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A Legislative Framework for Intellectual Property Financing: Intellectual property as collateral under the UNCITRAL Legislative Guide on Secured Transactions

Jae Sung LEE*

Contents

* Jae Sung LEE is a legal officer at the International Trade Law Division of the United Nations Office of Legal Affairs, which serves as the Secretariat of the United Nations Commission on International Trade Law (UNCITRAL). The views expressed herein are those of the author and does not necessarily reflect the views of the United Nations.

Abstract

This article introduces the UNCITRAL Legislative Guide on Secured Transactions and its Supplement on Security Rights in Intellectual Property, both of which are intended to provide guidance to States with regard to enacting legislation on secured transaction, in particular, regarding intellectual property. Based on the discussions provided therein, this article points to four elements to be included in the legislative framework for intellectual property financing: 1) that it should be a comprehensive regime for movable assets including intellectual property, 2) that it should be possible to create security rights in future intellectual property, 3) that it should provide priority rules for those financing the acquisition of intellectual property and 4) that it should contain rules on the law applicable to security rights in intellectual property. The article concludes that, while these innovative features once included in the legislative framework for intellectual property financing would foster the use of intellectual property as collateral in secured transactions, it is not enough, acknowledging that valuation of intellectual property is a practical barrier. In this context, this article urges the intellectual property community to develop standards for the assessment intellectual property based on the market mechanism with the understanding that secured transactions was, by nature, a risk-adverse transaction.

Keywords

Intellectual property financing, secured transactions, collateral, UNCITRAL Legislative Guide on Secured Transactions, Supplement on Security Rights in Intellectual Property, future intellectual property, acquisition financing, conflict-of-laws rule, valuation of intellectual property

I. Introduction

A. Background history

On 11 October 2010, the Sixth (Legal) Committee of the United Nations General Assembly ("General Assembly") met to discuss the report of the forty-third session of the United Nations Commission on International Trade Law ("UNCITRAL") held from 21 June to 9 July 2010,[1] during which the UNCITRAL Legislative Guide on Secured Transactions, Supplement on Security Rights in Intellectual Property (the "*Supplement*") was adopted. The Committee applauded the work of UNCITRAL as contributing to the modernization and enhancement of the existing legal framework, particularly with regard to secured transactions involving intellectual property.[2]

UNCITRAL, the core legal body of the United Nations system in the field of international trade law, was established by the General Assembly in 1966[3] and has played an important role in removing legal obstacles to international trade. The mandate of UNCITRAL is to further the progressive harmonization and modernization of international trade law by preparing and promoting the use and adoption of legislative instruments in numerous areas of commercial law.[4] These texts, negotiated through an

1) Official Records of the General Assembly, Sixty-fifth Session, Supplement No. 17 (A/65/17), available at http://www.uncitral.org/uncitral/en/commission/sessions/43rd.html.

2) General Assembly Press Release (11 October 2010, GA/L/3389), available at http://www.un.org/News/Press/docs/2010/gal3389.doc.htm.

3) General Assembly Resolution 2205 (XXI) of 17 December 1966.

4) UNCITRAL adopts a flexible and functional approach with respect to the methods used to perform its mandate. These methods operate at different levels and involve different types of compromise or acceptance. To some extent, they also reflect the process of modernization and harmonization occurring at different stages of business and law development. While the process at UNCITRAL entails the bringing of long-established practices closer together, there

international process involving member and non-member States, intergovernmental organizations and NGOs, offer solutions widely acceptable to various legal traditions and to States at different stages of their economic development.

However, it is only recent that intellectual property became a topic of UNCITRAL. Following the adoption of the 2001 United Nations Convention on the Assignment of Receivables in International Trade, which discusses issues related to receivables financing,[5] Working Group VI (Security Interests) started working on the UNCITRAL Legislative Guide on Secured Transaction ("the *Guide*") in 2002 so as to assist States in developing modern secured transactions laws with a view to promoting the availability of secured credit. In view of the increasing importance and economic value of intellectual property for businesses seeking to obtain credit, it was decided that intellectual property should be included in the scope of the *Guide*, which was finally adopted in December 2007.[6] The objective of the *Guide* with respect to intellectual property is to make secured credit more available for businesses that own or have the right to

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are instances where new principles or practices are established to minimize divergence when new issues are legislated into domestic law. Work in the field of secured transactions in intellectual property is a good example. In such a case, it is not always possible to draft specific provisions in the form of a convention or a model law. States may not yet be ready to agree on a single approach, there may not be a consensus on the need to find a uniform solution, or there may be different levels of consensus on the key issues and how they should be addressed. Therefore, it was agreed that a legislative guide, containing a set of legislative principles or recommendations, should be prepared. Instead of providing a single set of solutions for those issues, alternatives are provided, depending on applicable policy considerations. By discussing the advantages and disadvantages of different policy choices, a legislative guide assists readers in evaluating different approaches and allows them to choose the one most suitable in their particular domestic context.

5) Information about the Receivables Convention can be found at http://www.uncitral.org/uncitral/en/uncitral_texts/payments/2001Convention_receivables.html.

6) Information about the *Guide* and its negotiating history can be found at http://www.uncitral.org/uncitral/en/uncitral_texts/payments/Guide_securedtrans.html.

use intellectual property, by permitting them to use such rights as encumbered assets, while at the same time, without interfering with the legitimate rights of the owners, licensors and licensees of intellectual property under intellectual property law. However, as the *Guide* was prepared to cover movable assets in general and not intellectual property, in particular, work began on the Supplement in May 2008, following the completion of the *Guide*.[7)]

Consequently, Working Group VI carried out work over five sessions to develop a text that addresses the need to make secured credit more available and at lower cost to intellectual property owners and other right holders. The ultimate result of the discussions at the Working Group was the Supplement, which seeks to achieve that objective without inadvertently interfering with the basic rules of intellectual property law.[8)] The Supplement, which was adopted by the Commission in June 2010, was prepared in close cooperation with the World Intellectual Property Organization ("WIPO") and other intellectual property organizations from the public and private sector to ensure effective coordination with intellectual property law.

B. The Supplement: A General Introduction

As noted above, the finalization and adoption of the *Guide* in 2007 was based on the understanding that the Supplement would subsequently be prepared. This was because, although the *Guide* would generally apply to security rights in intellectual property, States would need further guidance

7) Information about the Supplement and its negotiating history can be found at http://www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html.

8) The pre-release version of the Supplement (15 July 2010) is available at http://www.uncitral.org/pdf/english/texts/security-lg/e/Final.Draft.15_July.2010.clean.pdf.

as to how the *Guide* would apply in an intellectual property context and as to the adjustments that need to be made in their laws to avoid inconsistencies between secured transactions law and intellectual property law. The following is a brief summary of the Supplement, which would all need to be taken into account in a legislative framework for intellectual property financing.

Chapter I deals with the scope of application, mainly noting that the *Guide* applies to security rights in all types of movable assets, including intellectual property.[9] Whereas the law recommended in the *Guide* applies to transfer of all movable assets for security purposes, it does not apply to outright transfers of intellectual property as such outright transfers are subject to intellectual property law.[10] This chapter also discusses the basic principle embodied in recommendation 4 subparagraph (b) of the *Guide* regarding the limitation on scope.[11] In the context of intellectual property financing, it follows that the secured transactions law recommended in the *Guide* does not affect and does not purport to affect issues relating to the existence, validity, enforceability and content of a grantor's intellectual property rights, as these issues are determined solely by intellectual property law.[12]

Chapter II deals with the creation of a security right in intellectual property. By drawing a distinction between the creation of a security right and its third-party effectiveness, the *Guide* suggests that requirements for creation of a security right should be kept to a minimum. Such a distinction makes it possible to establish a security right in a simple and efficient

9) The Supplement, paras. 53–56. See also chapter II. A. below.

10) Ibid, paras. 57–59. The *Guide*, however, applies to outright transfers of receivables as such transfers are usually regarded as financing transactions and are often difficult, in practice, to distinguish from loans against the receivable (Recommendation 3 of the *Guide*).

11) Ibid. paras. 60–73. See also chapter II. A. below.

12) Ibid, para. 63.

manner, to enhance certainty and transparency, and to establish clear priority rules.[13] Accordingly, a security right in intellectual property may be created by a written agreement between the grantor and the secured creditor.[14] However, intellectual property law in many States imposes different requirements for the creation of a security right in intellectual property. For example, registration of a document or notice of a security right in intellectual property may be required in the relevant intellectual property registry for creation. In addition, intellectual property to be encumbered may need to be described specifically in the security agreement.[15]

Chapter II also illustrates the types of intellectual property that may be encumbered mainly, rights of an intellectual property owner,[16] rights of a licensor,[17] and rights of a licensee.[18] However, intellectual property law may contain specific rules limiting the ability of an intellectual property owner, licensor or licensee to create a security right in certain types of intellectual property.[19] This chapter also touches upon security rights in a

13) The *Guide*, recommendation 1, subparas. (c), (f) and (g).

14) The *Guide*, recommendation 13, and the Supplement, paras. 82–85.

15) The Supplement, paras. 83–84.

16) The rights of an owner include the rights to enjoy its intellectual property, the right to prevent unauthorized use of its intellectual property and to pursue infringers, the right to register intellectual property and renew registrations, the right to authorize others to use or exploit the intellectual property and the right to collect royalties.

17) If a licensor is an owner, it can create a security right in (all or part of) its rights as an owner. If a licensor is not an owner but a licensee that grants a sub–licence, the rights of a licensor may include the rights to the payment of royalties owed by sub–licensees under the sub–licence agreement.

18) The rights of a licensee include the rights to use or exploit the licensed intellectual property, the right to grant sub–licences and to receive as a sub–licensor the payment of any royalties flowing from a sub–licence agreement.

19) The Supplement, paras. 119–120. In many States, only the economic rights of an author are transferable whereas the moral rights are not. In addition, an author's right to receive equitable remuneration may not be transferable and trademarks may not be transferable without their associated goodwill. Some intellectual property laws also provide that the licensee

tangible asset with respect to which intellectual property is used (for example, designer watches or clothes bearing a trademark), as such a security right may have an impact on the intellectual property to the extent a secured creditor may enforce its security right in the tangible asset.[20] In that context, it is recommended that a security right in the tangible asset does not extend to the intellectual property and a security right in the intellectual property does not extend to the tangible asset.[21]

Chapter III deals with third-party effectiveness, a concept referring to whether a security right in the encumbered asset is effective against parties other than the grantor and the secured creditor. As noted, the *Guide* distinguishes between the creation of a security right (effectiveness between the parties to the security agreement) and third-party effectiveness. Rules provided in the intellectual property law may differ depending on whether or not security rights in the intellectual property are registered in an intellectual property registry.[22]

Chapter IV of the Supplement discusses various issues related to the registry system.[23] Many States maintain national intellectual property registries (i.e. for patent and trademark), some of which allow security rights in intellectual property to be registered.[24] There are also international

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may not create a security right in its authorization to use or exploit the licensed intellectual property without the licensor's consent (see the Supplement, para. 107). The *Guide* respects these limitations on the transferability of intellectual property (see the *Guide*, recommendation 18).

20) Ibid, paras. 108–112. See also paras. 245–248 with respect to the enforcement of such a security right.

21) Ibid, recommendation 243.

22) Ibid, paras. 124–129.

23) The registry system functions as which functions as 1) a method to make security rights effective against third parties, 2) a reference point for priority rules based on registration and 3) a reference point for third parties whether the asset could be encumbered by a security right.

24) The Supplement, para 132.

intellectual property registries for certain types of intellectual property.[25] As the approach of the *Guide* is that States should establish a 'general' security rights registry,[26] it provides for a useful mechanism whereby security rights in certain types of intellectual property that may not be registered in a specialized registry (i.e. copyrights) can also be registered. Thus, this chapter deals with coordination among such registries,[27] dual registration or search,[28] and time-effectiveness of registration.[29] The chapter ends with a recommendation on the impact of a transfer of encumbered intellectual property on the effectiveness of the registration.[30]

Chapter V discusses issues related to priority, a concept related to whether the secured creditor may derive the economic benefit of its security right in an encumbered intellectual property against the rights of competing claimants.[31] The *Guide* provides extensive rules not only to determine priority in a predictable, fair and efficient manner but also to facilitate transactions by which a grantor may create more than one security right in the same asset, possibly utilizing the full value of its assets to obtain credit. However, the notions of "priority" and "competing claimants" should not be confused with the notion of "exclusive rights" nor "conflicting transferees" in intellectual property law. This chapter also discusses issues

25) Ibid, para 134.

26) See the purpose section of recommendations 54–75 in the *Guide*.

27) The Supplement, paras. 135–140.

28) Ibid, paras. 144–154.

29) Ibid, paras. 155–157.

30) Ibid, recommendation 244 and paras. 158–166. The law should provide that the registration of a notice of a security right in intellectual property in the general security rights registry remains effective notwithstanding a transfer of the encumbered intellectual property.

31) The *Guide* uses the term "competing claimant" to refer to another secured creditor with a security right in the same asset (which includes a transferee in a transfer by way of security), an outright transferee, lessee or licensee of the encumbered asset, a judgement creditor with a right in the encumbered asset and an insolvency representative in the insolvency of the grantor. See also the Supplement, paras. 10 and 11.

related to priority conflicts with transferees of the encumbered intellectual property[32] and rights of certain licensees in everyday legitimate transactions (such as off-the-shelf purchases of copyrighted software with end-user licence agreements).[33]

Chapter VI discusses the rights and obligations of the parties to a security agreement generally based on the principle of party autonomy. The key issue discussed is whether the secured creditor may be entitled to take steps to preserve the encumbered intellectual property.[34] Chapter VII discusses rights and obligations of third-party obligors in intellectual property financing transactions.[35]

Chapter VIII discusses the enforcement of a security right in intellectual

32) The *Guide*, recommendation 79. The *Guide* provides that a transferee takes the asset subject to a security right that was effective against third parties at the time of transfer.

33) The Supplement, para. 193–212. Licensees that take a non-exclusive licence in the ordinary course of business of the licensor without knowledge that the licence violated the rights of the secured creditor in the licensed intellectual property, takes its rights under the licence agreement unaffected by the security right previously granted by the licensor (see the *Guide*, recommendation 81, subpara. (c), which applies generally to intangible assets, but only if the security right was created and made effective against third parties before conclusion of a licence agreement). Therefore, in the case of enforcement of the security right in the licensed intellectual property by the secured creditor of the licensor, the secured creditor may collect royalties owed by the licensee to the licensor, but not sell the licensed intellectual property free of the rights of the existing licensee or grant another licence with the effect of interfering with the rights of the existing licensee as long as the licensee performs the terms of the licence agreement (The Supplement, para. 195). However, as the "ordinary course of business" is a concept of commercial law and not drawn from intellectual property law, a similar approach may create confusion in the intellectual property financing context. Typically, intellectual property law does not distinguish between exclusive and non-exclusive licences but rather focuses on whether a licence was authorized or not (Ibid, para. 200). In recommendation 245 on priority of rights of certain licensees of intellectual property, it is suggested that while the rule in recommendation 81, subparagraph (c) of the *Guide* is relevant, it should not affect the rights the secured creditor may have under intellectual property law.

34) Ibid, recommendation 246 and paras. 223–226. In essence, the grantor and the secured creditor may agree that the secured creditor is entitled to take steps to preserve the encumbered intellectual property.

35) Ibid, paras. 227–228.

property. States typically do not provide for specific enforcement remedies for security rights in intellectual property in their intellectual property laws and thus the general secured transactions regime would normally apply. Issues dealt in this chapter are the disposition of the encumbered intellectual property,[36] rights acquired thereby,[37] and collection of royalties.[38]

Chapters IX on acquisition financing and X on the law applicable to security right in intellectual property are discussed in more detail below (See chapters II. C & D, respectively). Chapter XI provides a summary of issues for States should consider in achieving a fair and efficient transition from the regime currently in force.[39] Chapter XII deals with situations whereby a licensor or a licensee of intellectual property, after creating a security right in its rights under the licence agreement, becomes subject to insolvency proceedings.[40] The impact that insolvency will have on such security rights, which would depend mainly on whether the insolvency representative decides to continue or reject the licence agreement, is discussed in the chapter.

C. Valuation of intellectual property

Another important yet a non-legal issue is the valuation of collateral. It is an issue that all prudent grantors and secured creditors have to address irrespective of the types of asset being encumbered. However, the valuation of intellectual property is more difficult as the question of whether

36) Ibid, paras. 237–238. Upon the grantor's default, the secured creditor has the right to dispose of or grant a licence in the encumbered intellectual property (see the *Guide*, recommendation 148).

37) Ibid, paras. 239–241.

38) Ibid, para. 243.

39) Ibid, paras. 340–344.

40) Ibid, paras. 345–367.

intellectual property may be exploited economically to generate income (and for how long) is one not easy to answer.[41] For example, whether a patent has any commercial application and, if so, how much income would be generated from its use are both questions difficult to answer.

As valuation affects the use of intellectual property as collateral, the complexities involved in appraising the value of intellectual property need to be understood and addressed in a broader framework. The Supplement, however, does not try to answer this question, because there is no universally accepted formula for calculating the value of the intellectual property and the expected cash flow. Guidance in this regard should be sought from independent intellectual property appraisers or valuation methodologies developed by national institutions, such as bank associations.[42] Nonetheless, it is an issue that a legislative framework for intellectual property financing must take into account.

II. FOSTERING AN ENVIRONMENT FOR INTELLECTUAL PROPERTY FINANCING

Intellectual property generally refers to copyrights, trademarks, patents, service marks, trade secrets and designs and any other asset considered to be intellectual property under the domestic law of the enacting State or under an international agreement to which the enacting State is a party.[43]

41) Ibid, para. 33.

42) Ibid, para. 34.

43) The *Guide*, Introduction, section B. The meaning given to the term "intellectual property" is intended to ensure consistency of the *Guide* with laws and treaties relating to intellectual property. As used in the *Guide*, the term "intellectual property" means any asset considered to be intellectual property under intellectual property law. In addition, references in the *Guide* to "intellectual property" are to be understood as references to intellectual property "rights" (See the Supplement, paras. 18–20).

This chapter introduces innovative features recommended in the *Guide* and the Supplement which aim at fostering a better and more efficient environment for intellectual property financing, which would all need to be taken into account in a legislative framework for intellectual property financing.

A. A comprehensive regime for movable assets including intellectual property

> Example: C PHARMA, a constant developer of new pharmaceutical products, wishes to obtain a revolving line of credit from Bank A secured in part by its portfolio of existing pharmaceutical patents and patent applications. C PHARMA provides Bank A with a list of all of its existing patents and patent applications. Bank A evaluates which patents and patent applications it will include in the "borrowing base" and at what value they will be included. Bank A then obtains a security right in the portfolio of patents and patent applications and registers a notice of its security right in the appropriate national patent registry.
>
> → If C PHARMA would like to include in the "borrowing base" 1) its famous trademark "Pharmacol®", 2) its manufacturing equipments in Vietnam and 3) its receivables for sales in China, a single, comprehensive regime for all movable assets including all types of intellectual property would make it easier for C PHARMA to obtain and Bank A to provide additional credit based on these assets.

A firm or an individual that does not have strong, well-established credit ratings will have difficulty obtaining financing unless it is able to grant a security right in its assets in favor of the lender. The amount of the

financing available and relevant cost (for example, the interest rate for the secured obligation) will depend on the creditor's estimate of the net realizable value of the collateral. In many States, immovable property is still the only type of asset that is available to, or accepted by, lenders to secure financing. However, many firms, in particular newly established ones, do not own any immovable property and therefore is prevented from borrowing from lenders. This is especially a problem considering that these firms possess other significant assets, such as equipment, inventory or intellectual property.[44)]

Traditionally, the types of asset that may be used as collateral have been restricted in many States. It is true that in many States, intellectual property may still not be used as collateral in secured transactions. Moreover, different secure transactions regimes have been developed for each type of asset, making it extremely difficult to encumber different types of assets at the same time. In the context of intellectual property, many States have attempted to develop a separate regime to regulate security rights in intellectual property, one that is distinct from the regime governing security rights in tangible assets and also distinct from one governing intangible assets. To add to such complexity, separate rules for different types of intellectual property have also been developed (one for patents, another for trademarks and so on). However, such an approach should be discouraged as it would significantly hinder intellectual property from being used as collateral.

Alternatively, States may attempt to create an integrated regime that seeks to create a common set of principles governing creation, third-party effectiveness, priority and enforcement of security rights in tangible and intangible assets alike (including all types of intellectual property). Modern

44) The *Guide*, Introduction, para. 39.

secured transactions regimes allow all types of assets to be used as collateral, unless specifically excluded by law. Security rights in intangible assets (including intellectual property) are governed under an integrated regime that also governs security rights in tangible assets.[45] Following this predominant trend, the *Guide* recommends that a secured transactions regime should apply to security rights in all types of movable asset, tangible or intangible, and in present or future assets, to ensure that grantors may utilize all of their assets, whatever their nature, to obtain credit.[46] The *Guide*, however, does acknowledge that there is a need to exclude certain types of assets from its scope.[47]

A legislative framework for intellectual property financing should not be a "separate, independent" regime for intellectual property but one that covers all types of movable asset. It should embrace tangible assets such as inventory, equipment and other goods. It should also embrace any rights less than full ownership that a debtor may have in such assets (for example, a right as lessee or licensee). It should also cover other intangible assets such as receivables, rights to payment of funds credited to a bank account and, most importantly, intellectual property.[48] In essence, the legislative

45) Ibid, Chapter I, para. 84.

46) Ibid, recommendation 2 (a): Subject to recommendations 3–7, the law should apply to all rights in movable assets created by agreement that secure payment or other performance of an obligation, regardless of the form of the transaction, the type of the movable asset, the status of the grantor or secured creditor or the nature of the secured obligation. Thus, the law should apply to: (a) Security rights in all types of movable asset, tangible or intangible, present or future, including inventory, equipment and other tangible assets, contractual and non–contractual receivables, contractual non–monetary claims, negotiable instruments, negotiable documents, rights to payment of funds credited to a bank account, rights to receive the proceeds under an independent undertaking and intellectual property. …

47) Ibid, recommendations 4–7. Assets excluded from the scope of the *Guide* are aircraft, railway rolling stock, space objects, ships, securities, financial contracts, foreign exchange transactions, immovable property and proceeds of the above–mentioned types of asset.

48) Ibid, Chapter I, para. 6.

framework for intellectual property financing should be a comprehensive regime governing movable assets in general, and one which will equally apply to intellectual property.

Interaction between secured transactions law and intellectual property law

It is obvious that general policy objectives of secured transaction law and intellectual property law are not the same. Intellectual property law is structured to encourage further innovation and creativity by preventing unauthorized use and by protecting the value of intellectual property.[49] These objectives are accomplished by according certain exclusive rights to intellectual property owners.

The legislative framework for intellectual property financing, while providing a mechanism to fund the development and dissemination of new works, should not interfere with those objectives of intellectual property law. This is why the *Guide* also includes a limitation to its scope of application (recommendation 4, subparagraph (b)),[50] setting out the basic principle with respect to the interaction of secured transactions law and national intellectual property law or related international agreements.[51] In fact, the regime elaborated in the *Guide* and the Supplement does not in any way define the content of any intellectual property right, describe the scope of the rights that an owner, licensor or licensee may exercise nor impede their rights to preserve the value of their intellectual property rights by

49) The Supplement, para. 48.

50) Recommendation 4, subparagraph (b) of the *Guide* states that the law recommended should not apply insofar as its provisions are inconsistent with national law or international agreements, to which the State enacting the law is a party, relating to intellectual property. For more detailed discussion, see the Supplement, paras. 2–7 and 60–73.

51) These international agreements refer to the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) as well as various conventions administered by the World Intellectual Property Organization (WIPO).

preventing their unauthorized use.[52]

The legislative framework for intellectual property financing should also follow the approach taken in the *Guide*, meaning that existing laws and treaties, conventions or international agreements relating to intellectual property should prevail, to the extent that there is any inconsistency. The legislative framework should also not inadvertently change basic rules of intellectual property law, in particular those relating to the existence, validity and content of a grantor's intellectual property rights.

Recommendation 4, subparagraph (b) of the *Guide* is also an indication that States need to review their intellectual property law when adopting a comprehensive regime for financing of movable assets. A State adopting such a regime with a view to making credit more available and at lower cost to owners of assets such as tangible assets and receivables will most likely wish to make the benefits available also to intellectual property rights holders. If so, States should ensure that the introduction of the legislative framework for intellectual property financing be coordinated closely with required revisions in their intellectual property law to avoid any inconsistencies which, as mentioned above, may deter the optimal results sought by such an introduction.

B. Security rights in future intellectual property

> Example: PACIFIC COSMETICS, a manufacturer and distributor of cosmetics, wishes to obtain a credit facility to provide ongoing working capital for its business. Bank B is considering extending this facility, provided that the facility is secured by not only PACIFIC COSMETICS's existing assets but also its "future assets", including

52) The Supplement, para. 49.

all future intellectual property rights that PACIFIC COSMETICS will own or license from third parties.

→ If secured transactions law does not allow future assets to be used as collateral, the basis for the credit facility would be limited to existing assets of PACIFIC COSMETICS. However, for start-up companies that do not have any existing assets (for example, a company with a patent application pending), this would mean that such a credit facility is not an option.

Legal systems have been increasingly confronted with the question of whether future assets (namely assets that the grantor acquires or that are created after the security agreement is entered into) may be covered by a security agreement. In most legal systems, grantors may only create security rights in assets that are in existence and that they own (or have limited property rights) at the time the security right is created. They are not able to grant security in assets not yet in existence or that they have not yet acquired. That is, the security agreement cannot be entered into until the grantor actually has rights in the assets that the agreement purports to cover.

This approach is based on the principle that the grantor cannot grant to the secured creditor more rights than the grantor has or may acquire in the future (*nemo dat quod non habet*). It is also based on the concerns that debtors would need to be protected from over-committing their assets, in particular their future assets, to one secured creditor and that in such case, it would be less likely for unsecured creditors of the debtor to obtain satisfaction of their claims.[53)]

Nonetheless, because businesses, especially those involved in the development of intellectual property, may not always have available

53) The *Guide*, Chapter II, para. 53.

existing assets to secure credit such a limitation prevents them from obtaining many types of credit that are predicated upon a stream of future assets.[54] Therefore, in some legal systems, parties are allowed to create a security right that encumbers a future asset, which allows debtors to use the full value inherent in their assets to support credit.[55] Such an approach is particularly important for securing claims arising under revolving loan transactions secured by a revolving pool of assets, for example, inventory and receivables.[56]

Technical notions of property law should not pose obstacles to meeting the practical need of using future assets as security to obtain credit.[57] Moreover, as noted, permitting future assets to be encumbered makes it possible for grantors with insufficient present assets to obtain credit, which is likely to enhance their business and benefit all creditors, including unsecured creditors. Accordingly, the *Guide* recommends that a security right may be granted in future assets.[58] In such instances, a security right in the future asset will becomes effective only from the time the grantor acquires rights in them or the asset comes into existence.[59] Like any other rule recommended in the *Guide*, this rule would generally apply to intellectual property.[60]

54) Ibid, Introduction, para. 63.

55) Ibid, Introduction, para. 50. This approach is also consistent with the United Nations Assignment Convention, which provides for the creation of security rights in future receivables without requiring any additional steps (see article 8, paragraph 2, and article 2, subparagraph (a)).

56) Ibid, Chapter II, para. 54.

57) Ibid, Chapter II, para. 53.

58) Ibid, recommendations 2 (a) and 17. Recommendation 17 states that a security right may encumber assets that, at the time the security agreement is concluded, may not yet exist or that the grantor may not yet own or have the power to encumber. It also states that a security right may also encumber all assets of a grantor.

59) Ibid, Chapter II, para. 25.

60) The Supplement, para. 113.

Following the approach taken in the *Guide*, the legislative framework for intellectual property financing should allow a security right to be created in future intellectual property. In fact, many intellectual property laws do take that approach, allowing intellectual property owners to obtain financing useful in the development of new works, provided that their value can be reasonably estimated in advance.[61] For example, it may be possible to create a security right in a copyright of a motion picture or software (the security right is created when the copyrighted work is actually created) and a patent application before the patent is actually granted (typically, once the patent right is granted, it is considered as having been created at the time of the application).[62]

In taking such an approach, the legislative framework for intellectual property financing should take into account two major obstacles that may exist in intellectual property law which hinder the creation of a security right in future intellectual property.

One is that intellectual property law may limit the transferability of various types of future intellectual property to achieve certain policy goals.[63] For example, transfers of rights in new media or technological uses that are unknown at the time of the transfer may not be effective so as to protect undue commitments.[64] Concepts like "improvements", "updates" or "adaptations" under intellectual property law may also limit the use of future intellectual property as collateral.[65] For example, a security right in a version of copyrighted software that exists at the time of the financing may

61) Ibid, para. 114.

62) Ibid.

63) If intellectual property law limits the transferability of future intellectual property, the law recommended in the *Guide* would not apply to this matter in so far as it is inconsistent with intellectual property law (the *Guide*, recommendation 4, subparagraph (b)).

64) The Supplement, para. 115.

65) Ibid. para. 116.

extend automatically to updates following the financing. However, in most instances, it will be treated as a separate asset and not an integral part of the existing software. In such circumstances, the secured creditor would need to take extreme caution if the updated version is to be encumbered, as it would have to be directly described in the security agreement as collateral.[66]

Another relates to the registration of notices of security rights in future intellectual property. Although an essential feature of the general security rights registry recommended in the *Guide* is that a notice of a security right may refer to future assets, existing intellectual property registries in many States do not readily accommodate registration of security rights in future intellectual property.[67] As transfers of or security rights in intellectual property are indexed against each specific intellectual property right (and not by the grantor, as is the case for the general security rights registry recommended in the *Guide*), they can only be effectively registered after the intellectual property itself is first registered in the intellectual property registry. This prevents a blanket registration of a security right in future intellectual property and a new registration is required each time new intellectual property is created or acquired.

The legislative framework for intellectual property financing should take these two issues into consideration first, by reviewing whether the benefits from limiting the transferability of future intellectual property outweigh the benefits from the use of such assets as security for credit (especially for the financing of research and development activities)[68] and second, by providing measures to permit the registration of a security right in future intellectual property.[69]

66) Ibid, paras. 117 and 241. Of course, if future intellectual property may not be encumbered, it would not be possible to encumber the updated version.

67) Ibid, para. 142.

68) Ibid, para. 118.

69) Ibid, para. 143.

C. Acquisition financing in an intellectual property context

Example: HK AUTOMOBILE creates a security right in all of its present and future movable assets (including intellectual property) in favour of Bank C which takes actions necessary to make that security right effective against third parties. Subsequently, HK AUTOMOBILE obtains a license to use the patent from TT ELECTRONICS to be used in HK AUTOMOBILE's business. Pursuant to the agreement between HK AUTOMOBILE and TT Electronics, HK AUTOMOBILE agrees to pay the license fee to TT ELECTRONICS over time and HK AUTOMOBILE grants TT ELECTRONICS a security right in its rights as a licensee over the patent to secure its payment obligation. TT ELECTRONICS then makes that security right effective against third parties 30 days after HK Automobile obtains the license.

→ TT ELECTRONICS' security right is an acquisition security right in HK AUTOMOBILE's licensee's rights securing the license fee. As an acquisition security right, it has a "special" priority over the security right of Bank C.

The purchase and sale of tangible assets is a key activity in a modern commercial economy. However, acquisition of tangible assets is not restricted to businesses. Consumers are constantly purchasing tangible assets ranging from low-price consumer goods to high-value assets such as automobiles. While in many cases the acquisition of tangible assets by businesses or consumers is on a cash basis, in many other cases these assets are acquired on credit. "Acquisition financing transaction" refers to a transaction where a business or a consumer acquires tangible assets on

credit, and rights in the acquired assets serve as collateral for credit. The right that the seller or the creditor (financier) retains or obtains in the acquired assets may be called an acquisition security right, a retention-of-title right or a financial lease right, depending on how the transaction is characterized.[70]

Acquisition financing transactions are not only an important source of credit for buyers of tangible assets, but are also critical to sellers.[71] For example, in many States, the sale of automobiles normally involves an acquisition financing transaction. While buyers may seldom engage in such transactions for other purchases, the availability of acquisition financing to buyers is essential for sellers of automobiles. While acquisition financing transactions are identical to ordinary secured transactions in many respects, they have particular features that have led States to provide for special rules governing such transactions.

In fact, many States have enacted a special regime to govern acquisition financing with respect to tangible assets.[72] Chapter IX of the *Guide*, while allowing States to adopt either a unitary or a non-unitary approach to acquisition financing,[73] provide guidance to States to achieve an efficient and effective regime to govern all types of acquisition financing transactions. These rules on acquisition financing streamline different legal techniques by which creditors may obtain an acquisition security right in tangible assets in accordance with the widespread practices.[74] In that

70) The *Guide*, Chapter IX, paras. 1–3.

71) Ibid, Chapter IX, para. 4.

72) The Supplement, para. 254.

73) A unitary approach refers to an approach whereby various devices for acquisition financing transactions are characterized as being functionally equivalent. A non–unitary approach refers to an approach whereby certain forms of existing acquisition financing transactions are retained and characterized by the parties, such as retention–of–title or financial lease (The *Guide*, Chapter IX, paras. 74–84).

74) The Supplement, para. 257.

process, the *Guide* distinguishes three different types of tangible assets (consumer goods,[75] inventory,[76] and assets other than inventory or consumer goods (such as equipment))[77] and provides rules on how an acquisition security right may become effective against third parties and how it may obtain priority for each type of asset.

For example, an acquisition security right in consumer goods is automatically effective against third parties upon its creation (no need for registration) and has priority against a competing non-acquisition security right.[78] With regard to inventory and assets other than inventory and consumer goods, the *Guide* provides alternatives depending on whether there should be a distinction between the two types of assets (Alternative A of recommendation 180 distinguishes the two types of assets whereas alternative B does not). Under alternative A, an acquisition security right in tangible assets other than consumer goods or inventory would have priority provided that the acquisition secured creditor retained possession of the asset or a notice of the acquisition security right was registered in the general security rights registry within a short period of time after the grantor obtained possession of the asset.[79] With regard to an acquisition security right in inventory, an acquisition secured creditor must have retained possession of the asset or a notice of the acquisition security right must have been registered in the general security rights registry and earlier-registered non-acquisition secured creditors need to have been notified of the acquisition secured creditor's intention to claim an acquisition security

75) Consumer goods refer to goods used or intended to be used by the grantor for personal, family or household purposes (The *Guide*, Introduction, sect. B. Terminology).

76) Inventory refers to assets held by the grantor for sale, lease or licence in the ordinary course of its business (The *Guide*, Introduction, sect. B. Terminology).

77) The basis for such a distinction is provided in the *Guide*, chapter IX, paras. 125–139.

78) The *Guide*, recommendation 179.

79) Ibid, recommendation 180, alternative A, subpara. (a).

right, both before delivery of the inventory to the grantor.[80] Under alternative B, whereby no distinction is drawn between inventory and assets other than consumer goods or inventory, an acquisition security right in tangible assets other than consumer goods would have priority provided that the acquisition secured creditor retained possession of the asset or a notice of the acquisition security right was registered in the general security rights registry within a short period of time after the grantor obtained possession of the asset.[81]

Whereas these rules in the *Guide* were envisaged for the acquisition financing of tangibles assets, the *Guide* does not mention a special regime for acquisition financing of intangible assets. In fact, the *Guide* leaves open the question whether it would be useful to permit the creation of acquisition security rights in favor of lenders that finance the acquisition (but not the original creation) of intellectual property.[82] Given the significant differences in legal regimes governing tangible assets and intellectual property, it would, however, be quite difficult to simply transpose the approach and recommendations of the *Guide* in an intellectual property context. Nonetheless, the idea of providing a regime for acquisition financing of intellectual property similar to that of tangible assets is not totally novel.[83] In fact, such an approach would provide general parity in the treatment of tangible assets and intellectual property. Therefore, the legislative framework for intellectual financing should make the following adjustments when adapting the acquisition financing regime of the *Guide* to an intellectual property context.

80) Ibid, recommendation 180, alternative A, subpara. (b).

81) Ibid, recommendation 180, alternative B.

82) Financing of the original creation of intellectual property may be sought in the context of security rights in future intellectual property. See the discussion in section B.

83) The Supplement, para. 256.

Basic adjustments in an intellectual property context[84]

First, the term "acquisition security right" would need to explicitly include a security right in intellectual property or a licence of intellectual property, provided that the security right secures the obligation to pay any unpaid portion of the acquisition price of the encumbered asset or an obligation incurred or credit otherwise provided to enable the grantor to acquire the encumbered asset.[85] In addition, any references to "possession" and "delivery" of the collateral, which applies only to tangible assets, would need to be eliminated. Moreover, appropriate distinctions between the acquisition financing of the intellectual property right itself and the acquisition financing of a licence or sub-licence of that intellectual property right should need to be developed. In addition, a number of specific adjustments mentioned below would be required.[86]

Third-party effectiveness and priority of an acquisition security right in intellectual property[87]

In adapting the recommendations of the *Guide*, the legislative framework for intellectual property financing should retain the distinction among the different types of assets based on the purpose of acquisition. For example, if intellectual property that is subject to an acquisition security right is used or intended to be used by the grantor for personal, family or household purposes, the rules that govern an acquisition security right in

84) Ibid, para. 257.

85) In the *Guide*, "acquisition security right" refers to a security right in a tangible asset (other than a negotiable instrument or negotiable document) that secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or credit otherwise provided to enable the grantor to acquire the asset. An acquisition security right does not need to be denominated as such (the *Guide*, Introduction, Terminology).

86) The Supplement, para. 258.

87) Ibid, paras. 259–263.

consumer goods should apply. If intellectual property is held by the grantor for sale or licence in the ordinary course of the grantor's business, the rules that govern an acquisition security right in inventory should apply. However, as intellectual property may be held for multiple purposes, reference should always be made to the primary purpose and the same criterion should be used for determining whether a transaction was in the ordinary course of business. In addition, terms like "sale, lease or license" should also be modified so as to be consistent with intellectual property law. For example, the term "sale" may be understood as meaning an "assignment" of intellectual property and "lease" may be understood as meaning a "licence" of intellectual property.

Priority of a security right registered in an intellectual property registry

The legislative framework for intellectual property financing would also need to take into account that special registries exist for intellectual property. The *Guide*, in recommendation 181, provides that the special priority of an acquisition security right (as provided under recommendations 179 or 180 of the *Guide*) cannot override the priority of a security right or registered in a specialized registry (as provided under recommendations 77 and 78 of the *Guide*). Recommendation 181 is a reflection that the *Guide* does not seek to modify any rules set out in law other than secured transactions law that are applicable to specialized registries in relation to priority. This is justified by the need to avoid interfering with specialized registration regimes.[88)]

Following this approach of the *Guide*, the general priority afforded to security rights registered in specialized registries is maintained. The special priority of an acquisition security right is only over security rights registered

88) Ibid, para. 264.

in the general security rights registry and not those registered in specialized registries. In the example above, if a security right over the patent license has been registered in the patent registry by Bank C (assuming that future patents acquired by HK AUTOMOBILE may be registered in that registry), TT ELECTRONICS would not be able to obtain a priority over the security right of Bank C on the basis that it had obtained an acquisition security right in the patent license.

In an intellectual property financing context, this rule could hinder acquisition financing to the extent intellectual property law (especially, its registration regime) does not provide for a special priority status for acquisition security rights in intellectual property. Therefore, the legislative framework for intellectual property financing should include rules providing special priority status to an acquisition security right over a security right registered in the intellectual property registry, under the condition that the acquisition security right is also registered in an appropriate manner in the intellectual property registry.[89)]

Priority of a security right in proceeds of encumbered intellectual property

Another key feature of the acquisition financing regime recommended in the *Guide* relates to the treatment of acquisition security rights in proceeds of the collateral. In the example above, the question may arise whether the priority of TT ELECTRONICS' acquisition security right extends to the proceeds of the patent license, for example, royalties received by HK AUTOMOBILE upon sub-licensing the patent to its affiliates.[90)]

89) Ibid, paras. 265–268.

90) "Proceeds" in the *Guide* refers to whatever is received in respect of encumbered assets, including what is received as a result of a sale or other disposition or collection, lease or license of an encumbered asset, proceeds of proceeds, natural and civil fruits or revenues, dividends, distributions, insurance proceeds and claims arising from defects in, damage to or

The general rule in the *Guide* is that the priority of a security right in proceeds should follow that of the security right in the original collateral.[91] By contrast, the priority of a security right in proceeds of collateral that was subject to an acquisition security right does not automatically follow the priority of the acquisition security right in the initial collateral.[92] The consequence, in an intellectual property context, is that although the proceeds of intellectual property right continues to be encumbered, the security right over those proceeds no longer retains a special priority.

As to whether TT ELECTRONICS (as acquisition financier and also as a licensor) or Bank C (as a secured creditor with all-asset security right) would have priority over sub-royalties to be received by HK AUTOMOBILE is the question to be answered. This is rather a policy decision that needs to be made by States balancing the needs of the intellectual property owners and licensor to collect royalties (which they rely on to develop new ideas protected by the intellectual property right) and the needs of the acquisition or general financier extending credit to the licensee based on the licensee's rights to the payment of sub-royalties.[93] The Supplement concludes that the rule recommended in the *Guide* should be transposed without further modification as it achieves an appropriate

loss of an encumbered asset. For example, the revenue stream generated by licensing of intellectual property (royalties) would be proceeds of the intellectual property.

91) The *Guide*, recommendations 76 and 100.

92) Ibid, recommendation 185. Once again, a distinction is drawn between consumer goods, inventory and assets other than inventory or consumer good. Under alternative A, a security right in proceeds of tangible assets other than inventory or consumer goods has the same priority as the acquisition security right itself (subparagraph (a)). However, a security right in proceeds of inventory only has the priority of an acquisition security right in the inventory, if the proceeds are not in the form of receivables, negotiable instruments, rights to payment of funds credited to a bank account or rights to receive proceeds under an independent undertaking (subparagraph (b)). Under alternative B, the security right in proceeds of the original collateral has only the priority of a non-acquisition security right.

93) The Supplement, paras. 271-272.

balance between the interested parties. The legislative framework for intellectual property financing would need to take these various aspects into consideration in introducing an acquisition financing regime for intellectual property.

D. Law applicable to a security right in intellectual property

Example: Kiwi Inc., located in the Korea, owns a portfolio of copyrights in and protected under the Korean laws and a portfolio of patents and trademarks in and protected under Japanese laws. Pursuant to a single security agreement, Kiwi Inc. creates a security right in both portfolios in favour of M Financial Group (Japan). Kiwi Inc. then creates a security right in the patent and trademark portfolio in favour of S Financial Group (Japan).

→ 1. Under which State law would MFG need to create its security right in the copyright portfolio and in the patent and trademark portfolio? Could MFG create its security right in all assets of Kiwi Inc. simply under the Korean law (where Kiwi Inc. is located)?

2. Under which State law would MFG need to meet the third-party effectiveness requirements for the copyright portfolio and for the patent and trademark portfolio? What if the insolvency procedure for Kiwi Inc. is already under way in Korea?

3. Which State law will govern the priority conflict between MFG and SFG?

4. Which State law will govern the enforcement of the security right in both the copyright and the patent and trademark portfolios?

An innovative feature of the Supplement, which the legislative framework for intellectual property financing needs to take into account, is

the recommendation on the law applicable to security rights in intellectual property. Needless to say, chapter X on the conflict-of-laws was the most debated chapter of the Supplement throughout the Working Group sessions. In fact, recommendation 248 was the last text that was agreed prior to the official adoption of the Supplement. In this context, it should be noted that the Hague Conference on Private International Law contributed greatly to the development of this chapter on conflict-of-laws.[94]

In essence, the focus of the debate was whether the law applicable to various aspects of secured transactions relating to intellectual property was the law of the State in which the intellectual property is protected (*lex protectionis*) or the law of the State in which the grantor is located (law of the grantor's location).[95]

The approach recommended in the *Guide* with respect to security rights in intangible assets is that the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right in an intangible asset is the law of the grantor's location.[96] However, the *Guide* does not

94) With respect to contractual matters (the mutual rights and obligations of the grantor and the secured creditor arising from their security agreement), the law applicable is left to party autonomy. In view of the wide acceptability of the application of the principle of party autonomy to contractual matters, the same rule should apply to security rights in intellectual property. In the absence of a choice of law by the parties, the law applicable would be the law governing the security agreement (The *Guide*, recommendation 216). For more information about the Hague Conference on Private International Law, see http://www.hcch.net/index_en.php.

95) The question whether an asset (including intellectual property) may be transferred or encumbered is a preliminary issue to be addressed before the creation of a security right and is not addressed by the conflict–of–laws rules recommended in the *Guide*. Thus, to the extent that other conflict–of–laws rules refer issues of transferability of intellectual property rights, for example, to the law of the State in which the intellectual property is protected, the Guide does not affect them. This is because these issues are not addressed in the Guide.

96) The *Guide*, recommendations 208 and 218, subpara. (b). The location of the grantor is defined as its place of business and, in the case where the grantor has places of business in more than one State, it is where the central administration is exercised (the *Guide*, recommendation 219).

provide an asset-specific recommendation for security rights in intellectual property.

The principal advantage of an approach based on the law of the grantor's location is that it leads to the application of a single law to various elements of secured transactions (as mentioned above, its creation, third-party effectiveness, priority and enforcement).[97] So, a secured creditor that wishes to obtain a security right in all present and future intangible assets (including intellectual property) of a grantor could obtain the security right, make it effective against third parties, ascertain its priority and have it enforced by referring to the law of a single State, even if the assets may have connections with several States. In particular, both registration and searching costs would be reduced, as a secured creditor would need to register and a searcher would need to search only in the State where the grantor is located. Accordingly, transaction costs would be reduced and certainty enhanced, potentially having a beneficial impact on the availability and the cost of credit. Another advantage is that the law of the grantor's location is likely to be the law of the State in which the main insolvency proceeding with respect to the grantor is to be administered.[98]

However, an approach based solely on the law of the grantor's location might not be appropriate for security rights in intellectual property. If the secured creditor needs to ensure its priority as against all competing claimants, it would have to meet the requirements of the law that typically governs ownership in intellectual property, that is, the *lex protectionis*. This would be the case, in particular, with respect to priority as against a transferee of intellectual property or an exclusive licensee of intellectual property where an exclusive licence is treated as a transfer. This would have a negative impact on the availability and the cost of credit as transaction

97) The Supplement, para. 291.

98) Ibid, para. 292.

costs would increase.[99] Because of these reasons, it was argued that the *lex protectionis* should be the law applicable to security rights in intellectual property.

In fact, international conventions designed to protect intellectual property generally adopt the principle of territoriality. Thus, in States that are parties to these conventions, the law applicable to ownership and issues related to the protection of intellectual property rights is the *lex protectionis*.[100] Although these conventions do not expressly address conflict-of-laws rules with respect to security rights in intellectual property, it may be argued that the principle of national treatment embodied in those conventions implicitly imposes a universal rule in favour of the *lex protectionis* for determining the law applicable not only to ownership of intellectual property but also to issues arising with respect to security rights in intellectual property.[101] In other words, States parties to these conventions might be obliged to apply the *lex protectionis*.

In such circumstances, a secured creditor would have to fulfil the requirements of the State in which the intellectual property exists in order to obtain an effective and enforceable security right in the intellectual property. The principal advantage of an approach based on the *lex protectionis* is that the same law would apply to both security rights and ownership rights in intellectual property.[102] However, it is, at the same time, also ineffective as registration would need to take place in registries located in several States. This will be the case, in particular, when a portfolio of intellectual property rights protected under the laws of various States is used as collateral, when the collateral is not limited to intellectual

99) Ibid, para. 306.

100) Ibid, para. 297.

101) Ibid, para. 298. See also the report of Working Group VI (Security Interests) on the work of its sixteenth session (A/CN.9/685, para. 90).

102) The Supplement, para. 299.

property that is used and protected under the law of a single State and when all assets of the grantor (including intellectual property) are encumbered.[103] In these instances, the cost and complexity of financing transaction would significantly increase due to additional registration and search costs.

The approach based on *lex protectionis* for security rights in intellectual property is not universally accepted nor is there a precedent on its application.[104] Even assuming that the above-mentioned international conventions impose certain conflict-of-laws rules, it is still questionable whether these rules cover all property effects with regard to a security right in intellectual property. Accordingly, even if one accepts the extensive effect of those conventions, it would still be necessary and useful for States to adopt conflict-of-laws rules applicable to issues arising with respect to security rights in intellectual property. Such rules would, at the very least, perform a gap-filling function whereby existing international intellectual property conventions do not provide a clear answer.[105]

Taking into consideration the advantages of the two approaches, one based on the *lex protectionis* (which provides consistency with the law applicable to ownership rights) and another based on the law of the grantor's location (which provides the benefit of a single law being applied to various elements related to secured transactions), the Supplement recommends the following combined approach:[106]

> Recommendation 248. The law should provide that:
> (a) The law applicable to the creation, effectiveness against third parties and priority of a security right in intellectual property is the

103) Ibid, para. 300.
104) Ibid, para. 301.
105) Ibid, para. 302.
106) Ibid, recommendation 248

law of the State in which the intellectual property is protected;
(b) A security right in intellectual property may also be created under the law of the State in which the grantor is located and may also be made effective under that law against third parties other than another secured creditor, a transferee or a licensee; and
(c) The law applicable to the enforcement of a security right in intellectual property is the law of the State in which the grantor is located.

In short, the *lex protectionis* would apply to the creation, third-party effectiveness and priority of a security right in intellectual property. However, a secured creditor could also effectively create a security right under the law of the grantor's location. In the example above, MFG could create its security in the copyright portfolio under Korean law and in the patent and trademark portfolio under Japanese law (in both cases, the *lex protectionis*). However, it would have the option of effectively creating its security right in all assets of Kiwi Inc. under Korean law (law of the grantor's location). As regards third-party effectiveness, MFG would need to meet the requirements under Korea law for the copyright portfolio and Japanese law for the patent and trademark portfolio (again, both the *lex protectionis*) However, it could simply meet the requirements of Korean law (the law of the grantor's location) to protect its security right against judgement creditors and Kiwi Inc.'s insolvency representative. The priority between the security right of MFG and SFG in the patent and trademark portfolio will be governed by Japanese law (the *lex protectionis*), whereas Korean law (the law of the grantor's location) will govern the enforcement of the security right in both the copyright portfolio and the patent and trademark portfolio.

This approach of the Supplement recognizes the importance of the *lex*

protectionis. At the same time, providing the possibility for a secured creditor to create and enforce a security right under a single law (the law of the grantor's location), which has significant practical benefits, in particular for transactions involving a portfolio of intellectual property protected in different States or a portfolio of various tangible and intangible assets, including intellectual property, located (or protected) in various States. The same benefits would result from the possibility for a secured creditor to make a security right effective as against judgement creditors and the grantor's insolvency representative under the law of the grantor's location.

The legislative framework for intellectual property financing should also consider adopting conflict-of-laws rules following the approach provided in the Supplement. It does not necessarily need to be addressed in the secured transactions law or the intellectual property law. It could possibly be included in the State's private international law legislation. Wherever such rules might be found, with the increase in cross-border financing of intellectual property, such rules would provide more certainty to those lending based on intellectual property as well as those borrowing using intellectual property as collateral and therefore should be an important component of the legislative framework for intellectual property financing.

III. Conclusion

This article provides a brief introduction of the *Guide* and the Supplement while focusing on four key innovative features that need to be considered in the legislative framework for intellectual property financing. These features, once included in the legislative framework, would assist in fostering intellectual property financing but in most cases, the main obstacle to intellectual property financing is not the non-existence of such

framework but rather the reluctance in the intellectual property community to insist on using intellectual property as collateral in secured transactions. In response, it may be argued that it is not the intellectual property community but rather the banks and other financial institutions that are hesitant in extending credit based on intellectual property, but that *status quo* can only change where there is first a change of perception within the intellectual property community.

The initial response from many intellectual property law experts when informed of the work done by UNCITRAL in the field of intellectual property financing is a bit skeptical, questioning how the issue of intellectual property valuation is dealt. As mentioned in the introduction of this article, this is a non-legal yet practical problem that is not dealt in the Supplement for obvious reasons. Yet it is an issue that needs to be resolved in order for the legislative framework for intellectual property to function properly. However, lack of standards to appraise the value of intellectual property alone should not be the basis for downplaying the possibility of using intellectual property as collateral in secured transactions.

In fact, valuation of assets is not a unique problem to intellectual property secured transactions. It is an issue that all grantors and secured creditors need to address irrespective of the type of collateral. It is, however, also true that the value of intellectual property is comparatively more difficult to assess because so many different factors (for example, market share, barriers to entry, legal protection, profitability, industrial and economic factors, growth projections, remaining economic life, and new technologies) are involved. This is especially so with regard to intellectual property in its earlier stages. Although many different approaches to valuation have been developed (for example, those based cost, income or competitive advantage) and are useful in estimating the value of intellectual property, in the context of using intellectual property as collateral, a market

approach based on the economic principles of competition, supply and demand would function most effectively, providing an assessment that financiers could rely on. Under this assumption, the focus of the intellectual property community should be to concentrate its efforts on developing a trustworthy valuation methods based on a market mechanism. National governments or international organizations might play a role in the initial stages of such development but only if and when the market is operate on its own, would intellectual property financing be facilitated.

It must also be emphasized that secured financing, by its nature, is quite different from a pure investment, which the intellectual property community may be more familiar with. Whereas investments are usually based on expected profits taking the risk of the loss of the principal sum, secured financing is fundamentally a risk-adverse transaction whereby the collateral operates as a security for possible loss in the transaction. Moreover, collateral is to be used only in the extreme case of default of the secured obligation. In short, secured financing does not rely on high profit but rather a sustained flow of income usually in the form of interests and only in rare cases does the collateral play a role (for example in the enforcement of the security right). Understanding this conventional character of secured financing, whether it suits the financing of intellectual property or not, is also required.

From a financier's perspective, an obstacle to financing based on intellectual property is that different regimes exist for different types of intellectual property (for example, copyright, patents, trademarks, trade secrets and so on). This means that a financier engaging in secured transaction involving intellectual property will have to register and search in different registries, which adds significant costs. An innovative feature in this regard would be to design a system whereby different registries of intellectual property would be coordinated so that a secured creditor could

register or at least, search in the various registries with a single inquiry.

At the outset, it was noted that UNCITRAL adopts a flexible and functional approach with respect to the methods used to modernize and harmonize international trade law. Taking a soft law approach, the *Guide* and the Supplement (both in the form of legislative guides) provides policy options, guidelines as well as rationale for issues to be considered in a legislative framework for secured transactions, in particular, in the context of intellectual property. Coordination of registries is just one of the many issues dealt in the *Guide* and the Supplement. Acknowledging that a one-size-fits-all approach would not apply in this field of laws, States are provided more flexibility in adopting the recommendations so that domestic factors might also be considered. Under these circumstances, States hoping to foster intellectual property financing should seriously reflect these UNCITRAL texts in their enactment. It is especially so because the Supplement addresses the intellectual property financing issue not simply from an intellectual property perspective but also from the financing perspective which may be lacking in the discussion in the intellectual property community.

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이재성

국문초록

이 논문은 우선 각국이 담보거래, 특히 지적재산권을 이용한 담보거래와 관련된 입법을 함에 있어 참고할 수 있는 유엔국제거래법위원회의 담보거래 입법지침 및 지적재산담보권에 대한 부속서를 소개한다. 이를 바탕으로 지적재산권을 활용한 금융거래의 활성화를 위한 법률 체계가 갖추어야 할 요소로 다음 네 가지를 제안한다. 우선 동 법률체계는 지적재산권만을 규율하는 별도의 체계가 아닌 동산을 포괄적으로 규율하는 체계이어야 하며, 장래의 지적재산권에 대해서도 담보권이 설정될 수 있도록 하여야 하며, 지적재산권 취득에 필요한 금융제공자에게 우선권을 부여하는 규정을 두어야 하며, 마지막으로 국제적인 담보거래에 대비 국제사법 관련 규정을 마련하여야 한다. 이 논문은 지적재산권을 활용한 금융거래의 활성화를 위해서는 이러한 요소들이 관련 법률 체계에 포함되는 것도 중요하지만 지적재산권의 경우 그 가치평가가 어렵기 때문에 담보거래에 활용되는 경우가 미미하다는 점을 지적한다. 또한, 투자와 다른 담보거래의 보수적인 특성을 고려, 시장에 기초한 여러가지 가치평가 방안을 마련할 것을 권고한다.

주제어

지적재산금융, 담보거래, 담보자산, 유엔국제거래법위원회(UNCITRAL) 담보거래 입법지침 및 지적재산담보권에 대한 부속서, 장래 지적재산권, 취득금융, 국제사법, 지적재산 가치평가