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BANKRUPTCY

Debtors who file for bankruptcy abroad may be able to enjoy the protection of U.S. bankruptcy law while avoiding some of the safeguards available to non-debtor intellectual property licensees.

Back to the Future (*Lubrizol*): Qimonda Bankruptcy Provides Debtors With a Windfall at the Expense of Their IP Licensees

BY BLAKE REESE AND BRADLEY S. FRIEDMAN

Qimonda AG, an Infineon Technologies AG spinoff, was once the world's second largest manufacturer of dynamic random access memory, or DRAM. However, this German giant felt the woes of the DRAM market and filed for bankruptcy in a German court in January 2009.

With the boom of global restructurings in the great recession, this story thus far, unfortunately, lacks a unique storyline. However, the Qimonda bankruptcy may have quietly struck a rather astonishing blow to intellectual property licensees' rights.

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That is, IP-licensor debtors may file for bankruptcy abroad, yet still enjoy some of the protections of U.S. bankruptcy law under Chapter 15 of the Bankruptcy Code, while avoiding certain safeguards that the U.S. Bankruptcy Code typically provides to non-debtor licensees.

I. 11 U.S.C. § 365(n)—Protections for Non-Debtor Licensees

Intellectual property licenses are usually executory contracts, and debtors have the right to assume or reject executory contracts in a bankruptcy case. Before Section 365(n) of the U.S. Bankruptcy Code, 11 U.S.C. § 365(n), if a debtor-licensor rejected its licensee's license, then the licensee would merely have a claim for money damages.

Unless this claim was secured against an asset, it usually was unsecured debt, and the licensee got pennies on the dollar.

Meanwhile, the licensee had no further rights to exploit the debtor-licensor's intellectual property, while the debtor was free to sell or license the underlying in-

tellectual property assets to the highest bidder. Companies that spent millions of dollars on intellectual property licenses and invested in infrastructure and a long-term business model based on these licenses were not content with having their rights abruptly cut off.

This result occurred in the Fourth Circuit's landmark *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc. (In re Richmond Metal Finishers Inc.)* case and led to Congress passing Section 365(n), which gave certain protections to non-debtor licensees and licensors if the debtor counter-party rejects their license.[1]

Those protections include the option for the non-debtor copyright or patent licensee to continue satisfying its obligations (e.g., paying royalties) in exchange for having the ability to keep exploiting the debtor-licensor's copyrights or patents.[2] Although the licensee is not entitled to any prospective rights under the license, such as maintenance or upgrades, it may continue using licensed technology.

While the use continues under the duration of the license, often these rights allow the licensee to plan a prudent transition to a new technology platform or provider.

II. Chapter 15

Congress codified Chapter 15 of the Bankruptcy Code as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[3] in order to provide ''cooperation between'' U.S. courts, trustees, examiners, debtors, and foreign courts ''involved in cross-border insolvency cases''; ''greater legal certainty for trade and investment''; ''fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor''; ''protection and maximization of the value of the debtor's assets''; and ''facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.''[4]

Chapter 15 opens the door for a foreign debtor to administer its U.S. assets, enforce contracts, and effectuate claims. Chapter 15 provides, among other things, an ancillary proceeding in the United States to a bankruptcy case taking place in a foreign court.

Often, U.S. law will afford the foreign debtor some of the more prevalent protections under the U.S. Bankruptcy Code. For instance, a U.S. bankruptcy court typically will give the foreign debtor relief under the automatic stay, which, for the most part, keeps creditors away from the U.S. assets during the bankruptcy.

Chapter 15 provides the court with a wide range of discretion in granting various forms of relief at the request of the ''foreign representative.'' This discretion formed the crux of the dispute between the licensees and licensor in the Qimonda bankruptcy.

[1] 756 F.2d 1043, 226 USPQ 961 (4th Cir. 1985).

[2] Trademark licensees are not afforded protection under Section 365(n). For a brief discussion of what is and what is not governed by Section 365, *see, e.g.*, J. Klaiber & B. Reese, *Chapter IP: Protecting Your IP When Your Licensee (or Licensor) is Bankrupt*, The Deal (April 17, 2009).

[3] Chapter 15 stemmed from the United Nations Commission on International Trade Law's Model Law on Cross-Border Insolvency.

[4] 15 U.S.C. § 1501.

III. Qimonda's Chapter 15 Bankruptcy

After Qimonda commenced an insolvency proceeding in Germany, the German court appointed a foreign representative to petition a U.S. bankruptcy court for recognition of the German proceeding. The foreign representative filed a petition under Chapter 15, and the U.S. court recognized the case as a ''foreign main proceeding,'' meaning that it is pending in the country where the debtor has ''the center of its main interest''—here, Germany. As a result of this recognition, the U.S. bankruptcy court enjoyed jurisdiction over Qimonda's U.S. assets.[5]

Shortly after recognizing the German proceeding, the U.S. bankruptcy court issued an order stating that, pursuant to Chapter 15, ''the following sections [of the Bankruptcy Code] are also applicable in this proceeding: §§ 305-307, 342, 345, 349, 350, *364-366*, 503, 504, 546, 551, 558.''[6] About two and a half months later, Qimonda moved to amend the order to strike the reference to Section 365 or to limit the application of Section 365 so that the debtor's rejection of licenses would be governed by German bankruptcy law.

Predictably, many of the significant licensees objected to Qimonda's motion to amend, as German bankruptcy law lacks the safeguards that Section 365 affords non-debtor licensees. Specifically, Section 103 of the German Insolvency Code allows the debtor to elect non-performance of executory contracts.

So, as in *Lubrizol*, Qimonda could elect non-performance of all its licenses and then liquidate the underlying intellectual assets to the highest bidder.

Despite the fact that Qimonda availed itself of the automatic stay provisions of the U.S. Bankruptcy Code; despite Congress's clear intent in enacting Section 365(n) to safeguard licensees in good standing against harsh ''*Lubrizol*-esque'' outcomes; despite a court order dictating the applicability of Section 365 in the Chapter 15 case; [7] and despite express provisions in the licenses that called for the application of Section 365(n) and New York law,[8] the U.S. bankruptcy court granted Qimonda's motion and amended its order.

The amended order states that ''Section 365(n) applies only if the Foreign Representative rejects an executory contract pursuant to Section 365 (rather than simply exercising the rights granted to the Foreign Representative pursuant to the German Insolvency Code).''

The U.S. bankruptcy court reasoned that ''[i]f the patents and patent licenses are dealt with in accordance with the bankruptcy laws of the various nations in which the licensees or licensors may be located or operating, there will be many inconsistent results. In fact, the same idea, process or invention may be dealt with

[5] It is instructive to note that the licenses at issue involved U.S. patents and that at least one of those licenses was expressly entered into under U.S. law, for example, New York state law.

[6] Emphasis added.

[7] On the other hand, the bankruptcy court arguably included Section 365 in the original order to give the debtor the right to assume or reject executory contracts, not necessarily to protect the creditor-licensee's interests.

[8] U.S. bankruptcy law generally prohibits ipso facto clauses, which are terms of a contract that are triggered by a company's insolvency or bankruptcy filing. However, some contractual provisions that deal with the parties' obligations in bankruptcy under Section 365 remain enforceable. *See* 11 U.S.C. § 365(e)(2)(A).

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differently depending on which country the particular ancillary proceeding is brought.''

IV. Conclusion

While the U.S. Court of Appeals for the Federal Circuit has refused to allow lower courts to litigate foreign patent disputes under supplemental jurisdiction theories, the reasoning it used to reach that result seems to run contrary to the bankruptcy court's rationale. For instance, in *Voda v. Cordis*, the Federal Circuit stated that ''[a] patent right is limited by the metes and bounds of the jurisdictional territory that granted the right to include.''[9]

In other words, ''a real patent right to exclude only arises from the legal right granted and recognized by the sovereign within whose territory the right is located.''

The court even noted that the Paris Convention ''clearly expresses the independence of each country's sovereign patent systems and their systems for adjudicating those patents,'' as ''[n]othing in the Paris Convention contemplates nor allows one jurisdiction to adjudicate the patents of another, and as such, our courts should not determine the validity and infringement of foreign patents.''

''Regardless of the strength of the harmonization trend,'' the court said, ''[p]ermitting our district courts to exercise jurisdiction over infringement claims based on foreign patents . . . would require [the Federal Circuit] to define the legal boundaries of a property right granted by another sovereign and then determine whether there has been a trespass to that right.''

Just as the Federal Circuit ruled that U.S. courts are not equipped to adjudicate foreign patents,[10] foreign courts are not equipped to administer U.S. patent assets, especially under foreign law.

While foreign insolvencies occur more frequently and more bankruptcy courts interpret their discretion under Chapter 15, patent licensees should pay close attention to how these courts administer patent licenses and the underlying assets. After all, all the time spent in carefully negotiating and drafting a license becomes moot when foreign law allows outright rejection of the license with no continuing rights for the licensee to exploit the licensed technologies.

[9] 476 F.3d 887, 81 USPQ2d 1796 (Fed. Cir. 2007) (73 PTCJ 397, 2/9/07).

[10] Even when they cover identical subject matter as their U.S. brethren.