law recommended in the *Guide*.

C. Requirements for the creation of a security right in intellectual property

5. As already mentioned (see para. 2 above), under the law recommended in the *Guide*, the creation of a security right in an intangible asset requires a written document, which by itself or in conjunction with the course of conduct between the parties evidences the agreement of the parties to create a security right. In addition, the grantor must have rights in the asset to be encumbered or the power to encumber it either at the time of the conclusion of the security agreement or thereafter. The agreement must reflect the intent of the parties to create a security right, identify the secured creditor and the grantor, and describe the secured obligation and the encumbered assets in a manner that reasonably allows their identification (see recommendations 13-15). No additional step is required for the creation of a security right in an intangible asset. The additional steps (for example, registration of a notice in a general security rights registry) required for third-party effectiveness of that security right are not required for the security right to be created and thus be effective as between the grantor and the secured creditor.

6. However, law relating to intellectual property in many States imposes different requirements for the creation of a security right in intellectual property. For example, registration of a document or notice of a security right in intellectual property (for example, a transfer for security purposes, a mortgage or pledge of intellectual property) in the relevant intellectual property registry may be required for the creation of the security right. In addition, under law relating to intellectual property, the intellectual property to be encumbered may need to be described specifically in a security agreement (see para. 7 below). Similarly, as some intellectual property registries in these States index registered transactions by the specific intellectual property to which they relate, and not by the grantor’s name or other identifier, registration of a document that merely states “all intellectual property of the grantor” would not be possible in these States and this would not create a security right (see A/CN.9/700/Add.3, para. 22). It would instead be necessary to identify each intellectual property right in the security agreement or in any other document to be registered in the intellectual property registry for the purposes of creating the security right.

7. Specific identification of the encumbered intellectual property right will often be necessary with respect to various types of intellectual property right such as, for example, a patent or a copyright. This may be so because, under law relating to intellectual property, an intellectual property right is often conceptualized as comprising a bundle of rights and, unless the parties intended to encumber all those rights, they may need to describe the assets to be encumbered specifically in the security agreement. In such a case, law relating to intellectual property may require

a specific description for certainty as to assets that are subject to a security right. Under such an approach, the intellectual property owner may use other concrete rights not covered by that specific description to obtain credit from another credit provider. It should also be noted that the nature of an intellectual property right as a bundle of rights allows the parties to encumber rights either as a bundle of rights or as separate rights, if they wish. Thus, if the parties wish to describe the encumbered intellectual property rights in a specific way, they are always entitled to do so and will probably do so in most cases; but this should not deprive the parties of the right to describe the encumbered intellectual property rights in a general way, unless otherwise required by law relating to intellectual property.

8. The standard to be met with regard to the description of the encumbered assets in the security agreement under the law recommended in the *Guide* is sufficiently flexible to accommodate all different situations in that it refers to a description of the encumbered assets “in a manner that reasonably allows their identification” (see recommendation 14, subpara. (d)); the same standard applies to the notice to be registered, see A/CN.9/700/Add.3, para. 21, and recommendation 63). Thus, this standard could vary depending on what is a reasonable description under the relevant law and practice with respect to the particular encumbered asset. Furthermore, in all these situations, under the principle embodied in recommendation 4, subparagraph (b), the law recommended in the *Guide* would apply only in so far as it is not inconsistent with law relating to intellectual property. States enacting the law recommended in the *Guide* may wish to consider reviewing their laws relating to intellectual property to determine whether the different concepts and requirements with respect to the creation of security rights in intellectual property serve specific policy objectives of law relating to intellectual property and should be retained or whether they should be harmonized with the relevant concepts and requirements of the law recommended in the *Guide*.

D. Rights of a grantor with respect to the intellectual property to be encumbered

9. As already mentioned (see para. 5 above), a grantor of a security right must have rights in the asset to be encumbered or the power to encumber it at the time of the security agreement or at a later time (see recommendation 13). This is a principle of secured transactions law that applies equally to intellectual property. A grantor may encumber its full rights or only limited rights. So, an intellectual property owner, licensor or licensee may encumber its full rights or rights limited in time, scope or territory. In addition, as a matter of general property law, a grantor may encumber its assets only to the extent that the assets are transferable under general property law (the law recommended in the *Guide* does not affect such limitations; see recommendation 18 and paras. 43 and 44 below). This principle also applies to secured transactions relating to intellectual property. So, an owner, licensor or licensee may only encumber its rights to the extent that those rights are transferable under law relating to intellectual property.

E. Distinction between a secured creditor and an owner with respect to intellectual property

10. For the purposes of the law recommended in the *Guide*, the secured creditor does not become an owner, licensor or licensee (depending on the rights of the grantor) on the sole ground that it acquired a security right in intellectual property. This may also be the case though under law relating to intellectual property (see the terms “owner” and “secured creditor”, A/CN.9/700, paras. 26, 29 and 30).

11. However, the exercise of the secured creditor’s rights upon default of the grantor will often result in the grantor’s encumbered intellectual property rights being transferred and, thus, the identity of the owner, licensor or licensee (depending on the rights of the grantor), as determined by law relating to intellectual property, might change. This may happen in situations in which the enforcement of the security right in the intellectual property results in acquisition of the encumbered intellectual property by the secured creditor in a disposition (see A/CN.9/700/Add. 5, paras. 16 and 17, and recommendations 142 and 148) or in an acquisition of the encumbered intellectual property by the secured creditor in total or partial satisfaction of the secured obligation (see A/CN.9/700/Add. 5, para. 21, and recommendations 156-159).

12. In any case, the question of who is the owner, licensor or licensee with respect to intellectual property and whether the parties may determine it for themselves is a matter of law relating to intellectual property. As already mentioned (see para. 10 above), under law relating to intellectual property, a secured creditor may at times be treated as an owner, licensor or licensee. Should intellectual property law so provide, the secured creditor could, for example, renew registrations or pursue infringers or agree with the owner, licensor or licensee that the secured creditor will become the owner, licensor or licensee (see A/CN.9/700/Add.5, paras. 2-5).

F. Types of encumbered asset in an intellectual property context

13. Under the law recommended in the *Guide*, a security right may be created not only in the rights of an intellectual property owner but also in the rights of a licensor or licensee under a licence agreement (see the term “encumbered asset”, A/CN.9/700, paras. 13-16, as well as A/CN.9/700/Add.1, paras. 2 and 3). In addition, although a security right in a tangible asset with respect to which intellectual property is used (for example, designer watches or clothes bearing a trademark) does not extend to the intellectual property (see paras. 32-36 below), such a security right may have an impact on the intellectual property used with respect to the tangible asset to the extent the secured creditor may enforce its security right in the tangible asset (see A/CN.9/700/Add. 5, paras. 24-27). As already mentioned (see paras. 5-8 above), under the law recommended in the *Guide*, the intellectual property to be encumbered needs to be described in the security agreement in a manner that reasonably allows its identification and this standard is sufficiently flexible to accommodate any requirements of law relating to intellectual property for a specific description of intellectual property to be encumbered (see recommendation 14, subpara. (d)).

14. It should be noted that the law recommended in the *Guide* does not override any provisions of law relating to intellectual property (or other law) that limit the creation or enforcement of a security right or the transferability of an intellectual property (or other) asset (see recommendation 18). In addition, the law recommended in the *Guide* does not affect contractual limitations to the transferability of intellectual property rights (recommendation 23 deals only with contractual limitations on the assignability of receivables). As a result of these two recommendations, if, under law relating to intellectual property, a security right may not be created or enforced in an intellectual property right or if that intellectual property right is non-transferable by law or contract, the law recommended in the *Guide* will not interfere with these limitations (see paras. 43 and 44 below). The law recommended in the *Guide*, however, does override legal limitations to the assignability of future receivables or of receivables assigned in bulk or in part on the sole ground that they are future receivables or are assigned in bulk or in part (see recommendation 23). In addition, under certain conditions, the law recommended in the *Guide* affects contractual limitations to the assignability of receivables (without affecting the different treatment of receivables for purposes of law relating to intellectual property; see recommendation 24 and paras. 26-29 below). As a result, to the extent that the law recommended in the *Guide* is enacted by a State, these legal or contractual limitations to the assignability of such receivables will no longer apply.

1. Rights of an owner

15. The law recommended in the *Guide* applies to secured transactions in which the encumbered assets are the rights of an owner (see A/CN.9/700, paras. 13-16, as well as A/CN.9/700/Add.1, paras. 2 and 3). Typically, the essence of the rights of an owner is the right to enjoy its intellectual property, the right to prevent unauthorized use of its intellectual property and to pursue infringers, the right to register intellectual property, the right to authorize others to use or exploit the intellectual property and the right to collect royalties (for the owner's rights to preserve the encumbered intellectual property by pursuing infringers and renewing registrations, see paras. 17-19 below).

16. If, under law relating to intellectual property, these rights are transferable, the owner may encumber all or some of them with a security right under the law recommended in the *Guide*. That law will apply to such a security right subject to recommendation 4, subparagraph (b). In such a case, all these rights would constitute the original encumbered assets (any rights to the payment of royalties would be proceeds of the owner's rights, unless included in the description of the encumbered assets in the security agreement). If these rights may not be transferred under law relating to intellectual property, they may not be encumbered by a security right under the law recommended in the *Guide*, since, as already mentioned (see para. 14 above), the law recommended in the *Guide* does not affect legal provisions that limit the creation or enforcement of a security right, or the transferability of assets, with the exception of provisions relating to the assignability of future receivables and receivables assigned in bulk (see recommendation 18 and paras. 22-25 below).

17. Whether the right of an owner to preserve its intellectual property (for example, by pursuing infringers and obtaining an injunction and/or monetary

compensation) may be transferred separately from the other rights of the owner is a matter of law relating to intellectual property. Typically, under law relating to intellectual property, the right to pursue infringers is part of the owner's rights and cannot be transferred separately from the owner's rights (see A/CN.9/700/Add.5, paras. 2-5). However, the grantor as an owner and the secured creditor, under secured transactions law, may agree that the secured creditor may acquire this right, if acquisition of such a right by the secured creditor is not prohibited by law relating to intellectual property (see A/CN.9/700/Add.1, paras. 23-24).

18. In addition, unless prohibited by law relating to intellectual property, the grantor as an owner and the secured creditor may agree that the benefits from the exercise of the right of the grantor to pursue infringers (such as the right to the payment of damages arising from an infringement once collected) are included in the original encumbered intellectual property. Thus, in cases where law relating to intellectual property treats such benefits as a movable asset that may be transferred separately from the owner's rights, the question of whether a security right may be created in those benefits would be a matter of secured transactions law (subject to the limitation introduced by recommendation 4, subpara. (b)).

19. For example, if, after the creation of a security right in the rights of an intellectual property owner, an infringement has been committed, the owner has sued infringers and infringers have paid compensation to the owner (for an infringement that occurred before or after the creation of the security right), the secured creditor may be able to claim the compensation paid either as proceeds of the original encumbered intellectual property or as an original encumbered asset if properly so described in the security agreement. If the compensation has not been paid at the time of creation of the security right, but is paid later after default of the grantor (owner), the secured creditor could also be able to claim the compensation paid either as proceeds of the original encumbered intellectual property or, if appropriately so described in the security agreement, as an original encumbered asset. To the contrary, under law relating to intellectual property, the right to pursue infringers would normally not constitute proceeds of the original encumbered intellectual property or an original encumbered asset (see para. 17 above). However, if the grantor (owner) has filed a suit against an infringer and the lawsuit is still pending at the time of enforcement of the security right, a person that acquired the grantor's rights in the encumbered intellectual property in the context of enforcement of the security right should be able to take over the lawsuit and obtain any compensation granted (again, if permitted under law relating to intellectual property).

20. Similar considerations apply to the question of whether the right to deal with authorities in the various stages of the registration process (for example, the right to file an application for the registration of intellectual property, the right to register intellectual property or the right to renew a registration of intellectual property) or the right to grant licences may be transferred, and thus be part of the encumbered intellectual property. Whether the right to deal with authorities or to grant licences may be transferred or is an inalienable right of the owner is a matter of law relating to intellectual property. Whether it is part of the encumbered rights of the owner is a matter of the description of the encumbered asset in the security agreement, assuming that it may be transferred under law relating to intellectual property.

2. Rights of a licensor

21. Under the law recommended in the *Guide*, a security right may be created in a licensor's rights under a licence agreement (see A/CN.9/700, paras. 13-16, as well as A/CN.9/700/Add.1, paras. 2 and 3). If a licensor is an owner, it can create a security right in (all or part of) its rights as mentioned above (see paras. 15-20 above). If a licensor is not an owner but a licensee that grants a sub-licence, typically, it may create a security right in its right to the payment of royalties owed by sub-licensees under the sub-licence agreement. In such a case where the grantor creating a security right in sub-royalties is a licensor but not the intellectual property owner, the sub-royalties would be the original encumbered assets; where the grantor creating a security right in the intellectual property itself is the intellectual property owner, the sub-royalties would be proceeds of the original encumbered intellectual property, unless the sub-royalties were included in the description of the original encumbered assets in the security agreement (for the licensee's rights, see paras. 30 and 31 below). Such a licensor may also create a security right in other contractual rights of value that the licensor might have under the licence agreement and the relevant law. These other contractual rights might include, for example: (a) the licensor's right to compel the licensee to advertise the licensed intellectual property or product with respect to which the intellectual property is used; (b) the licensor's right to compel the licensee to market the licensed intellectual property only in a particular manner; and (c) the licensor's right to terminate the licence agreement on account of the licensee's breach.

22. Following the approach taken in most legal systems and reflected in the United Nations Assignment Convention (see art. 2), the law recommended in the *Guide* treats rights to the payment of royalties arising from the licence of intellectual property as receivables (see the term "receivable" in the introduction to the *Guide*, sect. B). This means that the general discussion and recommendations dealing with security rights, as modified by the receivables-specific discussion and recommendations of the *Guide*, apply to rights to the payment of royalties. Thus, under the law recommended in the *Guide*, statutory prohibitions that relate to the assignment of future receivables or receivables assigned in bulk or partial assignments on the sole ground that they are future receivables or receivables that are assigned in bulk or in part are rendered unenforceable (see recommendation 23). However, other statutory prohibitions or limitations are not affected (see recommendation 18). In addition, a licensee could raise against an assignee of the licensor's right to the payment of royalties all defences or rights of set-off arising from the licence agreement or any other agreement that was part of the same transaction (see recommendation 120).

23. In this context, it is important to note that the statutory prohibitions rendered unenforceable by the *Guide* refer to future receivables only as future receivables, or receivables assigned in bulk or in part. They do not affect legal prohibitions based on the nature of receivables, for example, as wages or royalties that may by law be payable directly only to authors or collecting societies. Many countries have "author-protective" or similar legislation that designates a certain portion of income earned from exploitation of the intellectual property rights as "equitable remuneration" or the like that must be paid to authors or other entitled parties or their collecting societies. These laws often make such payment rights expressly non-

assignable. The *Guide*'s recommendations with respect to legal limitations on the assignment of receivables do not apply to these or other similar legal limitations.

24. Furthermore, it is important to note that the treatment of the right to the payment of royalties as receivables for the purposes of the secured transactions law recommended in the *Guide* does not affect the different treatment of this right to the payment of royalties for the purposes of law relating to intellectual property.

25. Finally, it is equally important to note that the treatment of rights to receive payment of royalties in the same way as any other receivable does not affect the terms and conditions of the licence agreement relating to the payment of royalties, such as that payments are to be staggered or that there might be percentage payments depending on market conditions or sales figures (for the principle of respecting licence agreements under the law recommended in the *Guide*, see para. 31 below, A/CN.9/700, paras. 23-25, A/CN.9/700/Add.3, paras. 38 and 39, and A/CN.9/700/Add. 4, paras. 15, 24 and 25).

26. Under the law recommended in the *Guide*, if a licence agreement, under which royalties are payable, includes a contractual provision that restricts the ability of the licensor to assign the right to the payment of royalties to a third party ("assignee"), an assignment of the right to the payment of royalties by the licensor is nonetheless effective and the licensee cannot terminate the licence agreement on the sole ground of the assignment by the licensor of the right to the payment of royalties (see recommendation 24). However, under the law recommended in the *Guide*, the rights of a licensee (as a debtor of the assigned receivables) are not affected except as otherwise provided in the secured transactions law recommended in the *Guide* (see recommendation 117, subpara. (a)). Specifically, the licensee is entitled to raise against the assignee all defences or rights of set-off arising from the licence agreement or any other agreement that was part of the same transaction (see recommendation 120, subpara. (a)). In addition, the law recommended in the *Guide* does not affect any liability that the licensor (or sub-licensor) may have under other law for breach of the anti-assignment agreement (see recommendation 24). As the term "licence" includes a sub-licence (see A/CN.9/700, para. 23), the same principles apply to a provision in a sub-licence agreement under which a sub-licensee restricts the ability of its sub-licensor to assign the right to the payment of the sub-royalties due from the sub-licensee to the sub-licensor.

27. It is important to note that recommendation 24 applies only to receivables, and not to intellectual property rights. This means that it does not apply to an agreement between a licensor and a licensee according to which the licensee does not have the right to grant sub-licences (such an agreement would be one way for the licensor to control by agreement the licensed intellectual property, who can use it and the flow of royalties). It is equally important to note that recommendation 24 applies only to an agreement between a creditor of a receivable and the debtor of the receivable that the receivable owed to the creditor by the debtor may not be assigned. It does not apply to an agreement between a creditor of a receivable and the debtor of the receivable that the debtor may not assign receivables that may be owed to the debtor by third parties. Thus, recommendation 24 does not apply to an agreement between a licensor and a licensee that prohibits the licensee from assigning its right to payment of sub-licence royalties from third-party sub-licensees. Such an agreement would be another way for the licensor to control by agreement the flow of royalties and may exist, for example, where the licensor and the licensee agree that

sub-licence royalties will be used by the licensee to further develop the licensed intellectual property. As a result, recommendation 24 does not affect the right of the licensor to negotiate the licence agreement with the licensee so as to control by agreement who can use the intellectual property or the flow of royalties from the licensee and sub-licensees. However, breach of such licence agreements by the licensee would only make the licensee liable for damages and would not invalidate a security right created by the licensee in its right to the payment of sub-royalties.

28. In addition, recommendation 24 does not apply to an agreement between a licensor and a licensee that the licensor will terminate the licence agreement if the licensee violates the agreement not to assign the right to the payment of royalties payable to the licensee by sub-licensees (such an agreement would be another way for the licensor to control by agreement the flow of royalties). In this context, it should be noted that the right of the licensor to terminate the licence agreement if the licensee breaches this agreement gives the sub-licensees a strong incentive to make sure that the licensor will receive payment. Moreover, recommendation 24 does not affect the right of the licensor: (a) to agree with the licensee that part of the licensee's royalties (representing a source for the payment of the royalties the licensee owes to the licensor) be paid by sub-licensees to an account in the name of the licensor; or (b) to obtain a security right in the licensee's right to the payment of royalties by sub-licensees, register a notice in that regard in the general security rights registry (or the relevant intellectual property registry) and thus potentially obtain a security right with priority over the licensee's other creditors (subject to the recommendations of the *Guide* for obtaining third-party effectiveness and priority of security rights; see A/CN.9/700/Add.4, paras. 41-46).

29. Under the law recommended in the *Guide*, a secured creditor with a security right in a receivable has the benefit of a security right in intellectual property securing payment of the receivable (see recommendation 25). However, this does not mean that legal limitations on the transferability of intellectual property rights are set aside (see recommendation 18). Similarly, this does not mean that contractual limitations on the transferability of intellectual property rights are affected, as recommendation 24 applies to assignment of receivables and not to transfers of intellectual property rights.

3. Rights of a licensee

30. Under an intellectual property licence agreement and the law governing it, a licensee may have the right to grant sub-licences and to receive as a sub-licensor the payment of any royalties flowing from a sub-licence agreement. The discussion above with respect to the rights of a licensor (see paras. 21-29 above) would apply equally to the rights of a licensee as a sub-licensor.

31. Typically, a licensee is authorized to use or exploit the licensed intellectual property in line with the terms and conditions of the licence agreement. Some laws relating to intellectual property provide that the licensee may not create a security right in its authorization to use or exploit the licensed intellectual property without the licensor's consent (although in many States an exception may arise where the licensee sells its business as a going concern). The reason is that it is important for the licensor to retain control over the licensed intellectual property and who can use it. If such control cannot be exercised, the value of the licensed intellectual property may be materially impaired or lost completely. If, however, the rights of a licensee

under a licence agreement are transferable and the licensee grants a security right in them, the secured creditor will take a security right in the licensee's rights subject to the terms and conditions of the licence agreement. If the licence is transferable and the licensee transfers it, the transferee will take the licence subject to the terms and conditions of the licence agreement. The law recommended in the *Guide* does not affect these licensing practices.

4. Tangible assets with respect to which intellectual property is used

32. Intellectual property may be used with respect to a tangible asset. For example: (a) a tangible asset may be manufactured according to a patented process or through the exercise of patented rights; (b) jeans may bear a trademark or cars may contain a chip that includes a copy of copyrighted software; (c) a compact disk may contain a software programme; or (d) a heat pump may contain a patented product.

33. Where intellectual property is used in connection with a tangible asset, two different types of asset are involved. One is the intellectual property; another is the tangible asset. These assets are separate. Law relating to intellectual property allows an intellectual property owner to control many but not all uses of the tangible asset. For example, law relating to copyright allows an author to prevent unauthorized duplication of a book, but typically not to prevent an authorized bookstore that bought the book in an authorized sale to re-sell it or the end-buyer to make notes in the margin while reading. As such, a security right in a tangible asset does not extend to the intellectual property used with respect to a tangible asset, and a security right in intellectual property does not extend to the tangible asset with respect to which the intellectual property is used. The draft Supplement recommends this approach (see recommendation 243 below).

34. However, under the law recommended in the *Guide*, the parties to the security agreement may always agree that a security right is created both in a tangible asset and in intellectual property used with respect to that asset (see recommendation 10). For example, a security right may be taken in inventory of trademarked jeans and in the trademark, giving the right to the secured creditor in the case of default of the grantor to sell both the encumbered trademarked jeans and the right to produce other jeans bearing the encumbered trademark. In such a case, where the manufacturer/grantor is the trademark owner, the encumbered assets are the owner's rights. Where the manufacturer/grantor is a licensee, the encumbered assets are the licensee's rights under the licence agreement.

35. The exact extent of the security right depends on the description of the encumbered asset in the security agreement. As already noted (see paras. 5-8 above), a description of the encumbered assets "in a manner that reasonably allows their identification" is sufficiently flexible to accommodate all different situations (see recommendation 14, subpara. (d)), as it sets a standard that could vary depending on what is a reasonable description under the relevant law and practice. It would thus seem that a general description of the encumbered tangible asset would be in line with the principles of the *Guide* and the reasonable expectations of the parties. At the same time, key principles of law relating to intellectual property with respect to a specific description of intellectual property to be encumbered in a security agreement would be accommodated by the law recommended in the *Guide*. In any case, if, under the law recommended in the *Guide*, a general description of

the encumbered intellectual property would be sufficient, while under law relating to intellectual property a specific description would be necessary, the latter requirement would apply to encumbered intellectual property under recommendation 4, subparagraph (b), of the *Guide*.

36. As already mentioned (see para. 33 above), a security right in a tangible asset, with respect to which intellectual property is used, does not extend to the intellectual property, but it does encumber the tangible asset itself, including those characteristics of the asset that use the intellectual property (for example, the security right applies to a television set as a functioning television set). Thus, a security right in such an asset does not give the secured creditor the right to manufacture additional assets using the intellectual property. Upon default, however, the secured creditor with a security right in the tangible asset could exercise the remedies recognized under secured transactions law, provided that such exercise of remedies did not interfere with rights existing under law relating to intellectual property. It may be that, under applicable law relating to intellectual property, the “exhaustion doctrine” (or similar concepts) might apply and permit the enforcement of the security right (for a discussion of enforcement issues, see A/CN.9/700/Add.5, paras. 24-27).

G. Security rights in future intellectual property

37. The law recommended in the *Guide* provides that a person may grant a security right in a future asset, namely an asset created or acquired by the grantor after the creation of a security right (see recommendation 17). Like any other rule recommended in the *Guide*, this rule too applies to intellectual property, except in so far as it is inconsistent with law relating to intellectual property (see recommendation 4, subpara. (b)). Accordingly, under the law recommended in the *Guide*, a security right can be created in future intellectual property (as to legal limitations in that regard, see recommendation 18, as well as paras. 43 and 44 below). This approach is justified by the commercial utility in allowing a security right to extend to future intellectual property.

38. Many laws relating to intellectual property follow the same approach, allowing intellectual property owners to obtain financing useful in the development of new works, provided that their value can be reasonably estimated in advance. For example, it is usually possible to create a security right in a copyrighted motion picture or software (the security right is created when the copyrighted work is created; see A/CN.9/700, para. 40). In some States, a security right may be created in a patent application before the patent right is granted (typically, after the patent right is granted, it is considered as having been created at the time of the application).

39. However, in certain cases, law relating to intellectual property may limit the transferability of various types of future intellectual property to achieve specific policy goals. For example, in some cases, a transfer of rights in new media or technological uses that are unknown at the time of the transfer may not be effective in view of the need to protect authors from undue commitments. In other cases, transfers of future rights may be subject to a statutory right of cancellation after a certain period. In other cases, the notion of “future intellectual property” may

include rights that have been created and that may be registered but that are not yet registered. Statutory prohibitions may also take the form of a requirement for a specific description of intellectual property.

40. Other limitations on the use of future intellectual property as security for credit may be the result of the meaning of the concepts of “improvements”, “updates”, “adaptations” or other changes to intellectual property under law relating to intellectual property. Such “other changes” in relation to copyrighted content can be, for example, changes regarding the quality of the content or the form of its delivery, such as the re-mastering or the digital conversion of a sound recording or new forms of electronic delivery of a sound recording that might lead to new, yet to be invented forms or uses, whether dependent or independent of any physical carrier.

41. The secured creditor should understand how these concepts are interpreted under law relating to intellectual property and how they may affect the concept of “ownership”, which is essential in the creation of a security right in intellectual property. For example, this determination is of particular relevance in the case of copyrighted software. In some States, a security right in a version of copyrighted software that exists at the time of the financing may extend automatically to modifications made to that version following the financing. However, typically law relating to intellectual property treats such future improvements as separate assets and not as integral parts of existing intellectual property. Thus, if future intellectual property rights may be encumbered, a prudent secured creditor that wishes to ensure that improvements are encumbered should describe the encumbered asset in the security agreement in a manner that ensures that improvements are directly encumbered (see A/CN.9/700/Add.5, para. 20). If future intellectual property rights may not be encumbered, improvements may not be encumbered either and the law recommended in the *Guide* does not affect any such limitations (see recommendation 18).

42. If law relating to intellectual property limits the transferability of future intellectual property, the law recommended in the *Guide* does not apply to this matter in so far as it is inconsistent with law relating to intellectual property (see recommendation 4, subpara. (b)). Otherwise, the law recommended in the *Guide* applies and permits the creation of a security right in future assets (see recommendation 17). States enacting the law recommended in the *Guide* may wish to review their law relating to intellectual property with a view to establishing whether the benefits from these limitations (for example, the protection of the owner from undue commitments) outweigh the benefits from the use of such assets as security for credit (for example, the financing of research and development activities).

H. Legal or contractual limitations on the transferability of intellectual property

43. Specific rules of law relating to intellectual property may limit the ability of an intellectual property owner, licensor or licensee to create a security right in certain types of intellectual property. In many States, only the economic rights of an author are transferable; the moral rights are not transferable. In addition, legislation in

many States provides that an author's right to receive equitable remuneration may not be transferable. Moreover, in many States, trademarks are not transferable without their associated goodwill. Finally, as is the case with assets other than intellectual property, an asset may not be encumbered by a person if that person does not have rights in the asset or the power to encumber it (see recommendation 13 and the *nemo dat (quod non habet)* principle). The law recommended in the *Guide* respects all these limitations on the transferability of intellectual property (see recommendation 18).

44. The only legal limitations on the transferability of certain assets that the law recommended in the *Guide* may affect and remove are the legal limitations on the transferability of future receivables, receivables assigned in bulk and parts of or undivided interests in receivables, as well as contractual limitations on the assignment of receivables arising from the sale or licence of intellectual property rights (see articles 8 and 9 of the United Nations Assignment Convention and recommendations 23-25). In addition, the law recommended in the *Guide* may affect and render ineffective contractual limitations, but only with respect to receivables (not intellectual property) and only in a certain context, that is, in an agreement between the creditor of a receivable and the debtor of that receivable (see paras. 26-28 above).

Recommendation 243¹

Security rights in tangible assets with respect to which intellectual property is used

The law should provide that, in the case of a tangible asset with respect to which intellectual property is used, a security right in the tangible asset does not extend to the intellectual property and a security right in the intellectual property does not extend to the tangible asset.

¹ If it could be included in the *Guide*, this recommendation would be placed in chapter II. Creation of a security right, as recommendation 28 bis.