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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:

Hungarian law provides for the possibility of creating security interests over IPRs, and with the growing startup company sector the establishment of security interests over such IPRs may be expected to become more widespread with the purpose of gaining financial support or attracting venture capital investors.

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)?

no

Please explain:

The corresponding regulation is defined by general commercial law principles, i.e. primarily Sections 5:84-144 of Act V of 2013 on the Civil Code (“**CC**”) on pledges and mortgages. These general provisions lay out the rules of the establishment and perfection of security interests, as well as the rights and obligations of the parties (i.e. security provider and security taker), while the particular provisions specific to IPRs (in the Trademark Act Sections 2, 46/C and 76/F, in the Patent Act Sections 25 and 53/C and in the Act on Registered Designs Section 21) are limited to issues on the recordal of such security rights in the respective databases of the Hungarian Intellectual Property Office (“**HIPO**”), as well as on payable fees. These specific IPR-related provisions are limited both in number and content, as well as in scope since they only extend to the regulation of pledges (mortgages).

- 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.

no

Please explain:

Only non-possessory pledge (hereinafter: pledge) is mentioned in the specific IPR Acts although various kinds of security interests are available under commercial law in Hungary. The law provides for the contractual establishment and subsequent registration of a pledge over IPRs. This type of security interest corresponds most closely to the institution of mortgage in the UK law and mortgage-lien in US law. Since the security right is established (perfected) by registration in the corresponding HIPO registry (and not by transfer of possession), Hungarian law construes the institution more to be a mortgage (*jelzálog*) than actually a pledge (*kézizálog*).^[1] This is notwithstanding the fact that recent legislation (especially the current CC in 2013) is generally understood as having facilitated the pledging of claims and certain kinds of rights and transfer of such pledges. One should note though, that a soon-to-be-expected amendment of the CC is very likely to affect exactly these rules and hence a certain degree of caution shall be taken at this point.

Assignment of the underlying IPR to the security taker is currently not possible under Hungarian law. This is partly because Section 6:99 of the CC explicitly prohibits the assignment or transfer of title of property, right or claim and the creation of option rights with the intent of providing security, and partly due to new provisions specific to the regulation of pledges (see below). There are however certain exceptions to this rule, of which financial leasing may be applied to the issue of setting up security interests over IPRs.

Though assignment before default is not available, the security taker does have certain rights to protect its interest prior to default (see Sections 5:109-110 of CC). Most important among these, and most relevant to the issue of IPRs as objects of pledge is probably the provisions which give him the right to exercise a certain degree of monitoring over changes in the value of the pledged property, claim, right (title). If a decrease in the value of the object threatens satisfaction of the underlying claim (or the guarantee thereof), the security taker may request, setting a reasonable deadline in such request to comply therewith, to restore said value or provide additional (supplementary) security, and even to effect sale of the pledged IPR in order to counter further deterioration of its value.

Footnotes

Footnotes

1. [^] *In the report we use the term 'pledge' (which would correspond to kézizálog in Hungarian) since its use is more widespread when discussing security interests over IPRs. On the other hand, the security right is established (perfected) by registration in the corresponding HIPO registry (and not by transfer of possession), which means that Hungarian law construes the institution more to be a mortgage (jelzálog).*

- 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:

Hungarian law provides for the realization of the security interest only in the event of a default on behalf of the security provider (i.e. when the claim secured by the pledge becomes due, provided that the security provider fails to perform). The pledged IPR in such an event could be sold, auctioned or purchased by the security taker as per the provisions of general commercial law. These rules provide for realization of the security interest either by way of initiating judicial enforcement proceedings, or by the available ways other than judicial enforcement (sale, auction, purchase).

The security taker's right to realize the security interest as per sections 5:127-138 of the CC (i.e. by means other than judicial enforcement) includes the right to sell the object of the pledge (CC section 5:134) by transferring its ownership to a third person in the name of the owner (i.e. the security provider).

The CC explicitly bans the use of contractual provisions which would entitle the security taker to gain the ownership of the object of the pledge (i.e. the IPR in question) in the event of a default by the security provider *ipso facto* (see section 5:136), but it does allow such transfer of property/right on the basis of the later agreement which the parties conclude after the occurrence of the event of default, and specify the purchase price for the transfer of the IPR and the setting-off with the actual amount of the debt.

- 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?

no

Please explain:

Use of the underlying IPR is not granted to the security taker by virtue of the establishment of the security interest (pledge or financial leasing). However, contractual arrangements between the parties may extend to such clauses or provisions, in which case the right to use may be entered into the respective registry kept by HIPO, as a licensee.

In case of liquidation, the liquidator, on behalf of the firm under liquidation, may use IPRs for the benefit of the creditors. Naturally, the liquidator's main task is to sell the IPRs.

- 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.

In view of the above, the security interest generally used in Hungary for IPRs is pledge.

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.

no

Please explain:

The security provider is not restricted in using the IPR after providing a security interest over that IPR, and the security provider is not prevented by the law from granting licenses.

The security provider is under a general obligation pursuant to CC to maintain the value of the security and not to jeopardise the sale of the security after the event of default (i.e., the security provider cannot conclude a license agreement which would jeopardise the sale of the security for a reasonable market price in the course of any enforcement).

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

yes

Please explain:

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)?

The transfer of the IPR shall be registered for registered IPRs. There are no statutory conditions for the transfer of an IPR even if it is encumbered.

The parties may exclude in their agreement that the security provider transfer the IPR with the security taker's consent only and register such restriction with HIPO. It is, however, not clear if such exclusion would be enforced by HIPO if the security provider did try to transfer the IPR notwithstanding the agreement with the security taker. If HIPO does not enforce the exclusion, HIPO records the transfer of the IPR and the security taker can only claim indemnity from the security provider.

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

yes

Please explain:

For IPRs for which registers are maintained, the security interest is effective vis-à-vis third parties if it is registered. A pledge is an *in rem* right.

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

The pledge will cover the licence fee paid by the licensor, as benefits ("fruits") of the security.

The security taker is not entitled to start actions in the case of an infringement. The enforcement can

be carried out by the right holder itself.

Nevertheless, if the IP holder starts an action and receives damages/unjust enrichment, the security taker (the creditor) may claim that the pledge covers this payment as well, as a benefit of the security. This statement is based on the broad interpretation of Art. 5:103(2) CC and 5:104(1) CC. This interpretation is not yet corroborated by court practice.

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

Unless otherwise agreed by the parties, the security provider (IPR holder) is responsible for the maintenance (i.e. payment of annual fees or the renewal fee). As the maintenance fee shall be paid by the security provider, the security taker is not even in the position to effect the payment on behalf of the security provider. The security taker can only request a renewal from the Hungarian Intellectual Property Office if the security provider grants a power of attorney.

In the cancellation/revocation action against the registered IPR, it is the security provider (IPR holder) which can act in the procedure to defend the IPR.

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.

If the IPR expires and there is no possibility for a renewal (in case of patents and designs), the creditor loses the security. It is not clear whether the creditor may request the debtor or the security provider to provide another security since the lapse of the IPR was foreseeable by the parties at the conclusion of the contract.

If the IPR expires by the security provider's failure to renew it or is revoked based on a third party action, the creditor may request the provision of additional security unless otherwise agreed by the parties.

In the case of EUTM, if the trademark holder converts the EUTM into national trademarks, it can be argued that the security taker is entitled to request that the security provider bears the costs of the conversion to national trademarks and the registering of the pledge.

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:

The parties are free to define the contents of the contract. However, any contractual provision cannot alter the nature of a pledge as an *in rem* right, in particular the effects of the pledge vis-a-vis third parties, and the creation of a pledge should be registered. The parties are free to agree on the scope of the pledge (i.e. who is entitled to receive the licence fee or damages from infringers), any events of default and the method of sale of the security in the case of an event of default, the cooperation of the parties if a revocation action is commenced, the obligation for the payment of maintenance fees, etc.

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?

no

Please explain:

There are no specific conflicts of laws rules in Law-Decree No. 13 of 1979 on International Private Law („**IPL**”) as to the availability and effect of security interests over IPR portfolios containing foreign as well as national IPRs.

In general, the parties are free to choose the applicable law of their contract. The provisions of IPL shall apply to the contractual obligations which are not covered by Regulation (EC) No. 593/2008 of the European Parliament and of the Council on the law applicable to contractual obligations. Section 29(1) IPL provides that the law of a contract shall apply to all elements of the contractual relationship, in particular, to the conclusion of the contract, material and formal validity, contractual effects, and, unless the parties agreed otherwise or unless otherwise implied by the provisions of this Law-Decree, to the agreements securing the contract.

Nevertheless, property rights, pledge and other *in rem* rights are governed by the law applicable at the place of the location of the asset (Section 21(1)). This rule is modelled on tangible assets or real properties, but it shall be applied *mutatis mutandis* to IPRs.

Further, in case of IPRs, as registered rights, we refer to the rules on jurisdiction: the Hungarian courts have exclusive jurisdiction:

- in proceedings in connection with registering, renewing or terminating industrial property rights in Hungary;
- in proceedings concerning the registration of rights, facts and data into official records in Hungary;
- in actions concerning enforcement in Hungary.

It follows that if the security is a portfolio of IPRs registered in different countries, the parties are free to set the applicable law, however the pledge shall be created in compliance with the law of the registration (it means that the perfection shall be carried out by the competent intellectual property offices) in order to have effect vis-à-vis third parties, and that the pledge can be enforced under this law.

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.

It is the law of the state where the IPR is registered which applies as to creation, perfection and effect of security interests over foreign IPR.

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:

No choice of law provision in a security interest agreement over IPRs overrules the applicable law as to availability and effect. Nevertheless, pursuant to the choice of law provision the parties are free to define their internal relationship (see response on the effects of securities in 12) above).

As set forth under 3), the new Civil Code explicitly prohibits the assignment or transfer of title of property, right or claim and the creation of option rights with the intent of providing security (Section

6:99). Although there is no case-law on this provision of the new Civil Code, it cannot be excluded that the court would consider an agreement on the full assignment of the IPR for security purposes as contrary to imperative rules and public policy.

Further, the application of the rules of bankruptcy and insolvency proceedings qualifies as public law from which no deviation is possible. Such rule is unaffected by the nationalities of the parties to the agreement or by the physical location of the assets involved.

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:

It is possible to create a solely contractual regime for security interests over IPRs under Hungarian law provided that the regime set up by the parties does not conflict with mandatory rules of Hungarian law (e.g. prohibition of fiduciary assignments (see also answer given to 3)a)), disguised and sham contracts, immoral contracts, contracts circumventing law, etc.).

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 existing regulatory framework regarding the provision of IPRs as security interest in Hungary is in general satisfactory as to substantive rules.

On the other hand, the lack of procedural rules specific to providing IPR as security creates uncertainty. For example, the pledge on IPR (similarly to mortgage for real property) is often linked with a restraint on alienation (and encumbrance), however, it is not clear if HIPO would register and enforce such restraints. It is not clear how ranking agreements (concluded between holders of security interests) would be enforced in the IPR registers.

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

Please explain:

Detailed rules on the restraint on alienation (and encumbrance) would be welcome in order to strengthen the position of security takers. Current rules only apply to tangible property and it is not clear if contractual restraints in respect of IPRs would be registered and enforced by the HIPO.

A right for the security taker to renew IPRs and/or defend IPRs against an invalidity/cancellation action should be considered if the security taker fails to do so.

A right for the security taker to enforce IPRs (against third-party infringement and/or conflicting third-party IPR applications) should also be considered if the security taker fails to do so.

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)?

no

Please explain:

No, the existing regulatory framework is satisfactory.

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.

no

Please explain:

The existing regulatory framework is satisfactory, we do not see here necessity for changes, in addition to proposals set forth in 17) above.

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:

In order to facilitate granting IPRs registered in different countries as security, it is desirable if the national laws are harmonized relating to the creation, perfection and effect of security interests over foreign IPRs. Nevertheless, we understand that the rules on pledge constitute the core of the civil law, therefore, harmonization is hard to achieve. As minimum harmonisation, we suggest harmonizing the rules on registering the security in the IPR registers.

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

no

Please explain:

N/a.

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

As minimum, the possibility of pledge on IPRs as security interest shall be available to the creditors and debtors.

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:

The same rules shall apply for all types of IPR. There is no reason to apply different rules since there is no difference relating to the legal nature of these types of IPRs.

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:

In view of the Hungarian Group, there is no need to restrict by law the security providers in their right to use or licence their IPR after they have provided a security interest over that IPR. It should be for the parties to define the contents of the contract in light of all the circumstances. Any restriction on use by the security provider would restrict the possibility to repay the loan from any profits arising from the use. For example, in the case of IPRs used for franchising, it follows from the nature of the IPR that the IP holder grants a license for the use of the IPR.

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

yes

Please explain:

Yes, unless otherwise agreed with the security taker (e.g. restraint on alienation). The transfer of the IPR does not affect the validity of the registered pledge.

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

In the view of the Hungarian Group, the security taker should have the right that the pledge covers the licence fee and damages, as benefits of their security.

A right for the security taker to enforce IPRs (against third-party infringement and/or conflicting third-party IPR applications) should also be considered. The security taker may invite the IPR holder to take appropriate action in order to stop the infringement, or start opposition. If IPR holder fails to take action within certain period of time (i.e., 30 days) from the invitation, the security taker recorded in the

respective IPR Register may institute proceedings for infringement in his own name, on its own cost. This is a solution similar to the exclusive licensee's right of enforcement.

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

yes

Please explain:

The parties will agree who has the obligation for the maintenance and defence. It is in the interest of the security taker to stipulate that, if the IPR holder fails to maintain the IP right, he/she may provide the payment to the competent intellectual property office.

A statutory right for the security taker to renew IPRs and/or defend IPRs against an invalidity/cancellation action should be considered.

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)?

If the creditor accepts IPR as security and the term of protection expires within a certain period of time, without the possibility of renewal (i.e. patent, design), the loss of the security is foreseeable to the creditor. Therefore the security taker should not be entitled to compensation.

On the other hand, if the IPR expires by the security provider's failure to renew it or is revoked as a result of third party's action, the creditor should be entitled to request another security (unless expressly excluded by the parties). Otherwise, the revocation of the IPR may be considered as an event of default.

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

yes

Please explain:

In the view of the Hungarian Group, the principle of contractual freedom should apply to pledge agreements relating to IPR. Nevertheless, a pledge is an *in rem* right. Therefore the parties' contractual provisions can be effective vis-a-vis third parties only if third parties are notified about the creditor's right (i.e. by registration).

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?

In view of the Hungarian Group, for foreign IPR the law of the state which registers the IPR shall apply as to the availability and the effects of security interests.

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

If yes, why?

no

Please explain:

There is no reason for establishing specific regime on applicable law in international private law rules for security interest agreement over IPRs.

If the security contains a portfolio with foreign IPRs, the situation is very similar as if the security covers a portfolio of real estates located in different countries.

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.

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

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

Summary

Hungarian law provides for securities over IPRs in the form of non-possessory pledge (hereinafter: pledge). The general provisions of the Civil Code on securities apply with a few procedural rules specific to IPRs. A full assignment of IPRs as security is prohibited. Security interests can only be realized in the event of default, the security taker is not allowed to gain the ownership of the pledge *ipso facto*. The security provider is not restricted in their use of the IPR, on the other hand, the security taker is not allowed to use the pledged IPR. Encumbered IPR is assignable. The security taker has few rights over the IPR: only the security provider can renew or enforce the IPR, however, parties are free to agree otherwise.

Hungarian law does not provide for specific conflicts of laws rules as regards as to the availability and effect or security interests over IPRs, these are governed by the law of the state of the registering authority.

The existing regulatory framework regarding the provision of IPRs as security interest in Hungary is satisfactory as to substantive rules. However, the Hungarian Group would strengthen the position of the security taker as to the maintenance and enforcement of the pledged IPRs. Moreover, certain procedural rules (e.g. on the enforcement of restraints on alienation and encumbrance) should be clarified.

The Hungarian Group would welcome harmonisation in order to facilitate granting IPRs registered in different countries as security.