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## 2016 – Study Question (General)

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**Security interests over intellectual property**

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### I. Current law and practice

You are reminded that **IPRs** refers to patents, trademarks and registered designs only.  
If more than one type of security interest is available under your Group's current law, please answer the questions for each type of security interest, as applicable.

#### Availability of security rights

1) Does your Group's current law provide for the possibility of creating security interests over IPRs?

yes

Please explain:

In our country, the *Real Rights Law of the people's republic of China*, the *Security Law of the People's Republic of China* and the judicial interpretations thereof provide the basis for creating security interests over IPRs.

If yes, please answer Questions 2) to 14) inclusive before proceeding to question 15) and following.  
If no, please proceed directly to question 15).

2) Are the available types of security interests defined by specific provisions relating to security interests over IPRs or by general commercial law principles (e.g. specific provisions in your Group's patent legislation rather than general commercial provisions that are applicable to tangible personal property as well as to patents)?

yes

Please explain:

In our country, the available types of security interests are specified in the general commercial law

principles including the *Real Rights Law of the people's republic of China*, the *Security Law of the People's Republic of China*, the judicial interpretations thereof and so on.

- 3) Under your Group's current law, what types of security interests are available for IPRs? In addressing the questions in sub-paragraphs a) to c) below, please specify briefly the main characteristics and differences of the available types of security interests.

a) Does your law provide for security interests which are characterized by the full assignment of the underlying IPR to the security taker? For example, an assignment of the IPR for the purpose of security or authorization to dispose/use fully in the event of default.

yes

Please explain:

Article 219, paragraph two of the *Real Rights Law of the people's republic of China* stipulates, where an obligor fails to pay his due debts or any circumstance for realizing the pledge right as stipulated by the parties concerned occurs, the pledgee may, upon negotiation with the pledgor, cash the pledge or seek preferential payments from the proceeds of the sale or auction of the pledged properties.

Article 71, paragraphs two and three of the *Security Law of the People's Republic of China* stipulate, where the pledgee does not receive payment at the expiration of the term for performance of the obligation, he may agree with the pledgor to convert the pledged property into value or may auction or sell the pledged property according to law. After pledged property has been converted into value or auctioned or sold, any portion of the proceeds that exceeds the amount of the obligation shall be owned by the pledgor and any shortfall shall be paid by the debtor.

Therefore, our laws don't provide for security interests which are characterized by the full assignment of the pledged IPRs to a security taker. Even in the event of default of the pledgor, the security taker is not entitled to use the pledged IPRs. The security taker may neither dispose/use by himself nor permit others to dispose/use the pledged IPRs by means of security/authorization. The security taker may only, upon negotiation with the pledgor, dispose (cash/auctioned/sold) the pledged IPRs and seek preferential payments from the proceeds of the dispose of the pledged IPRs.

b) Does your law provide for security interests that authorize the security taker to realize the security interest only in the event of default? For example, a pledge over an IPR that authorizes the pledgee to liquidate the pledged IPR in the event of default (but not to otherwise dispose of the IPR).

yes

Please explain:

Our laws provide for security interests that authorize a security taker to realize the security interests, no matter whether it's in the event of default or not.

Article 71, paragraphs two and three of the *Security Law of the People's Republic of China* stipulate, where the pledgee does not receive payment at the expiration of the term for performance of the obligation, he may agree with the pledgor to convert the pledged property into value or may auction or sell the pledged property according to law. After pledged property has been converted into value or auctioned or sold, any portion of the proceeds that exceeds the amount of the obligation shall be owned by the pledgor and any shortfall shall be paid by the debtor.

This law provision provides for the forms of authorizing a security taker to realize the security interest in the event of default of the pledgor, i.e. to guarantee the pledgee's right to seek preferential payments.

Article 79 of the *Security Law of the People's Republic of China* stipulates, in case of a pledge of a trademark, patent or copyright among property rights that are transferable according to law, the pledgor and the pledgee shall conclude a written contract and register the pledge with the authorities for the administration of such trademark, patent or copyright. The pledge contract shall become effective on the date of registration.

Article 80 of the *Security Law of the People's Republic of China* stipulates, after the rights specified in Article 79 hereof have been pledged, the pledgor may not assign such rights or permit others to use such rights. However, the pledgor and the pledgee may assign or permit others to use such rights through consultations. The assignment fee or license fee obtained by the pledgor shall be used for early fulfillment of the secured obligation to the pledgee or deposited with a third party agreed with the pledgee.

The above two law provisions provide for the forms of authorizing a security taker to realize the security interest in the absence of default of the pledgor, i.e. to strengthen the supervision over the acts of the pledgor and protect the security interests of the security taker by means of concluding a contract and registration therein specifies that, the pledgor is not entitled to use the pledge rights without the consent of the pledgee.

- c) Does your law provide for security interests that authorize the security taker to use the underlying IPR? For example, *usus fructus* rights that authorize the creditor to use and/or realize proceeds from the exercise of the IPR only during the term of encumbrance. Is any right to use the encumbered IPR conditional upon default of the security provider?

yes

Please explain:

Article 214 of the *Real Rights Law of the people's republic of China* stipulates, where a pledgee arbitrarily uses or disposes of the pledged properties within the duration of the pledge right, without the consent of the pledgor, and as a result of which the pledgor are damaged, the pledgee shall assume the compensation liabilities.

Article 227, paragraph two of the *Real Rights Law of the people's republic of China* stipulates, the pledgor may not transfer or permit the use of the pledged property right in the intellectual property rights, unless otherwise agreed by negotiation between the pledgor and the pledgee. The pledgor shall make early repayment of the debt with the proceeds from the transfer or permit the use of the pledged property right in the intellectual property right, or submit the proceeds to a competent authority for safekeeping.

Therefore, our laws don't provide security interests that authorize a security taker to use the secured IPRs .Within the duration of the secured IPRs, the pledgor is still entitled to the use and proceeds of the secured IPRs. Where a security provider fails to perform his obligation, in accordance with 3 (a) and 3 (b) hereof, the security taker is entitled to seek preferential payments from the proceeds of use/dispose of the secured IPRs upon negotiation with the security provider.

- 4) If more than one type of security interest is available under your Group's current law, what types are commonly used for IPRs? Please also specify if certain types of security interests are exclusively used for certain types of IPRs in your country. For example, patents may commonly be encumbered with pledges, while trademarks may commonly be assigned to the security taker.

Many types of security interest , including mortgage, pledge, lien and deposit and so on, are available under our country's current laws. However, in accordance with the provisions of Article 223 and 227 of the *Real Rights Law of the people's republic of China*, and Article 75 of the *Security Law of the People's Republic of China* thereof, only the pledge of rights in the pledge right is used for IPRs.

Effects of security interests

- 5) Is the security provider restricted in their right to use their IPR after providing a security interest over that IPR? For example, in respect of their right to grant licenses, or the right to use the protected subject matter. Please answer for each available type of security interest.

yes

Please explain:

In accordance with the provisions of Article 227, paragraph two of the *Real Rights Law of the people's republic of China* and Article 80 of the *Security Law of the People's Republic of China* thereof, a security provider is restricted in his rights to use his IPR after providing a security interest over that IPR.

- 6) May encumbered IPRs be assigned to third parties by the security provider?

yes

Please explain:

In accordance with the provisions of Article 227, paragraph two of the *Real Rights Law of the people's republic of China* and Article 80 of the *Security Law of the People's Republic of China* thereof, without the consent of the pledgee, a security provider may not assign or permit others to use the secured IPRs.

- 7) If yes:

- a) under what conditions may an IPR be assigned (e.g. obligation to obtain consent from the security taker, public notification or registration)?

To obtain the consent from the security taker.

- b) does the IPR remain encumbered with the original security interest for the benefit of the security taker?

yes

Please explain:

Article 70 of the *Security Law of the People's Republic of China* stipulates, where pledged property is likely to be damaged or obviously to diminish in value to an extent sufficient to jeopardize pledgee's rights, the pledgee may require the pledgor to provide a corresponding security.

Article 216 of the *Real Rights Law of the people's republic of China* stipulates, where any cause unattributable to the pledgee results in the destruction of the pledged properties or an obvious decrease in the value of the pledged property, which is sufficient to damage the pledgee's rights, the pledgee has the right to request the pledgor to provide a security correspondingly. Where the pledgor refuses to do so, the pledgee may sell or auction the pledged properties, and may, upon negotiation with the pledgor, seek early payments for the obligee's rights with the proceeds of the sale or auction, or submit such proceeds to a competent authority for safekeeping.

Therefore, a security taker maintains his initial security interests unchanged within the duration of the secured IPRs, seeks the payments at the expiration of the term for the secured IPRs based on the initial secured amount and not affected by changes in the value of the secured IPRs within the duration of the security.

- 8) What are the rights of the security taker before default (e.g. entitlement to damages, injunctions against infringers, or license fees)?

A pledgee of IPRs is entitled to the fruits (license fee) (Article 213 of the *Real Rights Law of the people's republic of China*), the right to transfer the pledge (repledge with agreement) (Article 217 of the *Real Rights Law of the people's republic of China*) and the right to seek preferential payments (Article 227, paragraph two of the *Real Rights Law of the people's republic of China*).

- 9) Who of the security provider or the security taker is responsible for maintenance and defence of the IPR provided as collateral?

During the term of IPR pledge, all the expenses for the maintenance of the IPR itself, such as the annual fee etc. shall be paid by the pledgor. In practice, the pledgee can also pay those expenses first, but under this circumstance, the pledgee is entitled to seek to recover the payments from the pledgor.

- 10) What are the legal consequences if the underlying IPR expires or is revoked? For example, the security right lapses simultaneously; the creditor has a compensation claim against the security provider.

Where a pledged IPR expires or is revoked, the legal consequences thereof shall be that the security right extinguishes, only the obligee's right which the secured amount acts as the subject matter exists.

- 11) Can any of these effects of security interests over IPRs before default be modified by contractual provisions between the parties? If so, which effects?

yes

Please explain:

Before default, unless otherwise stipulated by the mandatory law provisions, the effects of security interests over IPRs may be modified by agreements between the parties. In accordance with the provision of Article 227, paragraph 2 of the *Real Rights Law of the people's republic of China*, the pledgor may transfer or permit the use of the pledged property upon agreements with the pledgee. In accordance with the provision of Article 213 of the *Real Rights Law of the people's republic of China*, the pledgee may be entitled to the fruits upon agreements with the pledgor. In accordance with the provision of Article 217 of the *Real Rights Law of the people's republic of China*, the pledgee may transfer the pledge upon agreements with the pledgor.

#### Applicable law

- 12) Does your Group's current law provide for conflicts of laws as to the availability and effect of security interests over IPR portfolios containing foreign as well as national IPRs?

yes

Please explain:

Article 40 of the *Law of the People's Republic of China on Application of Law in Foreign-related Civil Relations* stipulates, the pledge of rights shall be governed by the laws of the place where the pledge is established. This is a specific law provision on security interests which provides for conflict rules of laws of security interests over IPRs portfolios containing foreign as well as national IPRs, and specially involving the place where the pledge is established.

- 13) Which national law applies as to creation, perfection and effect of security interests over foreign IPRs? For example, where a US patent is provided as collateral in respect of a financial transaction in Europe.

No national law applies as to creation, perfection and effect of security interests over foreign IPRs in our country.

- 14) Can a choice of law provision in a security interest agreement over IPRs overrule the applicable law as to availability and effect?

no

Please explain:

In accordance with the provision of Article 40 of the *Law of the People's Republic of China on Application of Law in Foreign-related Civil Relations* thereof, the parties may select applicable law provisions by selecting the place where the pledge is established to circumvent some current laws as to availability and effect, but may not overrule the current laws as to availability and effect.

#### Additional question

- 15) Regardless of your Group's current law relating to security interests over IPRs, is it possible to create a solely contractual regime for security interests over IPRs (i.e. beside the types of security interests defined by law) that is enforceable between the contracting parties?

yes

Please explain:

In view of the status of more and more financing through intellectual property pledge in our country, it's necessary that in future, the pledge shall be registered by a unified administrative authority.

## **II. Policy considerations and proposals for improvements of the current law**

- 16) Is your Group's current law regarding security interests over IPRs sufficient to provide certainty and predictability to the parties?

yes

Please explain:

The provisions of the *Real Rights Law of the people's republic of China* stipulates clearly that where an IPR acts as the subject matter of the pledge of rights. the basic meaning of the pledge lies in that if the obligor fails to pay a due debt or any circumstance as stipulated by the parties concerned occurs, the obligee shall be entitled to the right to seek preferential payments. The legal consequences that they require the rights are clear and predictable to both the pledgee and the pledgor.

- 17) Under your Group's current law, is there an appropriate balance between the rights between security takers and security providers? For example:

- a) are there situations in which the rights of security takers should be limited or extended (e.g. if assignment of an encumbered IPR is possible by the security provider without involvement of the security taker)?

yes

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Please explain:

According to the provision of Article 227 of the *Real Rights Law of the people's republic of China* thereof, without involvement of the security taker, a security provider's act to dispose the secured right may be supervised, but should not be limited.

The reasons are: 1. In our country, signing of the pledge contract and registration are the requirements for the pledge of rights to become effective. The effect by registration can guarantee the pledgee to realize the security interests. Where in Article 227, paragraph two, on the premise that the wishes of the pledgee be respected, a pledgor is encouraged to use the pledged IPR, which can effectively realize the value of IPR and is beneficial for fulfillment of his obligations. 2. Compared with the movable pledge and the pledge of rights which the securities pledge right such as bills, bonds, deposit receipts, warehouse receipts, bills of lading and so on act as the subject matter and which a pledgee possesses the pledged property and has the effect to challenge the third party while the pledgor doesn't possess the pledged property or pledged securities and can't actually dispose the pledged property, the pledgee of IPRs pledge right doesn't possess the pledged property, thus provides convenience for the pledgor to dispose the pledge right.

- b) are there situations in which the rights of security providers should be limited or extended (e.g. if the security taker is authorized to dispose of existing licenses without involvement of the security provider)?

yes

Please explain:

Article 214 of the *Real Rights Law of the people's republic of China* stipulates, where a pledgee arbitrarily uses or disposes of the pledged properties within the duration of the pledge right, without the consent of the pledgor, and as a result of which the pledgor are damaged, the pledgee shall assume the compensation liabilities.

- 18) Are there any aspects of these laws that could be improved? Are there any other changes to your Group's current law that would promote transactions involving IPRs as collateral? If yes, please briefly explain.

yes

Please explain:

At present, our security interests over IPRs are stipulated separately in the *Real Rights Law of the people's republic of China*, the *Security Law of the People's Republic of China* and the related judicial interpretations thereof, the registration and issue concerning patent and trademark as collateral are also conducted by different administrative authorities. With more and more finance activities, from the viewpoint of information sharing, it is necessary to establish a specific law over the secured IPRs and implement the management under a unified government authority.

Furthermore, considering that the secured IPRs acts as a quasi occupancy, in order to promote transactions involving IPRs as collateral, the repledge with responsibility should be specified clearly by law to make the pledge of rights be repledged repeatedly.

### III. Proposals for harmonisation

- 19) Does your Group consider that harmonization of laws concerning security interests over IPRs is desirable?

yes

If yes, please respond to the following questions without regard to your Group's current law.  
Even if no, please address the following questions to the extent your Group considers your Group's laws could be improved.

Security system regarding IPRs

20) Should there be specific provisions regulating security interests over IPRs (i.e. separate from security interests over tangible property) generally?

yes

Please explain:

There are specific provisions regulating security interests over IPRs in our country.

21) If no, should there be general commercial law principles that also apply to IPRs? If not, why?

yes

Please explain:

There are specific provisions regulating security interests over IPRs in our country.

22) What types of security interests should be available as minimum standard in all countries?

In our country, pledge is the only type of security interests where IPRs is provided as collateral.

23) Should the law be applied differently depending on the type of IPR? For example, should patents be encumbered exclusively with pledges, should trademarks be assigned to the security taker for the purpose of security?

no

Please explain:

Our laws are not applied differently depending on the type of IPRs, but applied as the unified relevant laws (provisions) for IPRs. Whether a trademark should be assigned the security taker, it depends on further amendment to the laws according to the development and actual requirement to security interests where IPRs is provided as collateral.

Effect of security interests

24) Should the security provider be restricted in their right to use their IPR after providing a security interest over that IPR (e.g. in respect of their right to grant licenses, or to use the protected subject matter)? If so, how?

no

Please explain:

A security provider should not be restricted in his right to use the IPR after providing a security interest over the IPR, this would be beneficial for the security provider to fulfill his obligations. In accordance with the provisions of our current law thereof, without the consent of the security taker, a security provider may not assign or permit others to use the secured IPR. Restrictions for license should also be liberalized except for that the proceeds obtained from the license of the secured IPR shall be used for



preferential fulfillment of the obligations.

25) Should the security provider be able to assign encumbered IPRs to third parties?

yes

Please explain:

A security taker may not assign the secured IPR to the third party, unless otherwise agreed by negotiation between the two parties. The agreement needs to be specified in the clauses of the contract.

26) What should the rights of the security taker be before default (e.g. entitlement to damages, injunctions against infringers, or license fees)?

A pledgee of IPRs is entitled to the fruits (license fee) (Article 213 of the *Real Rights Law of the people's republic of China*), the right to transfer the pledge (repledge with agreement) (Article 217 of the *Real Rights Law of the people's republic of China*) and the right to seek preferential payments (Article 227, paragraph two of the *Real Rights Law of the people's republic of China*).

27) Should the security provider or the security taker be responsible for maintenance and defence of the IPR provided as collateral?

yes

Please explain:

During the term of IPR pledge, all the expenses for the maintenance of the IPR itself, such as the annual fee etc. shall be paid by the pledgor. In practice, the pledgee can also pay those expenses first, but under this circumstance, the pledgee is entitled to seek to recover the payments from the pledgor.

28) What should the legal consequences be if the underlying IPR expires or is revoked (e.g. the security right lapses simultaneously; creditor gains a compensation claim against security provider)?

Where a pledged IPR expires or is revoked, the legal consequences thereof shall be that the security right extinguishes, only the obligee's right which the secured amount acts as the subject matter exists.

29) Should it be possible to modify these effects of security interests over IPRs before default by contractual provisions?

yes

Please explain:

It is possible to modify these effects of security interests over IPRs before default by contractual provision, unless otherwise stipulated by the mandatory law provisions.

#### Applicable law

30) Which law should apply as to the availability and the effects of security interests where a foreign IPR is provided as collateral? Why?

So far, there is no specific law applies to security interests over foreign IPRs in our country, and the *People's Republic of China on Application of Law in Foreign-related Civil Relations* thereof applies to the adjustment of security interests where a foreign IPR is provided as collateral.

31) Should a choice of law provision in a security interest agreement over IPRs overrule the applicable law? If yes, why?

no

Please explain:

In accordance with the provisions of Article 40 of the *Law of the People's Republic of China on Application of Law in Foreign-related Civil Relations*, the parties may select applicable law provisions by selecting the place where the pledge is established to circumvent some current laws as to availability and effect, but may not overrule the current laws as to availability and effect.

#### Additional considerations and proposals

32) To the extent not already stated above, please propose any other standards your Group considers would be appropriate to harmonize laws relating to security interests over IPRs.

The criteria for assessing the secured IPRs and the review on the qualification of the assessing authorities should be considered.

33) Please comment on any additional issues concerning any aspect of security interests over IPRs you consider relevant to this Study Question.

Creation of the corresponding provisions on procedures and implementations of security interests over foreign IPRs or IPR portfolios containing foreign as well as national IPRs should be considered.

Please indicate which industry sector views are included in part “**III. Proposals for harmonization**” of this form:

Financial industry, security industry, appraisal industry, legal industry, government department.

#### Summary

In this report, our related laws concerning creation, perfection and effect of security interests over intellectual property are discussed respectively in three aspects as below,

In terms of current law and practice in our country, the creation of security interests over intellectual property is mainly based on the provisions of the *Real Rights Law of the People's Republic of China* and the *Security Law of the People's Republic of China*, which stipulate clearly the rights and obligations of a security taker and a security provider,

In terms of policy considerations and possible improvements to our current laws, not only the rights and obligations of the parties are stipulated in the provisions of the *Real Rights Law of the People's Republic of China* and the *Security Law of the People's Republic of China*, but an appropriate balance between the rights of a security taker and a security provider is also specified thereof. However, there still need to be further perfected, and creation of the corresponding provisions on specifications and procedures of security interests over foreign intellectual property or intellectual property portfolios

containing foreign as well as national intellectual property should also be considered,

In terms of proposals for harmonization , we have been considering the harmonization of laws concerning security interests over intellectual property, which still needs some time and procedures to be further perfected at the level of legislation.