PRESERVING LICENSEE RIGHTS WHEN LICENSOR ENTERS BANKRUPTCY

This paper was created by the authors for the Intellectual Property Owners Association International Patent Law and Practice Committee to provide background to IPO members. It should not be construed as providing legal advice or as representing the views of IPO.

Executive Summary

Qimonda AG, a major German semiconductor manufacturer, filed for insolvency in Germany in 2009. That bankruptcy filing gave rise to the question of whether a bankrupt or insolvent debtor in a foreign country can terminate patent and other IP licenses in the United States. The U.S. bankruptcy code specifically allows a licensee to retain its IP license rights when a bankrupt licensor seeks to reject an executory license agreement. See 11 U.S.C. § 365(n). The bankruptcy laws of some countries, however, including Germany and other key jurisdictions, do not have specific provisions relating to IP. Those jurisdictions provide bankrupt licensors greater freedom to revoke rights previously granted under executory license agreements without 365(n)-like protections for licensees.

In the Qimonda AG insolvency, the insolvency administrator sought to terminate scores of license agreements, including many that were fully paid. Pursuant to a 2011 U.S. bankruptcy court ruling, U.S. licensees of Qimonda AG were able to retain their rights under Qimonda AG’s U.S. patents. However, that outcome is currently on appeal and the licensees’ rights under patents in other jurisdictions remain uncertain.

The Qimonda cases have called attention to the vulnerability of licenses from non-U.S. licensors and have caused companies both inside and outside IPO to revisit their approach to international licensing and risks under existing licenses.

Under the current state of the law, a non-U.S. licensor is free to seek bankruptcy or similar protection outside the U.S. (typically in its center of main commercial interest (“COMI”), such as where it is headquartered or where it is incorporated). In such a proceeding, the laws of the local jurisdiction may be applied to determine the powers of the bankrupt entity, or its administrator, to reject or disclaim executory agreements, including license agreements, and seek to cut off the licensee’s right to practice the licensed IP. The debtor-licensor may or may not also commence ancillary proceedings in jurisdictions outside its COMI. Where the main proceeding is brought outside the U.S., the ancillary jurisdictions may, before applying the COMI laws,

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consider the public policy effects of actions in the COMI proceeding. However, assessing the
effect of a license rejection in countries other than the COMI jurisdiction is complex, may be
intensely fact-dependent, and may require analysis under the laws of multiple countries.

Accordingly, there is no current “perfect” way for a licensee to take a license from a non-
U.S. licensor and be guaranteed that its license rights will be protected if the licensor files for
bankruptcy in a COMI in certain countries outside the U.S.

Analysis

This analysis discusses the background of the “license preservation” issue (including
cases and legislation and effects of authorized license termination following an insolvency), and
the risks to, and adverse impact on, companies (inside and outside IPO), industries, patent value,
technology licensing and sharing, technical standards, and economic growth that such forfeitures
and uncertainty would cause. The analysis concludes with actions IPO might consider taking.

1. Background

a. Bankruptcy and Intellectual Property Perspectives

In considering “license preservation” in bankruptcy, it should be appreciated that the IP
community and the bankruptcy law community see the matter through different lenses. The IP
community recognizes the importance of sharing technology (especially in fields where multiple
competitors conduct R&D and invest in patents), providing certainty in license arrangements so
that patent (and other IP) value can be effectively assessed, and driving economic growth and
corporate value. Some in the bankruptcy community are often focused on the prompt gathering
and liquidation of assets, and the distribution of proceeds to creditors in a reasonable, expeditious
manner based on their priority. While the interests of creditors and other parties are considered,
interests of IP licensees have often been inadequately recognized by the bankruptcy law
community.

In general, for a debtor-licensor, the bankruptcy system provides a meaningful
opportunity to reorganize and make a fresh start, such as by not compelling the debtor-licensor to
accept an executory contract\(^1\) that is burdensome to the estate or which drains the estate at the
expense of the debtor-licensor and creditors.\(^2\) In many instances, the right to reject an executory
contract based on the trustee’s sound business judgment may enable the debtor-licensor to obtain
more money by entering into a new contract with another party, the new contract thereby
benefiting the estate and its creditors.\(^3\) Exceptions to the right to reject executory contracts have
included real estate leases, collective bargaining agreements, and employee benefit agreements.\(^4\)

b. *Lubrizol Case*

Prior to the early 1980s, the U.S. bankruptcy law did not contain strong protections for IP
licensees. Indeed, in one high-profile case, *In re Richmond Metal Finishers, Inc.*\(^5\), the
Bankruptcy Court focused almost exclusively on the viewpoint of the debtor-licensor to the
detriment of an IP licensee, applying the “business judgment” test, and stating that the primary
concern of the court was the benefit to the estate and to the unsecured creditors.

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\(^1\) See 11 U.S.C. 365(a).
\(^3\) Id.
\(^4\) Id.
In Richmond, the Court allowed a debtor-licensor to reject a non-exclusive license agreement to allow the debtor-licensor to sell or license the technology free and clear of the license, based on the debtor-licensor’s assertion that the existence of the non-exclusive license was hindering post-petition efforts to sell or license the technology. The Court found that the trustee, in rejecting the contract, was exercising “sound business judgment” for the benefit of the debtor’s estate. The Court dismissed the licensee’s concerns simply by stating that the licensee had a remedy for breach of contract to file a timely proof of claim and share in any distribution with other pre-petition creditors, ignoring (1) the likelihood that the estate, even if it entered a more advantageous license, might not be able to satisfy the creditors (including the licensee) and (2) the existence of any non-monetary damages (e.g., damage to goodwill). The Court also found that public interest concerns did not apply, aside from helping to reorganize debtors and to providing them with a “fresh start”.

On appeal as Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., the Fourth Circuit likewise rejected the policy concerns raised by the licensee and upheld the rejection of the contract. That case drew intense criticism and ultimately resulted in a Congressional amendment to the Bankruptcy Code, 11 U.S.C. § 365(n), a provision aimed at allowing IP licensees to preserve their rights subject to certain conditions.

c. Enactment of Section 365(n)

Section 365(n) of the U.S. Bankruptcy Code was enacted in 1988, just three years after the Lubrizol decision. The legislative history of that provision contains extensive discussion of the need to balance the rights of debtor-licensors and licensees and the value of IP licenses that may be retained even in the face of a rejection effort by a debtor-licensor. Supporters of the Congressional bills that led to the adoption of section 365(n) were drawn from both the bankruptcy bar and the intellectual property bar once both communities became aware of the intersection of the two areas.

The Senate Report accompanying the enacted version of section 365(n) specifically noted that Lubrizol “leaves licensees in a precarious position” by “subject[ing] the licensee to the risk that, upon bankruptcy of the licensor, the licensee would lose not only any future affirmative performance required of the licensor under the license, but also any right of the licensee to continue to use the intellectual property as originally agreed.” The ability of a party in bankruptcy to elect non-performance of intellectual property licensing agreements was, according to the Senate Report, a “fundamental threat to the creative process that has nurtured innovation in the United States.” The passage of section 365(n), as noted by one commentator, avoided the “unjust results” of Lubrizol and the risk of “financial ruin” to many businesses.

Both the Senate Subcommittee on Courts and Administrative Practice of the Senate Committee on the Judiciary and the House Subcommittee on Monopolies and Commercial Law

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7 In re Richmond Metal Finishers, Inc., 36 B.R. at 272-274.
of the House Committee on the Judiciary heard testimony from numerous sources regarding their respective bills (S. 1626 and H.R. 4657, respectively).\textsuperscript{14}

Thomas M.S. Hemnes, Esq., an attorney at Foley, Hoag & Eliot and a lecturer at Northeastern University School of Law submitted statements before both Subcommittees, solely on his own behalf and not as a representative of any interested group or client, in opposition to the respective bills.\textsuperscript{15} In his statements, Mr. Hemnes argued that the bills would create substantial inequities by abrogating the principle of mutuality of obligation, such as with respect to cross-licensing, and would result in a “sweetheart deal” for licensees; that the bills were “overbroad” and ignored more complex types of arrangements, such as distributorship agreements and joint research and development ventures; and that the proposed bills would jeopardize rights in intellectual property and chill sublicensing by preventing the owner of the technology from protecting its technology in the hands of sublicensees.\textsuperscript{16} Instead, he proposed two alternatives – either to do nothing and allow the issue to work itself out within existing bankruptcy proceedings, or preferably, to provide the licensee with an option of retaining its rights under a simple, nonexecutory license only where the parties have already incorporated such a license into their business relationship under certain criteria.\textsuperscript{17} Mr. Hemnes alleged, for example, that a licensee that elected to retain its rights would be excused from any obligation other than the obligation to make royalty payments, but that “even this obligation may be subject to the defense that the debtor is materially in default of its obligation.”\textsuperscript{18}

In response to Mr. Hemnes, it was stated that (1) in circumstances in which the license benefited the estate, the bankruptcy trustee would be likely to maintain it; and (2) in situations in which the trustee rejected the deal but the licensee exercised the option to maintain it, the licensee would still have the obligations (e.g., payment of royalties) and could not use breach of contract


\textsuperscript{17} A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 282-321 at 293-295 (1988) (statement of Thomas M.S. Hemnes, Esq.) and A Bill to Amend the Bankruptcy Laws with Respect to Rejection of Intellectual Property Licenses: Hearing on H.R. 4657 Before the H. Subcommittee on Monopolies and Commercial Law of the H. Comm. on the Judiciary, 100th Cong. 39-42 (1988) (statement and remarks of Thomas M.S. Hemmes, Esq.). Under this proposal, such a “Protected Right” would have the following criteria: “a nonexclusive…right to use or to license others to use intellectual property owned by the licensor under which the licensor’s only substantial executory obligation is to permit the licensee to exercise such right and the only grounds on which such right may be terminated are the licensee’s failure to make payments or failure to protect the property against the loss or misappropriation (e.g., by failing to place appropriate copyright notices on copies of the property or by failing to comply with nondisclosure or noncompetition obligations).” A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 282-321 at 293-294 (1988) (statement of Thomas M.S. Hemnes, Esq.).

\textsuperscript{18} A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 282-321 at 286-288 (1988) (statement of Thomas M.S. Hemnes, Esq.).
as a defense to forego its obligations while exercising rights to the intellectual property in question. As one supporter of the legislation noted:

Those who have argued that the legislation is unnecessary usually suggest that the problem will be cured through a better balancing of equities between the debtor-licensor and licensee, pointing to a minority of courts which have expressed willingness to weigh hardship caused to the non-debtor party in determining whether to permit rejection. This is unpersuasive. Only a minority of courts have been willing to consider the impact on the non-debtor part. The prevailing view is to the contrary. Even if courts were willing to weight the rights of the non-debtor party, that alone will not change the outcome in most cases. Rejection often is necessary in order to relieve the Debtor of its burden of future performance. The primary problem lies not with rejection, but with the exaggerated effects of rejection under the Lubrizol decision, which would strip the licensee of rights he acquired prior to the licensor’s bankruptcy.

As another supporter of the legislation pointed out, in the absence of the legislation, the real “sweetheart deal” would belong to the licensor under Lubrizol, namely, “the right to sell a second time that which was in every practical and business sense, transferred in good faith prior to its bankruptcy filing.”

In general, a number of arguments were reiterated in the legislative history in favor of section 365(n)’s adoption:

• Until Lubrizol, the licensing system, as it has developed in the United States and in international trade, has not usually been viewed by the business world as creating a debtor-creditor relationship.

    Because intellectual property is inherently unique, licensees are unlike other contracting parties. The licensor’s status as the sole source of the intellectual property is derived from non-bankruptcy statutes.

19 A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 324-351, especially 330-331 and 340-343 (1988) (statement of John L. Pickitt on behalf of the Computer and Business Equipment Manufacturer’s Ass’n [CBEMA] and statement of George A. Hahn on behalf of the National Bankruptcy Conference).
20 A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 332-351, especially at 343 (1988) (statement of George A. Hahn on behalf of the National Bankruptcy Conference).
21 A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 324-351, especially 330-331 (1988) (statement of John L. Pickitt on behalf of the Computer and Business Equipment Manufacturer’s Ass’n [CBEMA]).
23 A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 324-351, especially 325 (1988) (statement of John L. Pickitt on behalf of the Computer and Business Equipment Manufacturer’s Ass’n [CBEMA]).
24 Id.
25 Id. In the United States, these sources include the U.S. Constitution. Id. See U.S. Const., Art. I, Sect. 8, cl. viii.
As a result, prior to Lubrizol, the licensor and licensee were not generally viewed as debtor and creditor, respectively. Instead, the intellectual property license was considered to be a flexible vehicle for dividing and transferring various rights in the intellectual property. In some instances, licensees have even had significant input in the development of the technology.

- Decisions like Lubrizol lead to uncertainty over intellectual property rights and to instability in licensing relations.

Rejection of contracts strips licensees of their right to continue to use the licensed technology. Under the “business judgment” rationale of Lubrizol, courts will nearly always permit unilateral rejection of the intellectual property license by the debtor-licensor, because valuable rights may revert to the bankruptcy estate, rather than having to be shared with the licensee. As a result, the innocent licensee will be stripped of rights central to the operation of an ongoing business, and the licensing system will be stripped of its dependability and flexibility.

As noted by Senator DeConcini,

[Lubrizol] terminates the licensee's use of one-of-a-kind technology without regard to the business that has been built around the technology. Intellectual

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26 A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 69-77 and 80-89 (1988) (statement of John L. Pickitt on behalf of the Computer and Business Equipment Manufacturer’s Ass’n [CBEMA]).

27 Id.

28 Id.


property is inherently unique -- by definition it cannot be replaced or purchased elsewhere.\textsuperscript{34}

The licensee is, therefore, left in a precarious position of having to compete (such as against its competitors) for a new license to the technology on which its business has been built.\textsuperscript{35} Where the licensee’s business is dependent on the license and the licensee’s field is competitive, the licensee may be forced to pay a much higher amount for the license.\textsuperscript{36} Failure of the original licensee to obtain a license may lead to failure of the original licensee’s business.\textsuperscript{37} As noted by one commentator, rejection of the license would force a licensee “either to surrender their licensed [technology] or perhaps to pay a second time for what they already purchased during the original license transaction.”\textsuperscript{38}

If the original licensee is forced to take a non-exclusive license in place of a previously exclusive license, then the original licensee’s competitors, who have made no prior investments, may reap rewards of a technology field in which the original licensee had previously made substantial investments in promoting products developed using the technology.

Because intellectual property, like real estate, is unique, it may not be possible for the original licensee to obtain a substitute.\textsuperscript{39} Monetary damages, even if the bankrupt estate of the debtor-licensor can eventually pay them, will not usually provide adequate compensation.\textsuperscript{40} The potential failure of a second company (i.e., the licensee) due to the failure of the debtor-licensor and its subsequent rejection of the contract is not a focus of the bankruptcy laws.\textsuperscript{41}

\begin{itemize}
\item \textsuperscript{34} See 134 Cong Rec S 12993 (1988) (statement of Sen. DeConcini).
\item \textsuperscript{37} 134 Cong. Rec. at H9303-9304 (1988) (statement of Rep. Fish).
\item \textsuperscript{38} A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100\textsuperscript{th} Cong. 352-354 at 353 (1988) (statement of Richard J. Wall, Jr., Esq., on behalf of Cerner Corporation).
\item \textsuperscript{39} See 134 Cong Rec S 12993 (1988) (statement of Sen. DeConcini). This situation has been compared to that of a real estate lessee. See, e.g., In re Richmond Metal Finishers, Inc., 38 B.R. 341, 343 (Bankr. E.D. Va. 1984); 134 Cong Rec S 12993 (1988) (statement of Sen. DeConcini); and A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100\textsuperscript{th} Cong. at 326 and 339-340 (1988) (statement of John L. Pickitt on behalf of the Computer & Business Equipment Manufacturers Ass’n [CBEMA] and statement of George A. Hahn on behalf of the National Bankruptcy Conference).
\end{itemize}
 deciding that *Lubrizol* would have a chilling effect on transactions involving intellectual property and on the development of technology.\(^{42}\)

The resulting uncertainty over whether a licensee would be able to use the technology in the event of bankruptcy and subsequent rejection by the debtor-licensor would discourage licenses in favor of outright assignments.\(^{43}\)

Licenses are generally less expensive and more flexible than assignments.\(^{44}\) They may be exclusive or non-exclusive, and they may be limited in scope of use or in geography.\(^{45}\) Smaller business and non-profit organizations may be better able to license, rather than to purchase, needed technology and licensing often provides start-up companies with an early revenue stream for funding further research and development projects and can allow an inventor to share in the profits.\(^{46}\) Limitations on use or geography may enable the licensor to grant multiple non-exclusive or non-exclusive, and they may be limited in scope of use or in geography.\(^{45}\) Smaller business and non-profit organizations may be better able to license, rather than to purchase, needed technology and licensing often provides start-up companies with an early revenue stream for funding further research and development projects and can allow an inventor to share in the profits.\(^{46}\) Limitations on use or geography may enable the licensor to grant multiple non-

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exclusive licenses, which in turn can enable licensees in different fields to use the licensed technology as a means of developing various distinctive new technologies or applications. Society derives a benefit from the security of license agreements, because it increases the number of companies taking advantage of innovative or cost-saving discoveries.

In addition, the licensor would be able to retain rights to the technology for further development and could share in the rewards of licensed technology, both of which could benefit not only larger licensors, but also small licensors and individual inventors.

Assignments are usually more expensive than licenses since they typically require payment of the full purchase price upfront whereas a license typically involves a percentage of the selling price and is therefore paid out of the profits from using the technology. As one commentator noted:

Outright purchase of the technology by the licensee could avoid the problems of rejection in bankruptcy. However, new enterprises frequently are unwilling to sell their intellectual property outright, because it may be the enterprise’s most important asset. It is often difficult to place a realistic monetary value on the intellectual property for sale when it involves discoveries or technology which have not been tested extensively or marketed and whose practical applications are yet to be fully explored. The prospective licensee may wish to exploit the intellectual property in only a single field of use and therefore be unwilling to pay a price higher than is warranted for that single field of use….The intellectual property is not static but often a continuous flow of cumulative developments and refinements to which the licensee is given access. Breaking up these accumulations into segments for outright sale may pose special problems. For all of these reasons the parties frequently disfavor outright sale, because it lacks all of
the flexibility, variety, and multi-purpose effects achievable through the medium of licensing agreements.\footnote{A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 332-360 especially at 338, 353-354, and 356 (1988) (statement of George A. Hahn on behalf of the National Bankruptcy Conference).}

The shift to higher cost assignments would have an adverse impact on small businesses and non-profit organizations.\footnote{S. Rep. No. 100-505, at 3201-3203 and 3209 (1988) (to accompany S. 1626 for P.L. 100-506), which became 11 U.S.C. 365(n). See also, A Bill to Amend the Bankruptcy Laws with Respect to Rejection of Intellectual Property Licenses: Hearing on H.R. 4657 Before the H. Subcommittee on Monopolies and Commercial Law of the H. Comm. on the Judiciary, 100th Cong. 16-24 (1988) (statement of James Burger on behalf of Apple Computer, Inc.) and A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 224-234 and 324-331 (1988) (statement of John L. Pickitt on behalf of the Computer & Business Equipment Manufacturers Ass’n [CBEMA]).} Even a large company might find an assignment unattractive, not only because of cost, but because ownership may provide more rights than it desires.\footnote{S. Rep. No. 100-505, at 3201-3203 and 3209 (1988) (to accompany S. 1626 for P.L. 100-506), which became 11 U.S.C. 365(n). See also, A Bill to Amend the Bankruptcy Laws with Respect to Rejection of Intellectual Property Licenses: Hearing on H.R. 4657 Before the H. Subcommittee on Monopolies and Commercial Law of the H. Comm. on the Judiciary, 100th Cong. 16-24 (1988) (statement of James Burger on behalf of Apple Computer, Inc.) and A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 224-234 and 324-331 (1988) (statement of John L. Pickitt on behalf of the Computer & Business Equipment Manufacturers Ass’n [CBEMA]; and statement of George A. Hahn on behalf of the National Bankruptcy Conference).} If an IP owner could offer only assignments instead of licenses, it may not be able to maximize its return through selling different “slices” of rights to multiple parties (or through taking payment in the form of running royalties), which could result in it being undercompensated for its patents.\footnote{A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 224-234 and 324-351 (1988) (statement of John L. Pickitt on behalf of the Computer & Business Equipment Manufacturers Ass’n [CBEMA]; and statement of George A. Hahn on behalf of the National Bankruptcy Conference).} Reliance on assignments would not help in situations in which an assignee cannot be found or in situations in which the assignor is unwilling to assign, because the assignor wants to retain some rights.\footnote{A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 224-234 and 324-351 (1988) (statement of John L. Pickitt on behalf of the Computer & Business Equipment Manufacturers Ass’n [CBEMA]; and statement of George A. Hahn on behalf of the National Bankruptcy Conference).}

Potential licensors would face the choice of granting an assignment of all or some of the rights, with its problems; licensing the technology, in which licensees would factor in the risk of termination; or creating an alternative device, such as a trust.\footnote{A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 224-234 and 324-351 (1988) (statement of John L. Pickitt on behalf of the Computer & Business Equipment Manufacturers Ass’n [CBEMA]; and statement of George A. Hahn on behalf of the National Bankruptcy Conference).} As one commentator stated:

Such devices are not risk-free, however. And their failure could force licensees either to surrender their licensed [technology] or perhaps to pay a second time for what they already purchased during the original license transaction.\footnote{A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the U.S. Code, the Bankruptcy Code: Hearing on S. 1626 Before the S. Subcommittee on Courts and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 224-234 and 324-351 (1988) (statement of John L. Pickitt on behalf of the Computer & Business Equipment Manufacturers Ass’n [CBEMA]; and statement of George A. Hahn on behalf of the National Bankruptcy Conference).}
Factoring in the risk of termination of a license would result in under-compensation or other measures detrimental to licensors.\textsuperscript{57} Overall, U.S. companies with patents would have difficulty in licensing patents with the added risk resulting from a \textit{Lubrizol}-type termination.\textsuperscript{58} Were the \textit{Lubrizol} view to prevail, it would have a particularly negative effect on smaller corporations, non-profit organizations, individual inventors, and entrepreneurs in higher risk fields and ultimately, could result in discouragement to invest in, develop, commercialize, or reward worthwhile technologies.\textsuperscript{59} In general, this situation would have a negative impact on the economy.\textsuperscript{60}

- Decisions like \textit{Lubrizol} jeopardize United States licenses in the world market, discourage full development of intellectual property in the worldwide marketplace, and could have a negative impact on the status of the United States as a leading innovator.\textsuperscript{61}

Although \textit{Lubrizol} was the decision of a United States court, its ramifications were perceived by U.S. experts, industry representatives, and legislators as having a broader potential impact, particularly in an era with a worldwide technology marketplace.\textsuperscript{62} If other countries adopted laws analogous to \textit{Lubrizol}, the adverse effects on licensing, patent value, and economics would be multiplied across borders.


\textsuperscript{62} Id.
As a result, after Lubrizol, many were concerned that these factors would decrease the ability of U.S. businesses to compete in an international marketplace and would also jeopardize existing licenses in the U.S. and globally. For example, small companies, start-up companies, and inventors do not have the ability to serve foreign markets, and the uncertainty of post-Lubrizol licensing would undercut their ability to compete in the international marketplace. This uncertainty could have put all U.S. companies at a disadvantage in the international marketplace, if foreign potential licensees were to view licenses from U.S. licensors as capable of being rejected in the event of bankruptcy by the U.S. licensor. Indeed, it is not difficult to imagine that licenses from a country following a Lubrizol-type rule would be viewed as having less potential value than those from a similarly situated country having a section 365(n)-type statute.

In the words of one commentator:

If inventors cannot raise capital through licensing, but are left with only the alternative of selling their inventions, it will be a major disincentive for many inventors and will disrupt well-established, international techniques of financing research and development. The possibility that some very small, prospectively unidentifiable percentage of licensors may resort to bankruptcy should not lead to the unraveling of the licensing system which promotes faster and fuller development of the ideas of [the] creative segment of the U.S. economy. Licensing is now a fully understood tool in international trade. Moreover, it is not desirable to create a legal environment where non-U.S. parties seeking a technology transfer insist upon an assignment of U.S. technology, rather [than] accepting a license. This could lead to expatriation on a significant scale of U.S. technology and ideas.

Moreover, as noted by Senator DeConcini in the legislation’s history, “In addition, this quirk in the bankruptcy law threatens American licensors competing in the international marketplace. Uncertainty over the law jeopardizes American technology licenses in the world market.”

As a result, it can be argued that 11 U.S.C. 365(n) was enacted in part to encourage full development of U.S. intellectual property in a worldwide marketplace, to foster development of
technology and ideas in the United States, and to maintain the position of the United States as a leader in the area of new technology development.\(^{67}\)

Overall, 11 U.S.C. 365(n) balances the rights of the debtor-licensor with those of the licensee and leads to a compromise between the competing interests of the licensee and the debtor-licensor. This compromise is premised upon the uniqueness of intellectual property. Thus, U.S. bankruptcy law, after a period of uncertainty, has provided strong protections for IP licensees for over 25 years while recognizing the value of patents made available by licensors. That balanced model has not, however, been mirrored in other countries.

d. Bankruptcy Laws in Other Countries

Debtors with assets in multiple countries may have discretion as to where they commence bankruptcy or insolvency proceedings. In general, the impetus for any such filing is to obtain protection from adverse actions by creditors and the location(s) in which such protection is needed will be an important factor in choosing where to file. Any country in which a case is filed may grant the administrator or trustee the right to affect contracts to which a debtor in that country is a party, regardless of the location of the counterparty.

The starting point of the analysis as to whether a licensee may lose rights under a particular contract is thus under the laws of the jurisdiction in which the insolvency or bankruptcy proceeding is pending. If that country does not allow for rejection (or permits the licensee to elect to retain its rights), the inquiry generally stops there. However, if that country allows for rejection, the laws of the jurisdictions in which the licensee wishes to retain its rights must also be analyzed to determine whether that country will extend comity and defer to actions pursuant to the other country’s proceedings.

As briefly described below, key non-U.S. jurisdictions have widely different rules with respect to the right of a debtor-licensor to reject its license agreements:

- In Germany, where Qimonda AG’s bankruptcy case was first initiated, courts have held that companies in insolvency proceedings may reject executory contracts, including executory license agreements, but not including agreements as to which one party has fully performed. Under section 103 of the German Insolvency Code, a debtor may terminate a licensee's right to use the debtor's patents, which would appear to essentially put the licensee in the same legal environment as in the U.S. after *Lubrizol* and before the passage of section 365(n).

  With respect to *Qimonda*, a parallel case of *Infineon Technologies AG v Jaffe*,\(^{68}\) has progressed in a German court. Infineon, the parent from which Qimonda AG was spun out, has argued that its license with subsidiary Qimonda AG and licenses to other parties granted through the agreement forming Qimonda AG should continue in force.\(^{69}\)

  The regional court in Munich issued a lengthy declaratory ruling on February 2012 that the rights licensed to Infineon Technologies AG by Qimonda AG and its U.S. and German affiliates have not lapsed and have not become unenforceable as a result of Qimonda AG’s insolvency proceedings. Furthermore, the regional court also declared that the Qimonda AG IP

\(^{67}\) Id.

\(^{68}\) Regional Court of Munich I, Case no. 7 O 1906/11 (2012).

\(^{69}\) A number of Qimonda AG patents were assigned to it by Infineon when Qimonda AQ was spun off.
rights licensed or sublicensed to third parties have not lapsed and have not become unenforceable as a result of Qimonda AG’s insolvency.

The regional court recognized that, after the institution of insolvency proceedings, section 103 of the German Insolvency Code applies to executory license agreements. That is, “(1) If a mutual contract was not (or not completely) performed by the debtor and its other party at the date when the insolvency proceedings were opened the insolvency administrator may perform such contract replacing the debtor and claim the other party’s consideration. (2) If the administrator refuses to perform such contract the other party shall be entitled to its claims for non-performance only as a creditor of the insolvency proceedings...”\(^\text{70}\)

Accordingly, under section 103, the insolvency administrator has the right to choose whether or not to perform any agreement that has not yet been fully performed by both parties. In the case, the court ruled, it is a threshold requirement for the applicability of section 103 of the German Insolvency Code that a bilateral agreement has not yet been fully performed by both parties.\(^\text{71}\) The issue the court went on to ponder was whether the license agreements were structured more like purchase agreements or rather like lease agreements. Ultimately, the court ruled that the license agreements provided for licensees to retain irrevocable licenses in perpetuity and throughout the world. Therefore, the court ruled, the bilateral license agreements were fully performed. Since there was no unperformed contract performance, section 103 of the German Insolvency Code would not be applicable and the license rights were not terminated.

The German decision will likely be appealed.

A bill has also been proposed to the German legislature under which bankruptcy administrators would have the right to terminate any and all IP licenses. Under the proposed legislation, existing licensees would be required to request and re-negotiate licenses within a short, prescribed period. If no agreement were reached, a tribunal would specify the terms and conditions, based on the current status of the parties at the time of insolvency.

- Under French bankruptcy law, a license agreement would be considered to be an executory contract (“contrat en cours”) in the context of a French insolvency. The judicially-appointed administrator of the debtor would have discretion as to whether or not to continue with the contract. If the other party puts the administrator on notice to declare if it wishes to continue the contract, and does not get a positive response within one month, the contract is deemed to have been cancelled for all purposes. The administrator may also apply to the court at any time to have the contract cancelled where it alleges that such cancellation is necessary to safeguard the business of the debtor or where the terms of the contract are alleged to be excessively burdensome for the debtor.

- Under UK bankruptcy law, there is no special protection for IP licenses – they are treated like any other contracts - but the bases for a bankrupt licensor’s rejection of an executory contract are somewhat more limited than in other jurisdictions. In particular, a licensor may only reject an agreement for specific reasons (transactions at an undervalue (gifts, transactions for no consideration or transactions for consideration that is significantly less than the consideration paid by the insolvent company), preferences that place the counterparty in a better position in the event of the licensor going into insolvent liquidation, and the like).

\(^{70}\) See German Insolvency Statute of 5 October 1994 as of 1 January 2004.

\(^{71}\) See Infineon Technologies AG v Jaffe at Grounds of Decision, Section B(II).
Canada recently amended its bankruptcy law and its insolvency law, the Bankruptcy and Insolvency Act and the Companies’ Creditors Arrangement Act,\textsuperscript{72} to provide protections similar to those of section 365(n).

Because of this diversity of outcomes, licensees face substantial uncertainty and companies with significant patent portfolios and that are predominantly licensors may have an incentive to, at this time, “forum shop” and commence bankruptcy proceedings in countries that provide a liberal right of license rejection.

e. Chapter 15 of the U.S. Bankruptcy Code

U.S. bankruptcy law was significantly amended in 2005, when Chapter 15 of U.S. Bankruptcy Code was enacted. Chapter 15 is directed to insolvencies which cross borders. As more and more businesses operate, have subsidiaries, and hold assets in various jurisdictions, Chapter 15 is intended to provide some consistency and uniformity when a company (and its related entities) files for insolvency.

Specifically, the purpose of the chapter is to promote “(1) cooperation between courts of the United States… and foreign countries,… (2) greater legal certainty, (3) fair and efficient administration… that protects the interests of all creditors, and other interested parties, [emphasis added] (4) protection and maximization of the value of the debtor's assets; and (5) facilitation of the rescue of financially troubled businesses…”\textsuperscript{73}

Under Chapter 15, a debtor may avail itself of protections provided by the U.S. Bankruptcy Code (such as the automatic stay of actions against the debtor), without commencing a complete stand-alone bankruptcy case, by filing a petition to recognize a proceeding in another country (where the business has a COMI center of main interest) as a “main” proceeding, while the business’ insolvencies filed in other jurisdictions are supplemental.\textsuperscript{74} A trustee or administrator for a “foreign” main proceeding can be recognized in a U.S. proceeding and, to a prescribed extent, the law of the main proceeding may receive comity.\textsuperscript{75} Comity is limited by at least several sections of the Code. Section 1520\textsuperscript{76} discusses how a number of sections – namely 361, 362, 363, 549, and 552 -- apply under specified conditions. In addition, Section 1522 provides that

(a) The court may grant relief under section 1519 or 1521, or may modify or terminate relief under subsection (c), only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected.

Moreover, under Section 1506, there is a public policy exception by which “Nothing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be \textit{manifestly contrary to the public policy} of the United States.” Accordingly, under the law, a court will consider whether any of the listed sections apply, whether the interests of parties are protected, and whether public policy is manifestly violated. It is noted that section 365(n), which preserves IP licensee rights, is not specifically mentioned in Chapter 15, meaning that section 365(n) would not necessarily apply in the context of any particular Chapter 15 proceeding and, as the law stands, it would be within the judge’s discretion as to whether it should apply.

\textsuperscript{72} Bankruptcy and Insolvency Act § 65.11(7); Companies’ Creditors Arrangement Act § 32(6).
\textsuperscript{73} 11 U.S.C. § 1501
\textsuperscript{74} 11 U.S.C. §§ 1504, 1515.
\textsuperscript{75} 11 U.S.C. §§ 1507, 1520, 1521.
\textsuperscript{76} Referenced sections pertain to Title 11 of the US Code unless otherwise identified.
A Chapter 15 proceeding is not legally required, even when the bankrupt or insolvent entity has U.S. assets, but it is a relatively common feature of large cross-border insolvency cases as it is common for foreign bankrupt entities to wish to avail themselves of the protective features of U.S. bankruptcy law. The application of Chapter 15 to patent licenses was a major focus in the Qimonda cases.

f. Qimonda AG Insolvency in the U.S. 77

A first Qimonda decision in the U.S. considered whether section 365(n) could be disregarded where the main bankruptcy proceeding was in Germany. The German Insolvency Administrator for Qimonda AG initially argued that section 365 (including section 365(n)) should apply in the U.S. proceeding, but then changed position and argued that German law did not include a provision like section 365(n) and that the U.S. court should, under Chapter 15 and principles of comity, apply German law without the preservation of licenses.

The Virginia bankruptcy court upheld the Administrator’s motion, which would allow for termination of patent licenses between Qimonda AG and numerous other companies. The decision was appealed to the Virginia district court that remanded the case for further consideration by the bankruptcy court in accordance with Chapter 15. Specifically, the district court raised the questions as to whether the parties’ interests were adequately protected” and whether fundamental public policy had been manifestly violated. Ultimately, the bankruptcy court, issued an opinion in October 2011 determining that the balance of interests favored preserving rights under section 365(n). The Administrator would still be able to monetize Qimonda AG’s patent portfolio by licensing the U.S. patents to unlicensed entities and by licensing non-U.S. patents according to appropriate foreign law. Although the application of section 365(n) would reduce the value of the German estate, the Court found that preserving the licenses would not impose an affirmative burden on the estate. On the other hand, allowing the Administrator to reject the licenses would have had a substantial negative impact on the significant investments in the United States by the licensees in reliance on the Qimonda licenses. 78

In addressing the public policy aspect, the court concluded, “there will be plenty of patent threats and patent litigation in the industry whether or not section 365(n) applies. But the issue is not whether there is or ever can be complete ‘patent peace,’ but whether declining to apply section 365(n) in the context of the semiconductor industry would nevertheless adversely threaten U.S. public policy favoring technological innovation.” Here the court weighed the evidence presented by the experts and opined on the one hand “innovation would obviously not come to a grinding halt if licenses to U.S. patents could be cancelled in a foreign insolvency proceeding.” On the other hand, the court was persuaded by testimony that the “resulting uncertainty would nevertheless slow the pace of innovation, to the detriment of the U.S. economy.” 79

The court determined that failure to apply section 365(n) under the circumstances of this case and this industry would “severely impinge” an important statutory protection accorded licensees of U.S. patents and thereby undermine a fundamental U.S. public policy promoting

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77 While bankruptcy and insolvency may have varying meanings in different jurisdictions, this paper will not draw distinctions. The paper will, for the Qimonda AG case, follow the German terminology, such as “insolvency” and “Administrator,” which will track the U.S. terms of “bankruptcy” and “trustee”.


79 Id at 185.
technological innovation. The court held that “deferring to German law, to the extent it allows cancellation of the U.S. patent licenses, would be manifestly contrary to U.S. public policy.”\textsuperscript{80}

The Qimonda AG Administrator has appealed the bankruptcy court’s ruling directly to the court of appeals, bypassing the district court. The primary question on appeal is whether section 365(n) should apply to the licensing agreements at issue. The district court has certified the bankruptcy court’s order for direct appeal as appropriate.\textsuperscript{81} The Fourth Circuit will now determine if it will review the certified case.

In the \textit{Qimonda} appeal to the Fourth Circuit, the licensees’ protections under section 365(n) are directly pitted against the essential principle of comity in bankruptcy proceedings. The district court certifying the appeal found “whether or not the protection provided by section 365(n) rises to the level of a fundamental public policy to be safeguarded by section 1506, it is clear that the ultimate enforcement or abrogation of section 365(n) in these circumstances is at least a matter of public importance”\textsuperscript{82}.

\textbf{g. Bankruptcy and Technical Standards}

One issue raised in the \textit{Qimonda} proceeding involved technical standards. A number of Qimonda AG patents were declared by the company as “standards essential patents,” that is patents which include claims that are necessarily infringed when a technical standard is implemented. Moreover, Qimonda AG patents were subject to licensing commitments made by Qimonda AG to a standards developing organization, JEDEC. Hence, the \textit{Qimonda} cases have also raised concerns that the practice of key standards might be jeopardized. As the bankruptcy court recognized,\textsuperscript{83} the semiconductor industry relies heavily on standards to promote the interoperability of semiconductor products, improve design and production efficiencies, reduce the uncertainty of investments, encourage innovation, and facilitate market entry. Importantly, standardization results in lower prices and improves consumer choice over products such as cell phones, computers, and even automobiles that rely on and incorporate semiconductors. Today, over 95\% of DRAM chips are compliant with one or more JEDEC standards. As a result, JEDEC requires that its members, prior to the adoption of a standard, notify JEDEC of any patents it owns that may be “essential” to practice a proposed standard and agree to license those patents on RAND [reasonable and nondiscriminatory] terms…

Even if Qimonda AG’s existing licensees are entitled to retain their license rights, if Qimonda AG is able to escape its commitments to standards organizations, entities not yet licensed might lose the ability to obtain licenses from Qimonda AG on a fair, reasonable and non-discriminatory basis.

Another bankruptcy case relating to standards commitments involved Nortel Networks Inc., a Canadian company, which filed for bankruptcy protection in January 2009. One of the significant assets of the company was its portfolio of approximately 6,000 patents and patent applications covering a broad range of wireless, data networking and internet technologies. In April 2011, Nortel moved for an asset sale of this portfolio under terms that would preserve only

\textsuperscript{80} Id.
\textsuperscript{81} See \textit{In re Qimonda AG}, BR Dist. Court, (E.D. Va, 2012).
\textsuperscript{82} Id.
\textsuperscript{83} In re Qimonda AG, 462 B.R. 165 at 175.
some of its contracted commitments to standard determining organizations and industry groups (SDOs). A number of companies, including AT&T Services, Inc., and an SDO submitted motions to object to the sale.

One of the main objections was that the successful bidder for Nortel’s patent portfolio might be able to acquire the portfolio without being bound by commitments that Nortel made to some SDOs. According to the motion filed by AT&T, Nortel had participated in SDOs that developed industry standards incorporating Nortel technologies and patents. Nortel had committed to licensing its patents embodied in these industry standards on a “fair, reasonable and non-discriminatory” (“FRAND”) basis. Numerous companies in the telecommunications and technology industries had accordingly incorporated Nortel’s technologies into their products and services. The concern was that a purchaser of the Nortel portfolio, who might not be bound by the commitments made by Nortel, would demand higher royalties or other burdensome licensing terms, thereby engaging in a “hold-up” of companies that relied on the continued licensing of Nortel’s patents on a FRAND basis. Such a hold-up would cause significant disruptions to the business operations of these companies and the industry as a whole. Microsoft, a potential buyer of the patents at the time, made a similar argument that the patents should be sold subject to all existing license obligations to SDOs.

Nortel’s patent portfolio was acquired for $4.5 billion by the Rockstar Consortium comprising Apple, EMC, Ericsson, Microsoft, Research in Motion and Sony. In Judge Kevin Gross’s July 11, 2011 order authorizing and approving the sale of the Nortel portfolio to Rockstar, it was ordered that the asset transfer would be subject to Permitted Encumbrances (set out in the sales agreement) and “Standards Obligations,” defined as any commitments granted by Nortel to SDOs including any written commitments, declarations and promises that were made by or on behalf of Nortel to the members of these groups. Further, in response to the objections with regard to commitments to standard-setting bodies, the definition of Permitted Encumbrances in the final sales agreement was also amended such that the portfolio would be transferred “subject to all promises, declarations and commitments made in writing by the Sellers to standard-setting bodies or industry groups.”

While the problems relating to patent holdup were resolved in the Nortel matter, it is not clear that the current bankruptcy laws adequately address this issue. In this case, there was significant pressure from third party companies and an SDO to ensure that the commitments were maintained. Not all bankruptcy proceedings involving standards essential patents will receive the same amount of attention, and not all SDOs will have resources to participate in bankruptcy proceedings or to monitor for bankruptcies of all patent holders subject to standards commitments. There appears to be no assurance that a bankruptcy court will require a transferee to honor commitments entered into by the bankrupt patent holder. Section 365(n) of the bankruptcy code does not specifically address “commitments” to license. It has been suggested that recognition by courts or the legislature that license rights and license commitment rights in

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85 Id.
86 Judge Kevin Gross’s order dated July 11, 2011 (United States Bankruptcy Court, State of Delaware 09-10138) at pages 17 and 18.
88 See the Institute of Electrical and Electronics Engineers, Inc. (IEEE)’s comments in response to the FTC’s Request for Comments and Announcement of Workshop on Standard-Setting Issues: http://www.ftc.gov/os/comments/patentstandardsworkshop/00046-80184.pdf
standards “run with the patent” may clarify the rights and expectations of parties to a patent sale.  

h. Different View of Section 365(n) on Trademarks — Sunbeam v Chicago American Manufacturing

A recent case has thrown open the question of whether a patent, trademark, copyright or trade secret licensor can, in a bankruptcy, terminate a licensee’s rights through 11 U.S.C. § 365. In brief, the 7th Circuit held that “rejection” of a trademark license under Bankruptcy Code Section 365(a) — as interpreted pursuant to Section 365(g) -- only results in the debtor asserting that it is in breach but does not result in licensee’s rights being terminated. This creates a split among the circuits (departing from the Lubrizol decision) questioning what it means when a debtor’s trustee “rejects” a license. Although mainly directed to a trademark-licensing context (that also involved a patent license), the Sunbeam case could have an effect on patent licensing per se, as well.

Contrary to the Lubrizol decision which found that a trustee could, in effect, terminate the rights of a technology licensee under 11 U.S.C. § 365(a), the 7th Circuit reads the effect of “rejecting an executory agreement” more narrowly.

In Sunbeam, Lakewood granted a patent license and a trademark license to Chicago American Manufacturing (CAM) to make and sell [drop-ship] box fans under the well-known “Lakewood” mark. Creditors filed a petition that entered Lakewood into involuntary bankruptcy. The trustee “rejected” the trademark license and sold the Lakewood assets (including the trademarks) to a Sunbeam entity. While Section 365(n) includes language that allows an IP licensee to preserve its rights under specified conditions, the definition of “IP” for Bankruptcy Code purposes does not include “trademarks.”

Over the years, trademark license terminations by bankrupt licensors have been halted on various grounds. In some cases, the trademark license was deemed a “supplementary agreement” to a patent or trade secret license, which Section 365(n) would cover. In other cases, legislative history was referenced. In still other cases, courts would apply “equity” in preserving licensee rights.

Arguing that a court cannot override the plain language of the Bankruptcy Code by invoking “equity” or legislative history, the court in Sunbeam looks at Section 365(g) which characterizes “rejection” as “a breach.” Chief Judge Easterbrook’s opinion for a unanimous panel then observes that a party’s breach precludes specific performance and enables the non-debtor to recover for unperformed obligations, but “nothing implies that any rights of the [licensee] have been vaporized.”

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91 Continuation of patent license rights pursuant to Section 365(n) are not in dispute in this case.

92 See 11USCode 101(35A)

93 2012 U.S. App. LEXIS 13883 at *5-6

94 The relevant portion of Section 365(g) provides:

> ...the rejection of an executory contract... constitutes a breach of such contract...

(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition or...
In that the decision would create conflict with another circuit, the opinion was sent to all 7th circuit judges, none of whom expressed opposition. While the Sunbeam case stirs up confusion concerning the operation of Section 365(n), it must be recognized that the holding was directed to a trademark license, is confined to U.S. law, and is in direct conflict with Lubrizol.

2. Conclusions

The Qimonda cases have recently highlighted that licenses granted by non-U.S. licensors may be vulnerable to rejection in bankruptcy and that in such cases, even rights under licenses to U.S. patents may be vulnerable. Licensees who know their rights will be secure will be willing to pay higher royalty rates and will be more willing to invest substantial amounts to build a plant or to develop and tool a product. Conversely, the loss of the license may result in potentially duplicative and excessive costs, perhaps requiring that the licensee shut down a product line or even an entire plant and perhaps lose its unamortized investment. Licensors could find challenges to patent value. This uncertainty thus poses direct costs to both licensees and licensors and creates distortion in the marketplace by driving parties to sub-optimal deal structures.

The current Qimonda ruling, while promising, is limited to the semiconductor industry. The logic applied to the Qimonda case should, as a matter of public policy, prevail in other industries, but that outcome is not certain. In addition Qimonda, by its terms, only protects rights under U.S. patents, leaving rights under non-U.S. patents vulnerable. Finally, the application of section 365(n) in the Qimonda case was caused by actions by the Administrator and, in future cases, the application of section 365(n) may not even be raised by the debtor-licensor. In short, the application of section 365(n) to licenses from non-U.S. debtor licensors in bankruptcy proceedings may be uncertain.

In addition to existing licenses, bankruptcy of a company owning patents that relate to an industry standard may put that company’s standards licensing commitments at risk. The importance of standards to companies, industries, and economic growth has been increasingly recognized in recent years. Concerns over “patent holdup” have been expressed by federal agencies and others. The loss of such a commitment may have an adverse impact on businesses that invest or have invested and/or otherwise relied upon such commitments. This cost and uncertainty with respect to security under license agreements and standards commitments harms both licensees and licensors. Appropriate action should be taken to encourage:

1. the adoption by other countries of provisions comparable to section 365; and

2. the amendment to U.S. law to provide that the public policy of allowing licensees to retain license rights overrides the principle of comity such that U.S. courts should not recognize rejection of IP license agreements in foreign bankruptcies.

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95 See USCS Ct App 7th Cir, Circuit R 40(e)