



General Assembly

Distr.: Limited
30 January 2009

Original: English

**United Nations Commission
on International Trade Law**
Working Group V (Insolvency Law)
Thirty-sixth session
New York, 18-22 May 2009

Discussion of intellectual property in the Legislative Guide on Insolvency Law

Note by the Secretariat

Contents

	<i>Paragraphs</i>	<i>Page</i>
A. References to intellectual property in the discussions of Working Group V . . .	5-17	2
B. The consequences of rejection of a contract	18-20	4
C. Provisions of the Legislative Guide concerning the decision to continue a contract and protection of the value of the secured asset.	21-27	5



1. At its 35th session in November 2008, Working Group V considered several issues concerning the impact of insolvency on a security right in intellectual property that had been referred to it by Working Group VI. The Working Group expressed its views on the first set of issues (as outlined in the table included at the end of document A/CN.9/667).
2. With respect to the second issue (as outlined in paragraph 133 of document A/CN.9/667), concerning the possibility that a licensee to a contract rejected by the insolvency representative of the licensor might be permitted, under some laws, to continue to perform that contract notwithstanding the rejection, the Working Group agreed that it was not in a position to properly consider that question without better understanding of the scope and extent of the issues involved and the commentary being proposed by Working Group VI. To assist its deliberations, the Working Group requested the Secretariat to prepare a working paper, for consideration at its next session that would provide background information on the discussion of the treatment of contracts that had taken place in the course of the development of the Legislative Guide on Insolvency law (the Guide)¹ and the recommendations that had been adopted.
3. The Working Group reached the same conclusion with respect to the third issue (referred to in paragraphs 137-138 of document A/CN.9/667), and requested the Secretariat to include in the working paper to be prepared background information and explanatory material from the Guide that would be relevant to a consideration of those proposals.
4. This note by the Secretariat provides that background information as requested.

A. References to intellectual property in the discussions of Working Group V

5. Consideration of the discussion in the Working Group indicates that issues specific to intellectual property were raised by delegations on only two occasions in the context of the treatment of contracts following commencement of insolvency proceedings. Little discussion of those specific issues ensued. The general approach of the Working Group was to agree on recommendations that would apply to contracts generally and to specify only limited exceptions.
6. The following paragraphs indicate the extent of the discussion as it related to intellectual property.

1. Recommendations

7. For consideration at its twenty-sixth session in May 2002, draft recommendation (54) as set forth in document A/CN.9/WG.V/WP.61 provided that:
“The insolvency law may provide special rules for the treatment of labour and [...] contracts.”

¹ UNCITRAL Legislative Guide on Insolvency Law, Sales No. E.05.V.10, text available at <http://www.uncitral.org>.

8. The report of the twenty-sixth session (A/CN.9/511) noted that:

“56. As to recommendation (54), it was suggested that specific mention should be made of financial transactions (addressed in detail in section F), as well as contracts involving intellectual property where it was desirable that the contract be able to be continued.”
9. Following that session, draft recommendation (54) (renumbered recommendation 67) was revised to include labour, intellectual property and financial contracts (A/CN.9/WG.V/WP.63/Add.8).
10. In the discussion at the twenty-seventh session in December 2002, several delegations questioned the need to refer to intellectual property contracts in draft recommendation (67), while many supported the inclusion of labour contracts.
11. Paragraph 155 of the report of that session (A/CN.9/529) reflects the Working Group’s conclusion as follows:

“155. Some concerns were expressed as to the intention of recommendation (67) and the contracts that should be included. There was general agreement that labour contracts should be addressed in view of the applicable international regimes. After discussion, the Working Group agreed on the need for a general provision referring to the special treatment of certain types of contracts, with the addition of some examples, such as labour contracts.”
12. Following that session, draft recommendation (67) was revised to include a specific exception to the recommendation on automatic termination clauses for financial contracts and a more general reference to the application of special rules in insolvency to certain types of contracts, such as labour contracts.
13. That revision appeared as draft recommendation (57) in document A/CN.9/WG.V/WP.70 (Part II). That version of the draft recommendation was approved and adopted by the Commission at its thirty-seventh session in 2004 and renumbered 71 in the published version of the Guide.

2. Commentary

14. In the published version of the Guide, paragraphs 134-135 of part two, chapter II adopt the approach used throughout the Guide of discussing the different approaches insolvency laws take to a particular issue, in that case rejection of a contract. No specific mention is made of intellectual property contracts and no suggestion appears to have been made by the Working Group that such a reference be included in those paragraphs.
15. The general approach suggested by the Guide and discussed in paragraph 113 of part two, chapter II is to set forth general rules that apply to all types of contracts (whether specifically mentioned or not) and identify exceptions for a limited number of special contracts. Labour contracts, financial contracts, contracts for personal services and contracts for loans and insurance are mentioned.
16. Intellectual property is specifically mentioned in:
 - (a) Paragraph 115 of part two, chapter II as a factor supporting the observance of automatic termination or acceleration clauses on the basis that

creators of intellectual property need to be able to control the use of that property or because of the effect on a counterparty's business of termination of a contract, especially one with respect to an intangible;

(b) Paragraph 116 of part two, chapter II, as a factor supporting the override of such automatic termination or acceleration clauses where, in reorganization for example, the contract involves the use of intellectual property embedded in a key product and continued performance of the contract may enhance the earnings potential of the business, capture value and assist in locking all creditors into a reorganization;

(c) Paragraph 143 of part two, chapter II, which discusses the two types of general exception to the power to continue performance, reject or assign contracts that exist in insolvency laws. The first relates to exceptions provided for specific types of contracts and several examples are given – short-term financial contracts, insurance contracts and contracts for the making of a loan. The commentary goes on to note that “Exceptions to the power to reject may also be appropriate in the case of [inter alia] agreements where the debtor is a lessor or franchisor or a licensor of intellectual property and termination of the agreement would end or seriously affect the business of the counterparty, in particular where the advantage to the debtor may be relatively minor.” The only two types of contracts discussed in further detail in that section are labour contracts and contracts for irreplaceable and personal services; and

(d) The second type of exception is discussed in paragraph 146 of part two, chapter II, that is contracts that cannot continue to be performed because they require performance of an irreplaceable personal service. One example given is a contract that involves particular intellectual property.

17. Those paragraphs of the published version of the Guide reflect the content of earlier drafts and no further detail or explanation appears to have been added to those particular paragraphs after the twenty-fifth session in December 2001.

B. The consequences of rejection of a contract

1. Recommendations

18. The only remedy for rejection of a contract that is the subject of a recommendation in the Guide is payment of damages. Recommendation 82 provides that:

“The insolvency law should specify that any damages arising from the rejection of a pre-commencement contract would be determined in accordance with applicable law and should be treated as an ordinary unsecured claim. The insolvency law may limit claims relating to the rejection of a long-term contract.”

2. Commentary

19. Paragraph 134, part two, chapter II of the Guide notes that many laws provide that the counterparty is only entitled to a remedy in damages in case of rejection of a contract, even if other remedies would have been available outside of insolvency.

One reason cited for that approach is that allowing other remedies, such as delivery of goods manufactured but not delivered prior to commencement of insolvency proceedings, would amount to paying the full claim of the counterparty, a result that would not be available to other unsecured creditors and that would depart from the principle of equal treatment.

20. The possibility of including references to other remedies in the commentary appears not to have been raised or discussed in the Working Group.

C. Provisions of the Legislative Guide concerning the decision to continue a contract and protection of the value of the secured asset

21. Working Group V was requested to consider and express its views on a third set of issues raised in paragraphs 135-138 of A/CN.9/667. Those paragraphs concern, on the one hand, sale by the secured creditor of the intellectual property right that was the object of the security right and recovery of its debt from the proceeds of that sale, and on the other, continuation of the performance of the licence contract to better maximise the value of the encumbered intellectual property right, thus opposing the immediate termination of the licence contract and consequent sale.

22. It was mentioned that the law of some States enabled the secured creditor to request the insolvency representative, or the insolvency court if necessary, to:

(a) Set a legally binding deadline for the decision to continue or not the performance of the licence contract; and

(b) Schedule a special hearing before the insolvency court, to attempt mediation between the insolvency representative and the secured creditor, in order to obtain further protection for the secured obligation.

23. Paragraphs 108-146 of part two, chapter II of the Guide discuss the various interests that arise with respect to continuation and rejection of contracts, including the advantages and disadvantages of possible policy options.

24. With specific reference to paragraph 22 (a) above, the Guide recommends that, rather than leaving the matter to the insolvency representative or the court to establish, this deadline be specified in the insolvency law to ensure certainty and transparency. Recommendation 74 provides that:

“The insolvency law should specify a time period within which the insolvency representative is required to make a decision to continue or reject a contract, which time period may be extended by the court.”

25. These issues are discussed in paragraphs 128-129 of part two, chapter II of the Guide.

26. With specific reference to paragraph 22 (b) above, the Guide recommends that the secured creditor should have a right to protection of the value of the assets in which it has a security interest. It would not be a question of mediation or negotiation between the insolvency representative and the secured creditor, but rather a matter to be determined by the court, based upon the provisions of the insolvency law. Recommendation 50 provides that:

“The insolvency law should specify that, upon application to the court, a secured creditor should be entitled to protection of the value of the assets in which it has a security interest. The court may grant appropriate measures of protection that may include:

- (a) Cash payments by the estate;
- (b) Provision of additional security interests; or
- (c) Such other means as the court determines.”

27. These issues are discussed in the commentary in paragraphs 63-69 of part two, chapter II of the Guide.
