

Bankruptcy and Licensing

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Background: IP Licenses in Bankruptcy

11 U.S.C. § 365 – Executory Contracts

- Prof. Countryman test – “The obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other.”
- Functional test – even more expansive, maximizes estate value and trustee discretion.
- EC or outright assignment

Background: IP Licenses in Bankruptcy

- Licensee executory duties:
 - Use notices and legends
 - Quality control (trademarks)
 - Pay royalties; keep accounts
 - Cooperate in enforcement
- Licensor executory duties:
 - Refrain from suing licensee
 - Honor exclusivity rights
 - Indemnification
 - Maintenance and enforcement

Background: IP Licenses in Bankruptcy

- Debtor may assume or reject ECs (§ 365(a))
- Defaults must be cured (§ 365(b))
- Debtor may assign EC (§ 365(f))
 - if contract is assumed
 - with assurance of future performance
 - even if EC or law restricts assignment
 - unless § 365(c) exception applies

Section 365(c) – Licensee in Bankruptcy

§ 365(c) – Debtor may not assume or assign EC without consent of non-debtor:

- even if contract is silent on assignability,
- if applicable law excuses non-debtor from accepting performance from “an entity other than the debtor or DIP,” even if contract is silent on assignability.

Section 365(c) – Licensee in Bankruptcy

Three questions for application of § 365(c):

- (1) What is “applicable law” to decide assignability?
- (2) What type of contract always requires consent to assign under “applicable law”?
- (3) If an EC cannot be assigned, can the debtor *assume* it?

Section 365(c) – Licensee in Bankruptcy

Applicable Law

- Federal IP law – Several U.S. appellate courts
- State contract law – A 1957 California Supreme Court case

Section 365(c) – Licensee in Bankruptcy

Qualifying Contracts

- Personal services contracts
- Contracts where party's identity is material
 - golf club memberships
 - government contracts
 - distributor and agency agreements
 - cable TV franchises
- Non-exclusive IP licenses
 - personal privilege of licensee
 - right only not to be sued
 - patent cases first; others by analogy

Section 365(c) – Licensee in Bankruptcy

Qualifying Contracts

Exclusive IP Licenses – limited case law

- Patents – consent required (BR Ariz)
- Copyrights
 - consent required – Ninth Circuit
 - consent not required – Del, MDNC, SDNY
 - indicia of ownership, property right
- Trademarks – consent required (SDNY)

Section 365(c) – Licensee in Bankruptcy

Assumption of Licenses

- Consent required – hypothetical test
 - follows plain language of § 365(c)
 - may not “assume OR assign,” whether or not contract prohibits assignment
 - 3rd, [4th], 9th, 11th Circuits; lower courts
- Consent not required – actual test
 - follows legislative intent; functional
 - reorganized debtor is same person
 - 1st Circuit; various lower courts

Section 365(n) – Licensor in Bankruptcy

- IP Bankruptcy Protection Act of 1988
- If trustee rejects IP license, non-debtor licensee may:
 - treat contract as terminated, if rejection amounts to terminable breach; OR
 - retain rights to licensed IP, including exclusivity, but no other rights of specific performance, if licensee:
 - pays royalties
 - waives right of setoff
 - waives administration claims.

Section 365(n) – Licensor in Bankruptcy

Limits of Section 365(n)

- Not all IP is “IP” for § 365(n)
 - only patents, patent applications, plant varieties, trade secrets, copyrightable works and mask works
 - no trademarks (one exceptional case)
 - no domain names, publicity rights
 - no unpatented inventions
 - no raw data
- Only IP existing at time of filing
- No springing licenses
- No support or maintenance obligations

Section 363(f) – Effect on IP Licenses

- *Precision Industries* (7th Cir. 2003)
 - Estate sold “free and clear of any interest” under § 363(f)
 - Tenant leases extinguished; failure to object
 - § 365(h) did not override failure to object
 - No objection is “consent” under § 363(f)(2)
- § 365(h) is analogous to § 365(n)
 - IP licensees must object – § 363(f)(2)
 - IP licensees must record – § 363(f)(1)
 - Other § 363(f) factors likely inapplicable

Practical Drafting Issues

- Prevent bankruptcy altogether
 - Financial covenants
 - Bankruptcy-remote vehicles
 - Restrict assignability
- Reduce risk of rejection
 - Outright sale v. license
 - Create security interest
 - Backload payments

Practical Drafting Issues

- For Licensors:
 - Restrict all assignability
 - Restrict changes of control
 - Choose friendly law/forum
- For Licensees:
 - State § 365(n) intentions; integrate the IP
 - No springing licenses
 - Segregate and label all payments; delay payments
 - Use one document
 - Source code escrow – “supplementary”
- For Sublicensees: Guard licensee’s rights

Bankruptcy and Privacy

- Sale of assets includes private data
- Sale should not violate privacy policy
- Opt-in versus opt-out method
 - Opt-out (Egghead.com, Living.com, Essential.com)
 - Opt-in (Toysmart, Etoys)
 - Data sales aborted (Toysmart, Craftshop.com)