UNCITRAL COLLOQIUM ON
FINANCING INTELLECTUAL PROPERTY ASSETS

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The purpose of this paper is to highlight some issues and recommendations to be considered during the discussions at the UNCITRAL Working Group VI Colloquium on Financing of Intellectual Property to be held in January 2007 in Vienna.

This paper follows the structure of UNCITRAL Working Group VI's Legislative Guide on Secured Transactions ("Guide"). The first part deals with issues involving the creation and perfection of security interests in intellectual property ("IP"), the second part, with priority issues and the third, with enforcement matters.

I. Creation and Perfection of Security Interests in IP

- Applicability of IP Laws to Security Interests in IP:
  - it is important to determine whether a security interest would trigger the application of IP law provisions relating to the transfer of IP rights (i.e. does the term "assignment" of an IP right include a security interest?).
- Types of IP rights that may be used as collateral:
  - software: given that in many cases IP may be integrated in tangible property, it should be clear whether the security interest in the tangible property would extend to the IP rights (Article 9-102(44) of the *Uniform Commercial Code* (UCC) defines "software" embedded structurally in goods as a "good");
  - licenses:
    - in some jurisdictions, it is not clear whether licenses form property that can be commercialized and granted as collateral to secure loans; for example, certain licenses originating from governmental bodies or licenses of a "personal nature" may not be secured;
    - most licenses contain restrictions on assignability and security ("anti-assignment clauses"); the Guide should deal with the effectiveness of the assignment or security interest grant despite the anti-assignment clause and the rights of the parties involved (i.e. rights of assignor vis-à-vis assignee; rights of account debtor vis-à-vis assignor).
- Title of IP rights:
  - in the security interest's creation, the ownership principles found in intellectual property laws must be considered because the secured party cannot have greater

rights than the debtor-IP owner (for example, the rules on employer-employee ownership of inventions, rules on joint ownership of works which can lead to IP rights being owned by different parties in different countries);

- o the IP procedural requirements involved in evidencing ownership of an IP right (i.e. application) should be considered in assessing at which stage a security interest can effectively be created: can a security interest be created in an IP application (i.e. copyright application?).

- Evolving nature of IP rights:

  - o it should be recognized that IP rights are not static, they evolve; for example, determine to what extent a security agreement's "after-acquired property" clause would encompass developments made on software (protected by patent and copyright laws), before or after bankruptcy?

  - o IP laws are "Asset" specific and therefore require that (i) the IP assigned/secured complies with specific rules (i.e. registration number of copyrighted subject-matter); (ii) multiple filings be made to secure an evolving IP right, making the perfection process costly and burdensome vs. Secured Financing laws, which are "Debtor" specific and one filing covering the debtor's "after-acquired property" would include an evolving IP right; any centralized system for recording or registering security interests should deal with this situation, which if not dealt with may create an impediment to intellectual property financing transactions;

  - o clarification is required as to whether licensees take the license "free" of a previously created and perfected security interest in the license (Article 9-321 of the UCC provides that non-exclusive licensees take free of a security interest their immediate licensor created).

- Structure of security instrument:

  - o the type of instrument used to secure IP rights may vary from one jurisdiction to another; this situation may affect the secured creditor's right and responsibilities. For example, where the security agreement takes the form of a "collateral assignment" (where the debtor assigns its IP rights to the creditor, transferring title to the property), the creditor will have to comply with the IP recordation/registration requirements (which provide for filings to be made in respect of one right at a time, creating the need for multiple filings where the IP evolves, as discussed in the previous section), the creditor as "holder" of the IP right will have to maintain and exploit the right (i.e. maintain a trademark's distinctiveness and participate in infringement proceedings). Note that under civil law (at least in the Canadian province of Québec), "collateral assignments" are not valid.

- Perfecting against unregistered IP rights:

- the possibility of registering a security interest against an unregistered IP right may vary from one jurisdiction to another and from one IP law to another (i.e. assignments of patent applications are allowed both in Canada and in the U.S.; in Canada, a security interest in an unregistered copyright is possible).

- Effectiveness of security interests against third parties:

  - any centralized registry system must consider the possible application of two distinct filing regimes for IP security interests (where the transfer provisions of IP laws would include a security interest): IP registries and Secured Financing registries. Furthermore, considering the possibility that one asset may involve multiple IP rights (i.e. software) and that such rights may have been registered in multiple jurisdictions, the registry should ensure that security interests in IP rights be filed in a cost-efficient manner and that a third party searching the registry may be able to view whether the IP rights are encumbered.

II. Priority Issues

In establishing the secured creditor's priority in enforcement proceedings, the following issues should be considered:

- Applicability of two or more sets of priority rules:

  - where the IP security interest was registered under secured financing and IP laws, which priority scheme do we look at to resolve a priority dispute?

    - priority dispute rules need to consider that intellectual property laws may not establish a complete framework for resolving disputes between competing interests and, in such cases, refer to secured financing laws for the resolution of the dispute.

  - priority rules should address the resolution of certain disputes, where secured financing laws fail to do so, for example:

    - priority disputes between security interests in the same IP right, but where one creditor registers under IP laws and the other, under secured financing laws;

    - priority disputes between security interests in after-acquired property, where a first creditor registers its security interest covering after-acquired property under secured financing law, but the second creditor registers its security in the after-acquired IP rights under IP law, after such rights are actually registered at the relevant IP office;

    - priority disputes between the secured creditor and third parties:

      - consider that secured financing laws may not provide priority rules resolving disputes between (i) a secured creditor and a subsequent

purchaser of the debtor's IP who registers its title under IP laws; (ii) a secured creditor and a subsequent licensee who registers its license at the relevant IP office.

- The foregoing issues assume that the IP right is owned by one debtor and is registered under the IP laws of one jurisdiction - to further complicate matters, the IP right secured may have multiple owners located in different jurisdictions, and thus be registered in multiple jurisdictions. This reality must be considered when crafting resolution of priority rules.

III. Enforcement

The remedies provided to the secured creditor when enforcing its rights upon the debtor's default or in the debtor's bankruptcy should consider the particularities of intellectual property assets, as follows:

- Adapting secured financing enforcement remedies to intellectual property assets: secured financing regimes need to provide certain remedies for IP assets and give some flexibility to the secured creditor to act quickly, due to the rapidity with which the value of IP can depreciate, especially in liquidation:
    - notice to debtor and other creditors of intention to sell the collateral:
        - secured financing regimes may provide for circumstances where the notice is not required (i.e. where the collateral is perishable or where the secured party believes that the collateral's value will rapidly decline); including an exception for IP collateral should be considered.
    - "seizing" of IP rights:
        - the right to take possession of IP rights should be clarified: does the seizing of any tangible materials supporting the IP include the IP rights?
- Each remedy provided under secured financing law must be "flexible" enough in order to accommodate the specific nature of IP rights:
    - Foreclosure (acceptance of collateral in satisfaction of obligation):
        - considering the importance of license agreement revenues generated from IP, perhaps it would be useful to address some of the issues relating to the rights of licensees vs. rights of secured creditors, i.e. terminating license agreement granted by the debtor after the security interest was created (as mentioned previously, Article 9-321 of the UCC does not extend the security interest to non-exclusive licenses granted in the ordinary course of business, so creditors cannot terminate such licenses and such licenses survive the secured party's foreclosure against the licensor).
    - Taking Possession of the Collateral (usually ending with a sale of the collateral):

- consider whether the concept of "control", rather than "possession" would be more appropriate for IP rights;

- outline the scope of the secured party's obligations during the period of possession; for example, establish the parameters of the creditor's "reasonable care" duty as it would relate to IP rights;

- to ensure that the IP rights are transferred to the purchaser and that the purchaser obtains clean title to those rights, consider giving the secured party the right to give clean title to the purchaser (i.e. creditor should be able to execute all assignments relating to the IP rights).

o Sale of Collateral:

- consider including "licensing" as a means of disposing IP rights;

- clarify what "commercially reasonably" conduct (which is the general guiding principle for sales) means in the case of IP rights; provide some guidelines to the secured creditor or allow creditor to obtain judicial approval of its sale process.

- Consider the following issues that may arise in a bankruptcy context:

o scope of the purchaser's rights to use the IP: does the purchase have a right to access materials kept under escrow?

o treatment of secured "after-acquired" IP rights (coming into existence after the bankruptcy/reorganization), their qualification under bankruptcy laws (i.e. "proceeds" of pre-bankruptcy rights?) and the possible impact on the secured party's rights;

o possible application of preferential treatment/fraudulent transfer/settlement provisions to a secured party's security interest:

- in evolving IP rights: secured creditor perfects its security interest in debtor's IP rights outside the preferential period provided under bankruptcy laws, but files its security interest in a new IP right of the debtor at the relevant IP registry within the preference period provided by bankruptcy laws: can the filing at the IP registry be considered an avoidable preference?

- in license agreements containing, for example, provisions granting rights in the other party's improvements, without any payment over and above the royalties provided for the license.

o possible application of bankruptcy provisions rendering the asset sale "free and clear" of any interests (i.e. a nonexclusive license was considered an "interest" which was extinguished by the bankruptcy sale in the 7th Circuit American case

FutureSource LLC v. *Reuters Ltd*., 312 F3d 281 (7th Cir. 2002)); this principle strips the licensee from its right to use the IP which in turn may adversely impact the rights of the licensee's secured party…

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