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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:

Please refer to questions 2 & 3 for elaboration.

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:

Security interests can be defined and created both under general law as well as under the specific statute for certain types of IP.

Several commercial statutes, as elaborated hereinafter contemplate the creation of security interests

over intangible assets, further defining intangible assets to include IPRs. However, the creation of such security interests over IPRs is not expressly mentioned, merely the recordal thereof.

General Law:

Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (hereinafter 'SARFAESI Act')

SARFAESI Act deals with creation of security interests at or during the time of debt restructuring.

Property has been defined under Section 2(1)(t)(v) of the SARFAESI Act to include “intangible assets, being know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of any nature.”

Section 2(1)(zf) of the SARFAESI Act defines security interest to mean ‘right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment’ other than those specified in Section 31 of that Act.

The Companies Act, 2013

Chapter VI of The Companies Act allows a company to create a charge “*within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India...*”

Schedule III of the said Act titled as ‘GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET AND STATEMENT OF PROFIT AND LOSS OF A COMPANY’ classifies intangible assets under Clause (J) as under:

Clause (J): Intangible assets (i) Classification shall be given as: (a) Goodwill; (b) Brands /trademarks; (c) Computer software; (d) Mastheads and publishing titles; (e) Mining rights; (f) Copyrights, and patents and other intellectual property rights, services and operating rights; (g) Recipes, formulae, models, designs and prototypes; (h) Licenses and franchise; (i) Others

The Act, therefore contemplates the creation of charge, whether fixed or floating, on intangible assets which includes IP and reputation and goodwill associated therewith.

Any charges on IP assets must necessarily be registered with the Registrar of Companies within thirty days of their creation or else leave must be sought to register such charge within a period of 300 days.

Even otherwise, a person may create other types of security interests via contractual arrangements. The nature of such a security shall be governed by the terms of the contract.

The Designs Act, 2000:

Section 30(2) of The Designs Act specifically provides for the recordal of security interest created by way of mortgage, license, or other interest apart from assignment. Section 30 of the said Act states that when a person becomes entitled to by assignments, transmission or *other operation of law* to the copyright in a registered design, he may make application to the Controller to register his title, and the Controller shall, on receipt of such application and on proof of title to his satisfaction, register him as the proprietor of such design, and shall cause appropriate entry to be made in the register.

Further, the creation of such security interests must be in writing and necessarily communicated to the Registrar of Designs in the form prescribed being Form-12.

The Patents Act, 1970:

Section 69(2) of The Patents Act contemplates the recordal of security interests by way of assignment,

licenses, mortgage or any other interest in the patent. Section 68 further clarifies that the creation of such interest must be recorded in writing and communicated to the Controller of Patents. Specific Form-16 has been prescribed for this purpose.

The Trade Marks Act, 1999:

There is no specific provision prescribing creation/recordal of security interests/mortgage of trade marks. The only provision for creating the interest is by way of assignment of trade mark. Under Indian Law, assignment of trade mark can be conditional and/or time-bound. Therefore, parties may create security interests over trade marks for limited period of time and as per conditions agreed upon and thereafter re-assign such trade mark in lieu of security interest.

Section 37 of the said Act allows a proprietor of a registered or unregistered trade mark to assign his rights in said trade mark, either with or without the goodwill associated with such trade mark.

- 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:

Please refer to Question 2.

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:

Security takers may, in the event of the default of the security provider, sell/auction the secured IPRs (intangible asset), with or without the intervention of the Court as provided under both SARFAESI Act as well as The Companies Act.

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:

A security taker may be entitled to use the underlying IPR subject to the terms of the agreement or the nature of the instrument i.e. assignment/mortgage/charge etc. For instance, in case of assignment of trade mark, the security taker has all the rights of the registered proprietor and may successfully exploit the trade mark or assign the same further to third party for consideration.

- 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.

Trade Marks may be assigned by way of security as per the provisions of The Trade Marks Act. Under the Designs and Patents Acts, specific provisions are provided for the recordal of mortgage/interest created.

Apart from the specific statutes, security interests may be created on IPRs, being intangible assets, by virtue of hypothecation or charge created thereupon, under general law, as stated above.

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:

Any restriction on the right of the right holder/security provider to grant licenses, use the intellectual property, etc depends upon the nature and terms of the security interest agreement/document entered into between the parties.

Thus, in case of security interests created by way of assignment, the right holder/security provider for the limited period of time for which the IPR has been assigned, may not be able to exercise his rights. Conversely, in cases where the IPR has been mortgaged or a charge created thereto, the security provider may use or grant licenses to the IPR, subject to the terms of the agreement between the parties.

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

yes

Please explain:

The right of a right holder/security provider to assign encumbered IPR to a third party depends upon the nature of the instrument and terms of the security interest agreement entered into between the parties. Thus, in case of creation of security interest by assignment, since the IPR has been assigned to the security taker, the security provider would be unable to assign the rights thereafter, till the subsistence of such time-bound assignment.

In case where the IPR has been mortgaged or fixed charge is created thereupon, the security provider is free to assign the said IPR to third-parties. In practice, however, most agreements contain a clause which restrains the security provider from assigning the encumbered IPR to third parties, without securing no-objection from the security taker.

Conversely, in case of floating charges unless the charge converts into a fixed charge, the security provider may assign the IPR rights to third parties duly informing the security taker.

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)?

Consent from the security taker depends upon the terms of agreement between the security provider and taker. However, such terms are expected to be there. Assignment of encumbered IPRs may be subject to any conditions that may have been agreed upon by the parties in the security interest agreement. Practically, conditions such as prior consent and notice may be included in the agreement. Furthermore, fundamentally, any IPR being assigned has to be necessarily registered with the appropriate authority, which may ascertain whether the manner of assignment or transfer of interests is in accordance with law. For instance, the proviso to Section 69 of the Patents Act states that the Controller may refuse to register any assignment, license, mortgage or interest if there is a dispute between the parties, until the rights of the parties have been determined by a competent court.

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

yes

Please explain:

Whether the IPR can or cannot be encumbered with the original security interest, depends upon the value of IPR, quantum of charge created, outstanding realisation, guarantee/guarantor, nature of the instrument, terms therein etc.

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

Prior to any default, a security taker shall only have such rights as determined by the agreement between the parties, and as per the law under which the security interest has been created. If there are specific clauses authorizing the security taker to take action either alone or together with the security provider, so as to prevent the depreciation of the value of the IPR mortgaged/licensed/assigned etc. the security taker can take actions, including damages, injunctions, license fee etc.

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

The creation of a security interest in an intellectual property would not devolve responsibility upon the security taker unless the specific clause in the instrument is to that effect so as to maintain the value of the IPR on which the security interest is created. The security provider as well as security taker are interested to preserve the value of IPR if not its appreciation and therefore the onus of maintaining and defending the IPR ought to be fixed at the time of executing the instrument.

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.

The legal consequence on account of underlying IPR getting expired or revoked would entitle the security taker to demand realization of its outstanding, apart from encashing the guarantee or recovering the same either from the right holder/security provider or from the guarantor depending upon the terms of the instrument. The obligation to pay the creditor would survive the revocation or the lapse of the IPR and the security provider would be liable to pay the outstanding.

Similarly, in case of liquidation of the assets of a company or restructuring of assets of a company, registered charges are taken into account by the liquidator or the restructuring authority. The security

taker may realize his security, either with or without the intervention of the court depending upon the satisfaction of the realization of the security interest.

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:

As per general laws, Yes. The same will depend upon the terms of the instrument having such clauses. These may include options of prior consent before licensing/disposing off the IPR, extension of term of security interest, rights of the security taker in defending or maintaining the IPR 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?

yes

Please explain:

There are no legal provisions under the IP laws. However, under the common law principles to resolve the conflict, the Courts may look into various factors, such as “closest and most real connection test”, the place where the contract was made, place of performance, place of registration of the subject matter IP and the applicable law thereto etc. apart from the factor that if the instrument itself was contrary to the law prevailing in the country, the same is *void ab initio* and non-executable.

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.

Though The Companies Act, as elaborated at Question 2, does provide for intangible assets outside India upon which charge can be created, it depends upon the factor that the beneficiary of such intangible assets must be in India, under the Indian jurisdiction on which such Act would apply. Additionally, the IPR outside India being worked outside India must be sufficiently valued and the security provider/right holder being Indian national is the lawful recipient of the benefits of the IPR and the same is not in conflict or under prohibition under the laws of the foreign country where the IPR is being worked.

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. While Courts in India are generally respectful of the choice of law provisions between the parties, the same must be legal, *bona fide* and conform to the public policy of India. By way of illustration, choice of law would not allow parties to create a mortgage on a patent registered in a jurisdiction, the law whereof bars the creation of such mortgage.

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:

However, such contracts cannot be used to circumvent any other laws in operation or the provisions of the Indian Contract Act, 1872 itself.

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?

no

Please explain:

We believe the law is multi-layered and ambiguous at the moment and requires clarity. Creation of security interests over IPRs is not as prolific in India as in some other jurisdictions and clarifying and consolidating the law would assist both right holders and creditors to successfully exploit the potential of their IPRs. The first step is an impartial and independent valuation of the IPR and public disclosure thereof.

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:

Currently, the rights are governed under the general law and purely depend on the terms and conditions and principles governing the validity of such agreements. We believe that the law could benefit from clarifications in several general laws by incorporating specific provisions with respect to IPR, its valuation and the same treatment as other forms of capital/assets. As of now, parties to a security interest agreement are free to work out the terms of the agreement to their mutual benefit and interest and thus create a balance for themselves.

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:

N/A. Refer to 17(a)

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:

We believe that the law could greatly benefit if the concept of creating security interest over IPRs is embodied in the specific statutes as well, leading to greater clarity and awareness. We note that the 2016 National IPR Policy, announced by the Government of India on 12.05.2016 does envisage the use of IPR as collateral and proposes to take steps in order to create the necessary legislative, administrative and market framework. It would be highly conducive if the said policy is given effect shortly.

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:

All IPRs are essentially intangible rights. The existing framework of laws and regulations seems primarily to have been prepared keeping in mind tangible assets which differ from IPR in many respects. A specified and defined regime would assist rights-holders in creating another form of value for their IPRs.

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

no

Please explain:

N/A. Refer to Question 20

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

As a minimum, right holders should be able to create some form of registrable security interest over their IPRs.

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?

yes

Please explain:

Different IPRs have different lifetimes and value thereof may increase or decrease with the passage of time and at different points of time during the life of the IPR and therefore may require different forms of security interest to adequately exploit the underlying IPR. However, a balance is required to keep the legislation simple and friendly to security providers and security

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:

The very idea of creating security interest is not to part away with the IPR forever. The entire concept is that if the need be the value of IPR built up/created by the right holder/security provider be encashed to its advantage. The value of IPR can be best preserved and exploited by the right holder/security provider. The security taker's interest is limited to the realization of the credit given and therefore, if the right holder is not allowed to exploit the IPR, the optimization of the IPR and realization thereof would be restricted to the disadvantage of both the security provider and the security taker. Some of the IPR which have limited lifespan such as patent, if made stagnant on account of limitation i.e., not worked or licensed, can be highly prejudicial. Subject to conditions that adequately redress the security takers concerns for realization of debt, parties may be free to agree upon the terms of use of the IPR.

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

yes

Please explain:

Provided there is notice and/or consent of the security taker. In certain cases, an encumbered IP may be transferred to a third party in order to prevent default in repayment or lapse of the underlying IP or to optimize the IPR to the advantage of both the security provider and the security taker.

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

The objective should be protection and preservation of the underlying IPRs. Such rights should be defined and created under the agreement between the parties and should be with the mutual consent.

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 responsibility for maintenance and defence of the IPR provided as collateral should be the responsibility of both the security provider and security taker.

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)?

The security provider shall be either made responsible to pay the outstanding or supplement the security taker with another asset/IPR matching the shortfall of security.

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

yes

Please explain:

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?

The governing law should be the law of the country where the IPR subject matter of the security interest is created.

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

no

Please explain:

Please refer to Question 30.

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.

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

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

Summary

The law pertaining to creation of security interest over IPRs is as yet nebulous in India. There is a lack of awareness and clarity both as to the procedure and scope and extent of this field.

The procedure for the creation of security interest over IPR does not find mention in the specific IP statutes but rather stems from general commercial and contractual laws. IP statutes are either silent on the subject (The Trade Marks Act) or mention merely the recordal of such an interest (The Patents Act and The Designs Act). General laws such as The SARFAESI Act and The Companies Act envisage the creation of security interest over IPRs on the premise that the same are intangible property/assets. Further, such security interests are governed largely by the agreement between the parties under The Contract Act, thereby at once according greater freedom and greater uncertainty to the parties.

It is the need of the hour that a special legislation is created in line with existing laws especially for IPR. The same will encourage innovation and creativity inspiring confidence amongst SMEs to come forward and create capital/assets in the form of IPR which can be utilized for further future investment.