



General Assembly

Distr.: Limited
29 August 2008

Original: English

**United Nations Commission
on International Trade Law**
Working Group VI (Security Interests)
Fourteenth session
Vienna, 20-24 October 2008

Annex to the UNCITRAL Legislative Guide on Secured Transactions dealing with security rights in intellectual property (Part 2)

Note by the Secretariat*

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* This note is submitted two weeks less than the required ten weeks prior to the start of the meeting because of an extremely heavy workload and the need to complete consultations and finalize subsequent amendments.



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IV. Effectiveness of a security right in intellectual property against third parties

[Note to the Working Group: For paras. 1-14, see A/CN.9/WG.VI/WP.33, paras. 137-145, and A/CN.9/649, paras. 29-31.]

A. The concept of third-party effectiveness

1. As already noted, the Guide distinguishes between creation of a security right (effectiveness of the security right as between the parties) and effectiveness of the security right against third parties of a security right. A security right becomes effective against third parties only if a notice of the security right is registered either in the general security rights registry or in the specialized registry, assuming that one exists and security rights may be registered therein (see recommendation 38). The notice may be registered before or after the creation of the security right or the conclusion of the security agreement (see recommendation 67). However, the security right cannot become effective against third parties before it is created (see recommendation 29).

2. These recommendations apply equally to security rights in intellectual property. As required by recommendation 4, subparagraph (b), however, if the intellectual property law of a State provides that registration in an existing intellectual property registry is the only method by which a security right in a particular type of intellectual property may be made effective against third parties, the recommendations of the Guide defer to that intellectual property law. Similarly, if a document, rather than a notice, has to be registered, with constitutive or declaratory rather than third-party effects, the Guide does not affect this outcome. Consequently, should registration in an intellectual property registry not produce third-party effects under intellectual property law, that registry would not be a specialized registry under the Guide and recommendations of the Guide relating to specialized registries would not apply. On the other hand, where other law relating to intellectual property does not deal with these matters, the Guide applies. States enacting the law recommended in the Guide may wish to review their law relating to intellectual property with a view to considering whether that law should provide that, to the extent a right in intellectual property may be registered in an intellectual property registry, a security right may also be registered in that registry (as to the requirements and legal consequences of registration, see chapter on the registry system below).

3. In some States, the creation and enforcement of security rights in intellectual property are governed by the same rules that govern those issues for other types of intangible property. In other States, as a matter of intellectual property law, these matters are addressed differently when the encumbered asset is intellectual property. It is very common, however, for intellectual property law to provide for particular methods in which a security right in some types of intellectual property may be made effective against third parties. The practices differ for rights in intellectual property that are subject to a specialized registration system (such as patents, trademarks and, in some countries, copyrights), and rights in intellectual property

that are not subject to such registration (such as copyrights, in some countries, and trade secrets). These matters are addressed in sections B and C below.

4. In the Guide, the term “effective against third parties” refers to whether a security right in an encumbered asset will be effective as against parties other than the grantor and the secured creditor that have (or may have in the future) a claim against that encumbered asset. Such third parties include creditors of the grantor, as well as transferees, lessees and licensees of the encumbered asset. In intellectual property law, by contrast, third-party effectiveness often refers not only to the effectiveness of a security right in intellectual property but also to the effectiveness of ownership or other rights in intellectual property itself (or a transfer or licence thereof). Thus, in an intellectual property context, the term “third parties” may include not only claimants competing with a secured creditor but also transferees and licensees competing among themselves, as well as infringers of intellectual property (who are not, of course, competing claimants – a term not used in intellectual property law – or competing transferees). These two sorts of references should not be confused. While effectiveness of a security right as against claimants competing with a secured creditor is a matter of secured transactions law, effectiveness of rights in intellectual property against transferees, licensees or infringers (where no security right is involved) is only a matter of intellectual property law. The Guide does not affect the meaning of the term “third parties” under intellectual property law.

[Note to the Working Group: The Working Group may wish to consider whether it is appropriate to refer to infringers in this context. Both the term “competing claimant” under secured transactions law and the term “competing transferee” under intellectual property law presuppose a legitimate transaction. Infringers are, by definition, illegitimate, unauthorized third parties. In line with their objectives, the Guide and Annex do not effect any change on that matter.]

B. Third-party effectiveness of security rights in intellectual property that are registrable in an intellectual property registry

5. Under the Guide, security rights or other rights in intellectual property that, under intellectual property law, are registrable in an intellectual property registry that provides for third-party effects of registration may be made effective against third parties by registration in the intellectual property registry or in the general security rights registry (see recommendation 38).

6. Under intellectual property law, the situation may be different. In some States, a security right is not effective against third parties or even as between the parties (i.e. is not created), unless and until it is registered in the relevant intellectual property registry. In some of these States, a security right is not even effective between the parties until such registration. In other States, intellectual property law provides that a security right is created and becomes effective against third parties when the security agreement is entered into, even without registration. Registration in the relevant intellectual property registry allows certain third parties, typically bona fide transferees without notice, to invoke a priority rule to take precedence over unregistered prior security right, but the unregistered security right still remains effective against other third parties. In still other States, a security right is

created when the security agreement is entered into, but registration in the relevant intellectual property registry is necessary to make the security right effective against any third parties, for example, by way of an evidentiary rule that prohibits evidence of unregistered security rights. In still other States, the registration system does not readily accommodate registration of security rights, and third-party effectiveness must be achieved outside the intellectual property registration system. Finally, in some States, it is possible to achieve third-party effectiveness of a security right by using either the intellectual property registry or an available general security rights registry.

7. In any case, the Guide does not recommend a rule that requires registration of a security right in both the relevant intellectual property registry and in the general security rights registry. Under the Guide's recommendations, registration in either the general registry or, assuming security rights may be registered in an intellectual property registry, in the intellectual property registry is sufficient. The Guide deals with the issue of the differing effects of registration in the two registries by way of priority rules that give priority to a security or other right registered in an intellectual property registry (see recommendations 77 and 78). The Guide is thus based on the assumption that, if a secured creditor expects that there will be competing claimants (as this term is understood in the Guide) and needs to have priority, that secured creditor will register in the intellectual property registry. If such registry does not exist or does not permit registration of security rights in intellectual property or the secured creditor is not concerned with priority, the Guide is based on the assumption that that secured creditor will register in the general security rights registry.

8. For example, under the Guide, if A creates a security right in a patent in favour of B who registers in the general security rights registry, and then A transfers title to the patent to C who registers in the patent registry (if so provided under patent law), C would take the patent free of the security right, because the security right was not registered in the patent registry (see recommendation 78). Similarly, if A, instead of making a transfer of the patent, creates a second security right in favour of C and only C registers in the patent registry (if so provided under patent law), under the Guide, C would prevail (see recommendation 77, subparagraph (a)). In either case, as registration of a security right in the patent registry gives superior rights, third-party searchers that intend to acquire a right that is registrable in the specialized registry could rely on a search in that registry and would not need to search in the general security rights registry.

9. If, in order to fully assess their rights, third-party searchers would need to search in both registries, in view of the different structures of the two registries, they would need to search under the name of A in the general security rights registry and under the identifying number of the patent in the patent registry (unless a registry had two indexes, one organized by grantor name and another organized by asset description). Absent dual indexing, these difficulties could only be resolved if the registration rules in the different systems were reconciled in a way that would allow a registration in the relevant intellectual property registry to be transmitted electronically to the security rights registry in the grantor's location and to be indexed under the grantor's name or other identifier. Such transmission would require that either the registrant or the staff of the intellectual property rights

registry register a notice that would also be registrable in the general security rights registry.

10. The fact that priority is accorded to a security right registered in the specialized intellectual property registry does not mean that registration in the general security rights registry is of no value, as it could still give a security right priority as against other creditors (e.g. the insolvency administrator in the insolvency of the grantor and other secured creditors that registered only in the general security rights registry). Moreover, security rights in some types of intellectual property may not be registrable in an intellectual property registry, and, in these situations, registration in the general security rights registry is the only alternative.

11. The discussion in the preceding paragraphs is based on the assumption that the registries are in the same State. If the registries are in different States, different applicable law issues arise, which are discussed below (see chapter X below).

C. Third-party effectiveness of security rights in intellectual property that are not registrable in an intellectual property registry

12. Under the Guide, a security right in intellectual property rights that are not registrable in an intellectual property registry may become effective against third parties by registration of a notice in the general security rights registry. The same rule would apply in cases where a security right in intellectual property is registrable in an intellectual property registry but it is not actually registered and in cases where registration in an intellectual property registry produces no third-party effects. In all these cases, registration of a notice in the general security rights registry is sufficient and the effect of registration is to make the security right effective against third parties (see recommendations 29, 32-33 and 38). The Guide does not recommend that States that currently do not have a specialized registry for certain types of intellectual property create such registries in order to permit the registration of security rights in intellectual property. Nor does it recommend that States that currently do not permit the registration of security rights in an intellectual property registry amend their laws to permit such registrations. Of course, States enacting the recommendations of the Guide may wish to consider permitting registration of security rights in existing intellectual property registries.

13. States take many different approaches to the question of registration under intellectual property law. In some States, often those whose secured transactions law derives from non-possessory pledge concepts, the lack of a general registration system means that a security right cannot be made effective against third parties under the secured transactions law, and since a pledge is not a transfer, it also cannot be registered in an intellectual property registry. In other States, often those whose secured transactions law utilizes mortgage concepts, a security right is treated as another type of “title” transfer and is therefore effective against third parties to the same extent as any other title transfer registrable in an intellectual property registry. Consequently, in those States, any non-title-based security right cannot be registered in an intellectual property registry. Finally, in a few States, there are additional requirements. These commonly include payment of a stamp duty

or other transaction tax, or a requirement to give notice to an administrative body, such as a national authors association or collecting society.

14. Where, under intellectual property law, a security right in intellectual property may not be registered in an intellectual property registry, under the Guide, a secured creditor may register a notice of its security right in the general security rights registry (see recommendation 38). However, if under intellectual property law, a transfer of intellectual property for security purposes or a mortgage or pledge in intellectual property may be registered in an intellectual property registry and such registration would give priority, a secured creditor will have to take such a different “security right” and register it in the intellectual property registry. Once again, States enacting the recommendations of the Guide might wish to consider integrating their secured transactions and intellectual property laws, replacing all existing security devices with a unitary notion of a security right.

V. The registry system

[Note to the Working Group: For paras. 15-31, see A/CN.9/WG.VI/WP.33, paras. 149-161, and A/CN.9/649, paras. 32-40.]

A. The general security rights registry

15. As already noted, the Guide recommends that States establish a general security rights registry (see recommendations 54-75). In general, the purpose of the registry system in the Guide is to provide an efficient method for making a security right in existing or future assets effective against third parties, to establish an effective point of reference for priority rules based on the time of registration and to provide an objective source of information for third parties dealing with a grantor’s assets as to whether the assets are encumbered by a security right. Under this approach, registration is accomplished by registering a notice as opposed to the security agreement or other document (see recommendation 54, subparagraph (b)). The notice need only provide basic information concerning the security right (see recommendation 57).

16. The Guide provides precise rules for identifying the grantor of the security right, whether an individual or a legal person. This is because notices are indexed and can be retrieved by searchers according to the name or some other reliable identifier of the grantor (see recommendations 54, subparagraph (h), and 58-63). The Guide contains other recommendations to simplify the operation and use of the registry.

B. Asset-specific intellectual property registries

17. As discussed above, many States maintain registries for recording transfers of intellectual property. In some of those registries, security rights may also be registered. For example, patent and trademark registries exist in most States, but not all provide for the registration of a security right. Moreover, in some States, the registration of a notice (whether of a security right or some other right) does not

produce third-party effects. Finally, a number of States have similar registries for copyrights, but the practice is not universal.

18. While some States have notice-based intellectual property registries, they mostly use recording act structures or “document registration” systems. In those systems, it is necessary to record the entire instrument of transfer, or, in some cases, a memorandum describing essential terms of the transfer. In addition to national registries, there are a number of international intellectual property registries and registration in these registries is subject to relatively modern treaties that simplify the registration process. For example, the registration requirements for trademarks are simplified by articles 10 and 11 of the Trademark Law Treaty (1994) and the Singapore Treaty on the Law of Trademarks and by the model international registration forms attached to both treaties. The reason for requiring registration of the transfer document or a memorandum stating the essential terms of the transfer is the need for transparency. Thus, it is essential for the instrument of transfer or memorandum to identify the precise right being transferred in order to give effective notice to searchers and to allow efficient utilization of assets. In addition, the intellectual property registries sometimes index registrations by the specific intellectual property, and not by the grantor’s (the intellectual property rights holder’s) identifier. This is because the central focus is on the intellectual property itself, which may have multiple co-inventors or co-authors and may be subject to multiple changes in ownership as transfers are made.

[Note to the Working Group: The Working Group may wish to consider whether international intellectual property registries and their usefulness for the registration of security rights in intellectual property should be discussed in more detail. Enhanced use of international intellectual property registries may be helpful in achieving an integrated registration system with respect to security rights in intellectual property across national borders.]

C. Coordination of registries

19. As the issue of coordination of registries may affect intellectual property law, the Guide addressed it through the general deference to intellectual property law and appropriate priority rules. Thus, the Guide does not address or purport to address in any way whether registration in the intellectual property registry is possible, the requirements for such registration or its effects. Even if an intellectual property registry does not provide for the registration of security rights or, having provided for their registration, does not give registration third-party effects, the Guide provides no recommendation to the contrary. However, the Guide does make recommendations concerning the registration of security rights in intellectual property in the general security rights registry. For this reason, to the extent that intellectual property law addresses the effects of registration of security rights in an intellectual property registry, the Guide defers to that law (recommendation 4, subparagraph (b)). By contrast, if intellectual property law does not address these issues, the Guide will apply. In addition, as noted above, the Guide ensures coordination of registries through appropriate priority rules. Thus, even in all cases where the Guide permits registration in the general security rights registry, in order to preserve the reliability of intellectual property (and other specialized) registries, and in particular in cases where intellectual property law provides no rule for

determining priority between such registrations, the Guide provides that a security right registered in the relevant intellectual property registry has priority over a security right registered in the general security rights registry (see recommendation 77, subparagraph (a)). For the same reason, the Guide provides that a transferee of intellectual property acquires it, in principle, free of a previously created security right, unless the security right is registered in the intellectual property registry (assuming that the relevant intellectual property law provides that security rights may be registered in such a registry) (see recommendations 78 and 79).

20. States enacting the recommendation of the Guide may wish to consider additional ways aimed at coordinating their existing intellectual property registries with the general security rights registry introduced by the Guide. For example, States might wish to consider requiring the transmission of a notice about a registration in an intellectual property registry to the general security rights registry (or vice versa). Of course, such a transmission of a notice might be easier, simpler and quicker in an electronic system rather than in a paper-based system.

D. Registration of notices about security rights in future intellectual property

21. An essential feature of the general security rights registry recommended in the Guide is that it can apply to future assets of the grantor. This means that the security right can cover assets to be later produced or acquired by the grantor (see recommendation 17). The notice may also cover assets identified by a generic description (see recommendation 66). Thus, if the security right covers all existing or future inventory, the notice may so identify such inventory. Since priority is determined by date of registration, the lender may maintain its priority position in future inventory. This approach greatly facilitates revolving credit arrangements, since a lender extending new credit under such a facility knows that it can maintain its priority position in new assets that are included in the borrowing base.

22. Existing intellectual property registries, however, in many States, do not readily accommodate registration of rights in future assets. As transfers of or security rights in intellectual property are indexed against each specific intellectual property right, they can only be effectively recorded after the intellectual property is first registered in the intellectual property registry. This means that a blanket recording of a security right in future intellectual property in an intellectual property would not be effective, but instead a new recording of the security right would be required each time new intellectual property is acquired.

23. If, under intellectual property law, intellectual property may not be acquired, transferred or encumbered before it is actually registered in an intellectual property registry, the Guide does not interfere with that prohibition and does not make the grant of a security right in such future intellectual property possible. However, if the creation of a security right in future intellectual property is not prohibited under intellectual property law, a security right in such an asset could be created and made effective against third parties under the Guide. States enacting the recommendations of the Guide may wish to consider reviewing their law relating to intellectual

property to determine whether a notice of a security right may refer to future intellectual property.

E. Dual registration or search

24. As already mentioned, the Guide leaves to intellectual property law the details of registration of a security right in an intellectual property registry and expressly gives priority, as a matter of secured transactions law, to rights registered in such a registry. As also noted above, this means that the Guide often obviates the need for dual registration or search. In particular, registration only in the general security rights registry would seem to be necessary and useful for secured transactions purposes: (a) where the encumbered asset is a type of intellectual property with respect to which no registration is required under intellectual property law (e.g. copyrights or trade secrets in many States); (b) where a security right in intellectual property is not registrable in an intellectual property registry; and (c) where there are other secured creditors that register only in the general security rights registry. On the other hand, registration in the relevant intellectual property registry may be preferable, for example: (a) where the encumbered asset is a type of asset for which a registration system exists that produces third-party effects and allows registration of security rights (e.g. patents or trademarks in many States); or (b) where the secured creditor needs to ensure priority over other secured creditors or transferees under applicable intellectual property law.

25. Before a secured transaction is entered into, a secured creditor exercising normal due diligence will typically conduct a search to determine whether there are prior competing claimants that have priority over the proposed security right. As a first step, the secured creditor will search the chain of title to identify prior transfers and to determine whether the grantor actually has rights in the intellectual property so that the security right can become effective in the first instance (but this due diligence requirement applies equally to all other movable assets). Unlike intellectual property registries, the general security rights registry does not record title and, as a result, a search of the chain of title will involve a search of the relevant intellectual property registry, provided that the relevant intellectual property is registrable. As a next step, the secured creditor will search to determine whether each prior party in the chain of title party has granted a security right which might have priority over the proposed security right. Finally, the secured creditor will determine the applicable priority as between rights registered in one of the two registration systems. In cases where the priority is determined solely by registration in the relevant intellectual property registry, as provided in the Guide, a search of only that registry may be sufficient. Otherwise (for example, where the specialized registry does not permit registration of security rights), a secured creditor may have to search in both registries.

F. Time of effectiveness of registration

26. Under patent and trademark law in many States jurisdictions, priority of a registered security or other right dates back to the date of application for registration (which is useful where the registry takes time to actually register the patent or trademark). Under the Guide, registration of a notice of a security right becomes

effective when the information in the notice is entered into the registry records and becomes available to searchers (see recommendation 70). Where the registry is electronic, registration of a notice will become effective immediately upon registration. However, where the registry is paper-based, registration of a notice will become effective only some time after registration.

27. In view of the priority given by the Guide to registration of a security right in a specialized registry irrespective of the time of registration (see recommendations 77 and 78), this difference in the approach as to the time of effectiveness of registration may not cause any problems. When the security right in a patent or a trademark becomes effective against third parties by registration in a specialized registry as a matter of patent or trademark law, it will gain priority even over a security right that was registered earlier in a security rights registry.

G. Impact of a transfer of encumbered intellectual property on the effectiveness of registration

28. The Guide recommends that the secured transactions law should address the impact of a transfer of an encumbered asset on the effectiveness of registration in the general security rights registry introduced in the law (see recommendation 65). The commentary to recommendation 65 discusses three ways in which an enacting State may wish to address the matter. One way is to provide that, where the encumbered asset is transferred, the secured creditor must register an amendment identifying the transferee as a new grantor within a certain specified period after the transfer. If the secured creditor fails to do so, the original third-party effectiveness is maintained in principle. However, the security right is subordinated to intervening secured creditors and buyers whose rights arise after the transfer of the encumbered asset and before the amendment notice is registered. A second way in which enacting States may wish to address this issue is to provide that the grace period for the registration of an amendment is triggered only once the secured creditor acquires actual knowledge of the transfer of the encumbered asset by the grantor. A third way might be to provide that a transfer of an encumbered asset has no impact on the third-party effectiveness of a registered security right.

29. If an enacting State adopts the third approach, a secured creditor of the transferor need not register a notice of its security right again. However, transferees down in the chain of title might not be able to discover, through a registry search, a security right granted by any person other than their immediate transferor. In such cases, they would still have to search the chain of title and status of an encumbered asset outside the general security rights registry. On the other hand, if an enacting State adopts the first or the second approach discussed above, a secured creditor will have to register a new notice identifying the transferee as the new grantor. In such a case, the secured creditor will have the burden of monitoring the status of the encumbered asset (to a different degree, depending on whether the first or the second approach is followed). At the same time, however, transferees down the chain of title will be able to identify a security right granted by a person other than their immediate transferor.

30. This discussion is relevant to security rights in intellectual property where the encumbered intellectual property is transferred. States enacting the Guide will have

to consider the relative advantages and disadvantages of these different approaches and, in particular, their impact on rights in intellectual property. For example, under the first approach mentioned above, a secured creditor extending credit against the entire copyright in a movie would need to make continuous registrations against tiers of licensees and sub-licensees (if the applicable copyright law treated a licence as a transfer that could be registered) to maintain its priority against them or their own secured creditors. This would be a significant burden on such lenders and might discourage credit against such assets. On the other hand, such an approach would make it easier for a lender to a sub-licensee to find a security right created by its grantor by a simple search only against the grantor. Here, the trade-off is between the relative costs of monitoring and multiple registrations by the lender to the “upstream” party as against the costs of conducting a search of the entire chain of title for security rights created by the “downstream” party. In this regard, it should be noted that typically under intellectual property law a prior transfer or security right retains its priority over later transfers or security rights without the need for an additional registration in the name of a transferee of an encumbered asset.

H. Registration of security rights in trademarks

31. The International Trademark Association (“INTA”) issued a series of recommendations with respect to the registration of security right in trademarks.¹ More specifically, INTA endorsed uniformity and best practise in registration mechanisms and methods regarding security rights in trademarks, recognizing that: intellectual property rights, including trademarks and service marks, are a major and growing factor in commercial lending transactions; lack of consistency in the recording of trademark security rights fosters commercial uncertainty, and also poses a risk that a trademark owner may forfeit or otherwise endanger its trademark-related rights; many States have no recording mechanisms (or have insufficient mechanisms) for the registration of security rights in trademarks; many countries apply different and conflicting criteria for determining what can and will be recorded; and international initiatives on security rights in intellectual property rights by organizations such as UNCITRAL will have broad implications for the way secured financing laws are implemented to deal with registration and other aspects of trademark security rights, especially in developing countries.

32. The main features of such best practices are the following:

(a) Security rights in registered trademarks and in marks covered by pending applications should be registrable;

(b) For purposes of giving notice of the security right, registration in the applicable national Trademark Office or in any applicable commercial registry is recommended, with free public accessibility, preferably through electronic means;

(c) The grant of a security right in a trademark should not effect a transfer of legal or equitable title to trademarks that are the subject of the security right, and should not confer upon the secured creditor a right to use the trademarks;

¹ See http://www.inta.org/index.php?option=com_content&task=view&id=1517&Itemid.

(d) The security agreement creating the security right should clearly set forth provisions acceptable under local law enabling the renewal of the trademarks by the secured creditor, if necessary to preserve the trademark registration;

(e) Valuation of trademarks for purposes of security rights should be made in any manner that is appropriate and permitted under local law and no particular system or method of valuation is preferred or recommended;

(f) Registration of security rights in the local Trademark Office should suffice for purposes of perfecting a security right in a trademark; at the same time, registration of a security right in any other place allowed under local law, such as a commercial registry, should also suffice;

(g) If local law requires that a security right be registered in a place other than the local Trademark Office in order to be perfected, such as in a commercial registry, dual registration of the security right should not be prohibited;

(h) Formalities in connection with registration of a security right and the amount of any government fees should be kept to a minimum; a document evidencing: (i) existence of a security right, (ii) the parties involved, (iii) the trademark(s) involved by application and/or registration number, (iv) a brief description of the nature of the security right, and (v) the effective date of the security right, should suffice for purposes of perfecting a security right;

(i) Regardless of the procedure, enforcement of a security right through foreclosure, after a judgement, administrative decision or other triggering event, should not be an unduly burdensome process;

(j) The applicable Trademark Office should promptly record the entry of any judgement or adverse administrative or other decision against its records and take whatever administrative action is necessary; the filing of a certified copy of the judgement or decision should be sufficient;

(k) In the event that enforcement is triggered by means other than a judgement or administrative decision, local law should provide for a simple mechanism enabling the holder of the security right to achieve registration, with free public accessibility, preferably through electronic means;

(l) In cases where the trademark owner is bankrupt or otherwise unable to maintain the trademarks which are subject to a security right, absent specific contract provisions the holder of the security right (or the administrator or executor, as the case may be) should be permitted to maintain the trademarks, provided that nothing shall confer upon the secured creditor the right to use the trademarks; and

(m) The relevant government agency or office should promptly record the filing of documentation reflecting release of the security right in its records, with free public accessibility, preferably through electronic means.

VI. Priority of a security right in intellectual property

[Note to the Working Group: For paras. 33-61, see A/CN.9/WG.VI/WP.33/Add.1, paras. 1-25, and A/CN.9/649, paras. 41-56.]

A. The concept of priority

33. Under the Guide, the concept of priority refers to the question of who among competing claimants may receive payment first out of the proceeds of the disposition of an encumbered asset in the case of the debtor's default. In intellectual property law, by contrast, the notion of priority may relate to notions of title and basic effectiveness. In many States, when intellectual property is transferred by a rights holder once, a second transfer by the former rights holder will transfer no rights to the second transferee. In such a case, no issue of priority in the sense this term is used in the Guide arises. Accordingly, the Guide would not apply and this matter would be left to intellectual property law. Under intellectual property law, a security right in intellectual property cannot be created by an unauthorized party. Likewise, under the Guide, a party that has no rights in, or the power to encumber, an asset may not create a security right in the asset (see recommendation 13).

B. Identification of competing claimants

34. The notion of "competing claimant" in a secured financing context means a secured creditor (which, under the Guide, includes a transferee in a transfer by way of security), a transferee of an encumbered asset, a judgement creditor or an insolvency representative in the insolvency of the grantor. In an intellectual property context, the notion of "conflicting transferees" is used instead and it includes transferees and licensees competing among themselves, or with infringers. Thus, under the principle enunciated in recommendation 4, subparagraph (b), the Guide would not apply to a conflict between transferees or licensees unless one of the transferees took its right through a transfer of intellectual property by way of security under secured transactions law and there is no priority rule of intellectual property law that applies to that conflict. Similarly, the Guide does not apply to a conflict between a transferee of an encumbered asset that took the asset from a secured creditor upon default and enforcement and another secured creditor that later received a right in the same asset from the same grantor, as this is not a real priority conflict under the Guide (this may well be a conflict addressed by intellectual property law).

35. On the other hand, the Guide does apply to priority conflicts: (a) between a security right registered in the general security rights registry and a security right registered in the relevant intellectual property registry (assuming that intellectual property law provides that security rights may be registered in such a registry); (b) between two security rights registered in the relevant intellectual property registry (assuming that intellectual property law provides that security rights may be registered in such a registry); (c) between the rights of a transferee or licensee and a security right; and (d) between two security rights registered in the general security rights registry.

C. Relevance of knowledge of prior transfers or security rights

36. Under the Guide, knowledge of the existence of a prior security right on the part of a competing claimant is irrelevant for determining priority (see recommendation 93). Thus, the security right of a creditor that has knowledge of a

security right created earlier may nonetheless have priority over the earlier-created security right if a notice of it was registered (or was otherwise made effective against third parties) before the earlier-created security right. By contrast, many intellectual property laws provide that a later conflicting transfer or security right may only gain priority if it is registered first and taken without knowledge of a prior conflicting transfer. The deference to intellectual property law under recommendation 4, subparagraph (b), should preserve these knowledge-based priority rules. However, States enacting the Guide might wish to consider whether the policy underlying such knowledge-based priority rules should be maintained with respect to priority conflicts between a security right creditor and the right of a competing claimant (i.e. a secured creditor, transferee or other claimant).

D. Priority of a security right registered in an intellectual property registry

37. The Guide recommends that registration in a specialized registry (including an intellectual property registry, if intellectual property law provides that a security right may be registered in such a registry) should provide a security right with higher priority status than a security right registered in the general security rights registry, regardless of the respective order of registration in that registry (see recommendations 77 and 78). This recommendation is equally applicable to security rights in intellectual property.

38. More specifically, if there is a conflict between two security rights, one of which was registered in the general security rights registry and the other was registered in the relevant intellectual property registry, the Guide applies and gives priority to the security right that was registered in the relevant intellectual property registry (see recommendation 77, subparagraph (a)). If there is a conflict between security rights registered in the relevant intellectual property registry, the first right registered has priority, and the Guide confirms that result (see recommendation 77, subparagraph (b)).

[Note to the Working Group: The Working Group may wish to consider whether the principle of deference would apply to a different priority rule in relation to intellectual property. If, for example, a priority rule based on prior knowledge were to displace the registration-based rule of the Guide, the policy of the Guide to ensure transparency of security rights could be seriously compromised. It would seem that, in the absence of registration in an intellectual property registry, no issue particular to intellectual property would arise and thus the Guide should apply.]

39. In situations where security rights are registrable in an intellectual property registry but are not registered, the recommendations of the Guide on priority will apply to a priority conflict between such an unregistered security right and a security right registered in the general security rights registry. However, if intellectual property law provides that any such rights are not effective against subsequent transferees or licensees that have registered their rights in the intellectual property registry, the priority rule of the intellectual property registry will apply.

40. If there is a priority conflict between the rights of a transferee of intellectual property and a security right that, at the time of the transfer, was registered in the

relevant intellectual property registry, the transferee would take the encumbered intellectual property subject to the security right. However, if the secured creditor had not registered its security right in the relevant intellectual property registry, the transferee takes the encumbered intellectual property free of the security right (see recommendations 78 and 79). Thus, if A creates a security right in a patent in favour of B that registers in the general security rights registry, and then A transfers title to the patent to C, which registers in the patent registry, under the Guide, C would take the patent free of the security right, because the security right was not registered in the patent registry (see recommendation 78). Similarly, if A, instead of making a transfer, creates a second security right in favour of C and only C registers in the patent registry, under the Guide, C would prevail (see recommendation 77, subparagraph (a)). In either case, as registration in the patent registry gives superior rights, under the Guide, third-party searches could rely on a search in that registry and would not need to search in the general security rights registry. In all these examples, who is a transferee and what are the requirements for a transfer are matters of intellectual property law. It should also be noted that registration in the intellectual property registry would normally refer only to a security right in intellectual property. It would not refer to a security right in tangible assets with respect to which intellectual property is used.

E. Priority of a security right that is not registrable in an intellectual property registry

41. If a security right in intellectual property is not registrable in an intellectual property registry, in principle, the priority of that right will be determined by the order of registration of a notice with respect to that right in the general security rights registry (see recommendations 4, subparagraph (b), and 77). However, if there is a contrary priority rule that arises strictly as a matter of intellectual property law (rather than a contrary rule currently applicable in a State to intellectual property, but arising as a general matter of the law of property of obligations), that contrary rule would prevail.

42. A subsequent transferee or licensee would, in principle, take the encumbered intellectual property subject to the security right (see recommendation 79). If the intellectual property had been transferred by the grantor of the security right before the creation of the security right, the secured creditor will have no security right at all on the basis of the first-in-time rule (based on the generally acceptable *nemo dat* property law rule, the application of which the Guide does not affect).

F. Rights of transferees of encumbered intellectual property

43. As mentioned above, under the Guide, a transferee of an encumbered asset (including intellectual property) normally takes the asset subject to a security right that was effective against third parties at the time of the transfer (see recommendation 79). There are two exceptions to this rule. The first exception arises where the secured creditor authorizes the disposition free of the security right (see recommendation 80, subparagraph (a)). The second exception relates to a transfer in the ordinary course of the transferor's business (see recommendation 81, subparagraph (a)). It is important to note that, under the Guide, a licence of

intellectual property is not a transfer of the intellectual property. Thus the rules of the Guide that apply to transfers of encumbered assets would not apply where there is a security right in intellectual property and then a licence of that intellectual property is granted. In any case, in view of the principle of deference to intellectual property law embodied in recommendation 4, subparagraph (b), the Guide does not affect the characterization of a licence (in particular, of an exclusive licence as a transfer) under intellectual property law.

G. Rights of licensees in general

44. Intellectual property is routinely licensed and the retained rights of a licensor, such as the ownership right or the right to receive royalties, as well as the licensee's authorization to use the intellectual property under the terms of the licence agreement, are used as security for credit.

45. Where the rights holder of intellectual property creates a security right and makes it effective against third parties and thereafter grants a licence, in principle, the licensee takes the licence subject to the security right created by the licensor (see recommendation 79). This means that, if the licensor defaulted on the loan and the lender sought to enforce its security right in the royalties owed by the licensee to the licensor, the lender could collect the royalties from the licensee (see also recommendation 168), as licence royalties are treated as any other receivable. In addition, absent an agreement or the application of the exception for certain ordinary-course-of-business licences, the secured creditor of the licensor would typically, under intellectual property law, be entitled to terminate the subsequent licence.

46. If the licensee also creates a security right, that security right would be in a different asset (the licensee's rights under the licence agreement) and, in effect, be subject to the security right created by the licensor, as the licensee took its rights subject to that security right (see recommendation 79) and the licensee cannot give to its secured creditor more rights than the licensee has (based on the *nemo dat* principle). So, if the lender of the licensor enforced its security right, it could dispose of the encumbered intellectual property free of the licence. Thus, the licence would terminate and the licensee's lender would no longer have an asset encumbered by its security right. Likewise, whether or not the licensor had granted a security right to one of its creditors, if the licensee defaults on the licence agreement, the licensor can terminate it and the licensee's secured creditor would be again left without an asset encumbered by its security right.

47. The rights of the licensor and the licensee under the licence agreement and the relevant intellectual property law would remain unaffected by secured transactions law. So, if the licensee defaults on the licence agreement, the licensor can terminate it and the licensee's secured creditor would be again left without security. Similarly, secured transactions law would not affect an agreement between the licensor and the licensee prohibiting the licensee from granting sub-licences or assigning its claims to royalties owed by sub-licensors to the licensee.

48. There are two exceptions to the rule that a licensee of encumbered intellectual property takes the licence subject to a pre-existing security right. The first exception arises where the secured creditor authorizes the licence free of the security right

(see recommendation 80, subparagraph (b)). The second exception relates to a non-exclusive licence in the ordinary course of the licensor's business (see recommendation 81, subparagraph (c), and paras. 49-55 below).

H. Rights of ordinary-course-of-business non-exclusive licensees

49. Under recommendation 81, subparagraph (c), a non-exclusive licensee that took a licence in the ordinary course of business of the licensor without knowledge that the licence violated a security right, would take free of a security right previously granted by the licensor. The result of this rule is that, in the case of enforcement of the security right by the secured creditor of the licensor, the secured creditor could collect any royalties but not terminate the licence as long as the licensee performed the terms of the licence agreement.

50. This rule would apply only if the rights holder neither authorized nor prohibited the granting of a licence by the licensor. In other words, the contractual arrangement between the secured creditor and the licensor, which neither authorizes the owner/licensor to grant a licence nor prohibits the owner/licensor from granting a licence, does not produce third-party effects. If the rights holder authorized the granting of the licence, recommendation 80, subparagraph (b), would apply. If the rights holder prohibited the granting of a licence, nothing in the Guide would interfere with such prohibition and the secured creditor could terminate the licence. Whether a secured creditor with a security right in intellectual property is a rights holder for this purpose is determined under intellectual property law.

51. The phrase "takes free" does not mean that the non-exclusive licensee gets a "free" licence. The non-exclusive licensee may continue to use the licence following the secured creditor's foreclosure against the licensor only if the non-exclusive licensee complies with all of the terms of the licence (including payment of licence royalties to the person that acquired the licensor's rights at the sale in the context of enforcement of the security right). Thus, all of the licensee's obligations remain in place and the licensor's successor may terminate the licence agreement for non-performance by the licensee.

52. If the secured creditor of the licensor does not want to encourage non-exclusive licences, it can, in its security agreement (or elsewhere), require the borrower (the licensor) to place in all of the non-exclusive licences a provision that the licence will terminate if the licensor's secured creditor enforces its security right. Similarly, if the licensor does not want its licensee to grant any sub-licences, it can include in the licence agreement a provision that the grant of a sub-licence by the licensee is an event of default under the licence agreement that would entitle the licensor to terminate the licence. Nothing in the Guide would interfere with the enforcement of such provisions as between the secured creditor and its borrower (or as between the licensor and its licensee). Ordinarily, of course, the secured creditor will have no interest in doing that, since the licensor (and any licensee) is in the business of granting non-exclusive licences and the secured creditor expects the borrower to use the fees paid under those licence agreements to pay the secured obligation.

53. The exception in recommendation 81, subparagraph (c), will be relevant only if: (a) the secured creditor as the rights holder does not authorize its borrower to

grant a licence (in this case recommendation 80, subparagraph (b), will apply); and (b) the secured creditor as the rights holder does not prohibit the borrower from granting a non-exclusive licence (if the secured creditor does that, the licence will terminate in the case of enforcement by the secured creditor). In any case, no licensee would take the encumbered intellectual property right free of the security right of the licensor's secured creditor, if the rights holder (the borrower or its secured creditor) had not authorized the granting of the licence. Thus, the fact that recommendation 81, subparagraph (c), provides for certain rights in the limited circumstances described above does not provide a justification for unauthorized or compulsory licences.

54. Somewhat comparable results may be obtained under intellectual property law. It is often the case that the secured creditor authorizes the licensor in the security agreement to grant licences. If the security agreement is silent on the point, but, as a matter of intellectual property law, the licensor, and not the secured creditor, remains the holder of the encumbered intellectual property rights, then the rights holder is typically authorized to grant licences as well. As this is common practice, in most cases licences will be authorized. Then, under typical intellectual property law priority rules, a secured creditor takes its security right in the intellectual property subject to these authorized licences. However, in some cases the secured creditor becomes a rights holder in intellectual property law terms. In such a case, if the borrower grants a licence (or a sub-licence), then the licence is unauthorized and infringing if not authorized by the secured creditor. The Guide does not interfere with this result.

55. To reflect the above-mentioned understanding, recommendation 81, subparagraph (c), may be supplemented by an asset-specific recommendation along the following lines:

“The law should provide that recommendation 81, subparagraph (c), applies in the case of a security right in intellectual property only if: (a) the secured creditor as a rights holder under intellectual property law does not authorize its borrower to grant a licence (in this case recommendation 80, subparagraph (b), will apply); and (b) the secured creditor does not prohibit the borrower from granting a non-exclusive licence (but if the secured creditor as a rights holder does so prohibit the borrower, the licence will terminate in the case of enforcement by the secured creditor).”

[Note to the Working Group: The Working Group may also wish to consider alternative wording along the following lines:

“The law should provide that recommendation 81, subparagraph (c), does not apply to licences of intellectual property and the matter is left to the security agreement. If the security agreement does not address it, the secured creditor should be presumed to have authorized the licence in which case the rule in recommendation 80, subparagraph (b), applies.”

It is argued that, in the intellectual context, there are many cases where intellectual property is exploited under a non-exclusive licence where it is commonly understood that there may be prior security rights that will continue during the licence term and maintain priority. These include movie exhibition licences, patent licences, franchise licences and the like. In many cases, these licences provide for the payment of ongoing royalties over time and the

credit-worthiness and performance of the licensee is important both to the licensor and the licensor's secured lender. In such cases, a lender may approve the licence and be content to allow the licence to continue in case of default and enforcement against the licensor, in which case recommendation 81, subparagraph (c), is unnecessary. But in other cases, the lender may want the right to terminate the licence in case of the licensor's default, unless the licensee negotiates an agreement otherwise, in which case recommendation 81, subparagraph (c), frustrates normal commercial expectations and may impair the extension of secured lending in this context.

In other words, it is argued that the concept of an "ordinary-course-of-business" licence has no precedent in intellectual property law, making it difficult to distinguish an "ordinary-course-of-business" from a "non-ordinary-course-of-business" licence. Indeed, since most intellectual property earns value by licensing, in one sense all licences may be considered as being "ordinary-course-of-business" licences. On the other hand, since many licences are specifically negotiated (movie licences, franchise licences), in another sense, no licence is an "ordinary-course-of-business" licence. In addition, many licences may be "mixed" in the sense that they contain both exclusive and non-exclusive grants. For example, for patent licences it is common to grant a licence which is exclusive for certain periods or performance criteria, and otherwise non-exclusive. For copyrights, it is common to license some rights exclusively (e.g. distribution rights) and other rights non-exclusively (e.g. rights to make advertising materials). As such, it is argued that the concept of an "ordinary-course-of-business licence" has no commercial certainty in application to intellectual property and its use could act as an impediment to encouraging secured lending in this area.

It is suggested that current intellectual property law already addresses this issue in an appropriate manner by leaving it for the parties to decide in the security agreement. In some cases, the secured creditor may desire the grantor to undertake licensing practices, and may allow all licences or those that meet certain criteria to "take free" of the security right. Alternatively, the secured creditor may require prior approval of licences. In either case, the normal commercial expectation of a licensee should be to conduct appropriate due diligence to determine whether its licence is "free" of a prior security right (meaning that on enforcement of a prior security right the licence can nonetheless continue) or "subject to" a prior security right (meaning that, in case of default and enforcement, the licence will terminate unless other arrangements are made with the secured creditor).]

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

56. Where a licensor "finances" the acquisition of a licence by a licensee (in the sense that payment is made in future royalty instalments), the licensor's right to the payment of the royalties owed to it 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 creditors inasmuch as they may seek to collect the sub-royalties themselves. However, the licensor has numerous ways to protect itself in this circumstance.

57. The licensor could protect its rights by: (a) prohibiting the licensee from assigning or encumbering its claim against sub-licensees for the payment of royalties owed under sub-licence agreements; or (b) terminating the licence in cases where the licensee assigned its royalty claims against sub-licensees. The Guide does not interfere with these provisions if they are effective under intellectual property law and the law of obligations.

58. In addition, the licensor could obtain a security right in royalty claims of the licensee against sub-licensees. However, the priority of the security right of the licensor would be subject to the general priority rules. This means that a secured creditor of A with a security right in all present and future assets of A that registered a notice of its security right on Day 1 would have priority over the rights of the secured creditor of B, where B is a licensor and A is a licensee under a licence agreement entered into on Day 2 and the secured creditor of B registered a notice of its security right on Day 3.

59. In situations where the encumbered asset is a tangible asset with respect to which intellectual property is used, a secured creditor may obtain an acquisition security right. However, as discussed (see A/CN.9/WG.VI/WP.35/Add.1, paras. 91-94), that right encumbers the tangible asset and not the intellectual property. The right of the acquisition secured creditor to dispose of the encumbered assets as they are (i.e. including the intellectual property) is treated as a matter of enforcement and, as discussed below, is subject either to the exhaustion of the rights of the rights holder of the intellectual property used in the specific tangible encumbered assets or to the authorization given to the secured creditor by the rights holder to dispose of the encumbered assets as they are (see paras. 81-84 below).

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

60. Under the Guide, a security right that was made effective against third parties before a judgement creditor obtained rights in the encumbered asset has priority as against the right of the judgement. 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). This recommendation applies equally to security rights in intellectual property. In such a case, under intellectual property law, the judgement creditor will have to obtain a transfer of the intellectual property, which may have to be registered in an intellectual property registry. If this transfer takes place before a security right was made effective against third parties, both under the law recommended in the Guide and intellectual property law, the transferee of encumbered intellectual property will take the encumbered intellectual property free of the security right (see also recommendation 79).

K. Subordination

61. The Guide recognizes the principle of subordination (see recommendation 94). The principle applies equally to security rights in intellectual property. The essence

of this principle is that, as long as the rights of third parties are not affected, competing claimants may alter by agreement the priority of their competing claims in an encumbered asset. This is important for intellectual property in view of the divisibility of the rights of rights holder, licensor or licensee.

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

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

A. Application of the principle of party autonomy

62. With few exceptions, the Guide generally recognizes the freedom of the parties to the security agreement to tailor their agreement so as to meet their practical needs (see recommendation 10). The principle of party autonomy applies equally to security rights in intellectual property, subject to any limitations specifically introduced by intellectual property law. For example, where the rights of a rights holder are encumbered, the right to sue infringers may not be part of the encumbered asset if intellectual property law provides that only a rights holder may exercise, transfer or encumber that right.

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

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

[Note to the Working Group: The Working Group may wish to consider the following intellectual-property-specific recommendations:

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

The law should provide that[, unless prohibited by intellectual property law,] the secured creditor should be entitled to pursue infringers and renew registrations if the rights holder fails to exercise these rights in a timely fashion.”

The Working Group may wish to consider that the bracketed text is not necessary as: (a) recommendation 4, subparagraph (b), defers to intellectual property law any matter which is addressed in the Guide in a way that is inconsistent with intellectual property law; and (b) recommendation 18 already provides that any statutory limitations to the transferability of certain types of asset.]

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

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

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

IX. Enforcement of a security right in intellectual property

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

A. Intersection of secured transactions law and intellectual property law

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

66. This approach to the enforcement of security rights applies not only to intellectual property (for example, a patent, a copyright or a trademark), but also to other rights that are derived from these types of intellectual property. Hence, consistently with the United Nations Assignment Convention, assets such as royalties and licence fees are treated as receivables and are subject to the enforcement regime for receivables recommended in the Guide. Likewise, a

licensor's or sub-licensor's other contractual rights as against a licensee or sub-licensee will also be governed by a State's general law of obligations, and security rights in these contractual rights will be enforced under a State's general secured transactions law. And again, a licensee's or sub-licensee's rights of use are treated in the same way as a lessee's or purchaser's rights, and are governed by a State's general law of obligations, except as regards (where specifically mentioned in intellectual property laws) questions of registration.

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

68. As for substantive enforcement rights of secured creditors, once a State adopts the Guide's recommendations, there is no reason to develop different or unusual remedial principles to govern enforcement against intellectual property serving as encumbered assets. The Guide merely recommends a more efficient, transparent and effective enforcement regime of a secured creditor's rights, without in any way limiting the rights that the rights holder of intellectual property may exercise to protect its rights against infringement, or collect royalties from a licensee or sub-licensee. As pointed out in the section of this Annex on creation of a security right (see A/CN.9/WG.VI/WP.35, para. 75), the secured creditor can never acquire security in more rights than the rights with which the grantor is vested at the time enforcement occurs.

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

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

- (a) The intellectual property in itself;

- (b) Receivables arising under a licence agreement;
- (c) The licensor's other contractual rights under a licence agreement;
- (d) The licensee's rights under a licence agreement;
- (e) The rights holder's, licensor's and licensee's rights in tangible assets with respect to which intellectual property is used.

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

C. Taking “possession” of encumbered intellectual property

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

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

D. Disposition of encumbered intellectual property

73. Under the Guide, the secured creditor has the right upon the grantor's default to dispose of or grant a licence with respect to intellectual property encumbered by its security right, but always within the limits of the rights of the grantor. As a result,

if the grantor is the rights holder, the secured creditor should, in principle, have the right to assign or license the intellectual property in which it has taken a security right. However, if the grantor had previously granted an exclusive licence to a third party that has priority over the security right, upon default, the secured creditor will be unable to grant another licence, as the grantor had no such right at the time the secured creditor acquired its security right (*nemo dat quod non habet*).

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

E. Rights acquired through disposition of encumbered intellectual property

75. Under the Guide, rights in intellectual property acquired through judicial disposition would be regulated by the relevant law applicable to the enforcement of court judgements. In the case of an extrajudicial disposition in line with the provisions of secured transactions law, the first point to note is that the transferee or licensee takes its rights directly from the grantor. The secured creditor that chooses to enforce its rights in this manner does not become the rights holder as a result of this enforcement process.

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

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

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

F. Proposal by the grantor to accept the encumbered intellectual property

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

G. Collection of royalties and licence fees

79. Under the Guide, where the encumbered asset is the right to receive payment of royalties or other fees under a licence agreement, the secured creditor should be entitled to enforce the security right by simply collecting the royalties and fees upon default and notification to the person that owes the royalties or fees (see recommendation 168). In all these situations, the royalties are, for the purposes of secured transactions laws, receivables, and the rights and obligations of the parties will be governed by the same principles pertaining to receivables that are elaborated in the United Nations Assignment Convention and the Guide for receivables. Once again, the secured creditor that has taken security over present and future royalty payments is entitled to enforce only such rights to receive payment of royalties as were vested in the grantor (licensor) at the time the security right in the receivable is enforced.

H. Licensor's other contractual rights

80. In addition to the right to collect receivables, the licensor will normally include a number of other contractual rights in its agreement with the licensee. These may include, for example, a limitation in the licence agreement on the right to sub-license or a prohibition on the granting of security over the licence or a right to terminate the licence agreement under a set of specified conditions. Merely because the licensor may have granted a security right in the right to collect royalties and this right to collect has become enforceable and is being enforced by the secured

creditor has no direct bearing on these other rights of the licensor under its licence agreement or under generally applicable intellectual property law. These rights remain vested in the licensor, unless they themselves have been assigned to a third party or were included in the description of the encumbered asset over which the secured creditor that is enforcing its security right obtained a security right from the grantor.

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

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

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

83. In situations where the tangible asset is produced using intellectual property that has been licensed to the grantor, the licensor may provide that the licensee cannot grant security rights in such assets or that a creditor that takes security may only enforce its rights in a manner agreed to by the licensor. In both these cases, the licensor will typically provide in the licence agreement that the licence may be revoked if the grantor or secured creditor is in breach of the licence agreement. As a consequence, to enforce effectively its security rights against the tangible asset, the secured creditor would need to obtain the consent of the rights holder-licensor in line with the licence agreement and the relevant intellectual property law.

84. In cases where the secured creditor also wishes to take security over the intellectual property itself (including, to the extent the grantor has the right to sell or license the intellectual property, the right to sell or license), it would be necessary for the secured creditor to specifically mention such intellectual property as encumbered assets in the security agreement. Here, the encumbered asset is not the tangible asset produced using the intellectual property, but rather the intellectual property itself (or the licence to manufacture tangible assets using the intellectual

property). A prudent secured creditor will normally take a security right in such intellectual property so as to be able to continue the production of partially completed tangible assets.

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

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

86. In situations where the grantor is a licensee, upon the grantor's default, the secured creditor will have the right to enforce its security right in the licence and to dispose of the licence to a transferee, provided that the licensor consents or the licence is transferable, which is rarely the case. Likewise, the enforcing creditor may grant a sub-licence, provided that the licensor consents or the grantor-licensee had, under the terms of the licence agreement, the right to grant sub-licences. In situations where the secured creditor proposes to a grantor-licensee to accept the licence in full or partial satisfaction of the secured obligation and neither the grantor nor other interested parties (e.g. the licensor) object, the secured creditor becomes vested with the licence according to the terms of the licence agreement between the licensee and the licensor. As in the case of a transferee or licensee that acquires intellectual property upon a disposition by a secured creditor, the licensee or secured creditor that accepts the licence in full or partial satisfaction of the secured obligation will be obliged to register its rights as a licensee in the relevant intellectual property registry, if this is possible under intellectual property law. Otherwise, the licensee or secured creditor will be obliged to register its rights in the general security rights registry under the law recommended in the Guide.

87. Where the encumbered asset is the sub-licensor's right to receive payment of royalties under a sub-licence agreement, the secured creditor is entitled to treat the asset as a receivable. This means that the secured creditor may collect payment of the royalties to the extent that these were vested in the grantor-sub-licensor at the time when the security right in the receivable is enforced. If enforcement against royalties payable by a sub-licensee constituted a breach of the licence agreement, then the secured creditor would not be able to enforce against any receivables arising after that breach.

88. Where the encumbered asset is another contractual right stipulated in the sub-licence agreement, the secured creditor may enforce its security right in this

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

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

X. Law applicable to a security right in intellectual property

[*Note to the Working Group: For paras. 90-98, see A/CN.9/WG.VI/WP.33/Add.1, paras. 53-57, and A/CN.9/649, paras. 77-80.*]

A. Law applicable to proprietary matters

90. International conventions that protect intellectual property generally adopt the principle of territoriality and, in many States, the law applicable to ownership issues concerning intellectual property is the law of the place where the intellectual property is protected (*lex protectionis*). Accordingly, a transferee or a licensee will ensure that the transfer or licence will be recognized in each State in which the transferee wishes to exercise its rights.

91. As a security right is a property right, consistency would dictate that the same territorial approach be followed for the determination of the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right in intellectual property. Hence, many States refer to the *lex protectionis* for such issues. The benefit of referring to the *lex protectionis* for security rights in intellectual property is that the same law applies to both a security right and a transfer of ownership in the same assets. For example, a priority dispute between a secured creditor and a transferee under an outright transfer made by the grantor of the security right would be more easily resolved if reference is made to one single law to resolve the dispute.

92. Not all States, however, adopt the *lex protectionis* as the law applicable to security rights in intellectual property. Some States, in which the conflict-of-laws rule for intangible assets in general points to the location of the grantor, use the same rule for security rights in intellectual property, at least with respect to

third-party effectiveness and priority issues. Under this approach, the general conflict-of-laws rule of the Guide for intangible assets (i.e. the law of the grantor's location) would also apply to intellectual property. Recommendations 208 and 218, read together, in effect generally result in the application of the law of grantor's location to the creation, third-party effectiveness, priority and enforcement of a security right in intangible assets. The same conflict-of-laws rule would then be applicable to intellectual property.

93. The advantage of an approach that refers to a single law for all issues is that a secured creditor that obtains a security right in all present and future intangible assets (including intellectual property) of a grantor would be entitled to ascertain the extent of its right by referring to only one law, even if the assets have connections with several States. This would also reduce transaction costs; for example, registrations would be required to be made in only one State.

94. However, as outright transfers would still be governed by the *lex protectionis*, such an approach would not refer to one single law to resolve a priority conflict between the rights of a secured creditor and an outright transferee. To achieve that goal, the approach based on the law of the grantor's location would have to be subject to a variation whereby a priority conflict involving the rights of an outright transferee would be governed by the *lex protectionis*. A similar (but not identical) variation is provided by the Guide in the case of a dispute between the rights of holder of a security right in a receivable arising from the sale or lease of immovable property and a competing claimant that has registered its right in the immovable property registry of the State in which the immovable property is situated (see recommendation 209).

95. With this variation, a secured creditor would also need to establish its right under the *lex protectionis* only in instances where a competition with an outright transferee is a concern. In the typical case where the insolvency of the grantor is the main concern, it would be sufficient for the secured creditor to rely on the law of the State in which the grantor is located, as would be the case for certain other categories of intangible assets (such as receivables).

96. A further variation would be to defer to the *lex protectionis* only where that law provides that the intellectual property concerned may be registered in an intellectual property registry. This further variation might, however, be found unsatisfactory for outright transferees of intellectual property not subject to registration under the *lex protectionis*. They would have to investigate the law of the State of the grantor's location to ensure that their transfer is not subject to a previous security right.

97. The approaches mentioned above may be summarized with the following alternatives:

Alternative A

The law should provide that the law applicable to the creation, effectiveness against third parties, priority and enforcement of a security in intellectual property is the law of the State in which the intellectual property is protected.

Alternative B

The law should provide that the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right in intellectual property is the law of the State in which the grantor is located. [However, the law applicable to a priority conflict involving the right of a [competing claimant] [transferee or licensee] is the law of the State in which the intellectual property is protected [if under that law the intellectual property may be registered in an intellectual property registry] [if under that law a security right may be registered in an intellectual property registry.]

Alternative C

The law applicable to the creation, effectiveness against third parties, priority and enforcement of a security right in intellectual property subject to registration in an intellectual property registry is the law of the State under whose authority the registry is maintained.

[Note to the Working Group: The Working Group may wish to note that, with the exception of the bracketed text, alternative B is similar to recommendation 209 and alternative C is similar to recommendation 205. The Working Group may also wish to consider whether renvoi should be permitted where the law of the State in which the intellectual property is protected permits renvoi or, under contract law principles, defers to the law of the State in which the secured creditor, the grantor or a third party is located, in particular where a security right in a specific type of intellectual property may not be registered in an intellectual property registry (e.g. copyright or trade secret).]

B. Law applicable to contractual matters

98. The mutual rights and obligations of the grantor and the secured creditor with respect to the security right may be left to party autonomy. In the absence of a choice of law by the parties, the law applicable to these matters might be the law governing the security agreement (see recommendation 216).

XI. The impact of insolvency on a security right in intellectual property

[Note to the Working Group: For the discussion of this matter, see A/CN.9/WG.VI/WP.33/Add.1, paras. 58-72, A/CN.9/649, paras. 98-103 and A/63/17, para. 326. The Working Group may wish to consider the matter again once Working Group V (Insolvency Law) has had a chance to discuss it.]