



BANKRUPTCY LAW REPORTER



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Intellectual Property

Attorneys Discuss Bankruptcy Code's Treatment of IP Licenses, *Qimonda* Impact

With more companies filing for bankruptcy protection, it is essential that both bankruptcy and intellectual property lawyers understand not only the bankruptcy process, but also the treatment of intellectual property (IP) licenses under Bankruptcy Code Section 365, and IP asset sales free and clear of encumbrances, according to attorneys speaking May 18 during a BNA webinar.

Blake Reese, a registered patent attorney in the IP Practice Group of Milbank, Tweed, Hadley & McCloy, New York, Bradley Scott Friedman, an associate in the firm's Financial Restructuring Group, and Michael M. Murray, a partner with the firm and the moderator of the webinar, "Back to the Future (Lubrizol): An Overview of IP & Bankruptcy Issues, Chapter 15, and the *Qimonda* Chapter 15 Proceeding," also discussed the Chapter 15 case of *In re Qimonda AG*, Bankr. E.D. Va. (RGM), *order granting debtor's motion to amend supplemental order* 11/19/09.

Qimonda is an important case, according to Reese and Friedman, because it "may have quietly struck a rather astonishing blow to intellectual property licensees' rights" (see related BNA Insights article at 22 BBLR 316, 3/4/10). The *Qimonda* bankruptcy, Reese and Friedman said, provides debtors with a windfall at the expense of their IP licenses.

***Qimonda* Background.** Friedman provided a brief summary of the *Qimonda* case. Once the world's largest manufacturer of dynamic random access memory, *Qimonda AG* commenced an insolvency proceeding in Germany and appointed Dr. Michael Jaffe as insolvency administrator and foreign representative. Dr. Jaffe then filed a petition for relief on June 15, 2009, under Chapter 15 in the U.S. Bankruptcy Court for the Eastern District of Virginia.

On July 22, 2009, Judge Robert G. Mayer of the U.S. Bankruptcy Court for the Eastern District of Virginia entered an uncontested order of recognition of a foreign main proceeding, and 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." About two and a half months later, *Qimonda* moved to amend the order and strike the reference to Section 365, which allows for the assumption or rejection of executory contracts, or to limit the application of Section 365. According to Reese, significant licensees objected to the motion, because like most countries' law, German law does not provide the Section 365(n) protections to licensees.

The bankruptcy court granted *Qimonda's* motion to amend, Reese pointed out, despite the fact that: (1) it was availing itself of the U.S. automatic stay provisions in the U.S. bankruptcy court, (2) Congress's clear intent in enacting Section 365(n) to avoid harsh "*Lubrizol*-esque" outcomes, (3) the court's earlier order dictating the applicability of Section 365 in the Chapter 15 case, and (4) express provisions in at least one of the licenses that called for the application of Section 365(n) and New York law.

According to the bankruptcy court, efficiency and judicial economy concerns were of primary importance, Reese said. "If 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 differently depending on which country the particular ancillary proceeding is brought," Reese said, quoting the court. "All patents should be treated the same. There should not be disparate results simply because of the location of a factory or research facility or corporate office," the court said.

Impact of *Qimonda*. According to Reese, if the *Qimonda* holding becomes widely-accepted, IP licensees should be aware that debtors gain extraordinary lever-

age over non-debtor licensees that are potential infringers. Thus, IP licensees should watch out when multinational entities file abroad and then bring Chapter 15 proceedings in the United States to allow foreign bankruptcy court control over U.S. assets, he said. Based on *Qimonda*, the U.S. bankruptcy court then defers to foreign proceedings and foreign law on licenses involving U.S. patents, Reese noted.

Reese also pointed out that *Qimonda* is currently on appeal to the U.S. District Court for the Eastern District of Virginia, and oral argument was heard May 14 (*In re Qimonda AG*, Nos. 1:10cv26, 1:10cv27, 1:10cv28 (TSE), oral argument 5/14/10). Judge Thomas S. Ellis III of the U.S. District Court for the Eastern District of Virginia ordered supplemental briefs to be filed by May 21. According to Reese, the case will likely be further appealed to the circuit court.

Call to Action. The IP community needs to be aware of *Qimonda*, Reese said, because it could have a dramatic impact on businesses. The bankruptcy community, he said, views the way the case was handled as an “efficiency,” but the IP community needs to pay attention and advocate their position that this is a potential windfall at the expense of their IP licensees. Reese urged the IP community to write amicus briefs and be heard on this issue.

Seek Bankruptcy Counsel to Protect Rights. Friedman, who provided a brief summary of bankruptcy “basics” in the webinar with regard to a Chapter 11 reorganization plan and disclosure statement, encouraged IP attorneys to immediately engage competent counsel who understand the bankruptcy process when the case is in bankruptcy, and to carefully review the disclosure statement. File objections if your rights are impaired, Friedman said. You should also look at the debtors’ schedules to make sure that your licenses are listed, and check if there is an exhibit list with all of the license agreements in the disclosure statement and reorganization plan, he added.

Friedman also encouraged IP licensees to make sure that they perfect any liens and security interests that they have. According to Reese, this is typically done by filing a financial statement with the U.S. Patent and Trademark Office, or with the Copyright Office. He also noted that frequently in order to perfect the lien, you must file a motion to lift the automatic stay in the bankruptcy case. This motion must demonstrate cause for relief under Section 362, Friedman said.

Free, Clear IP Asset Sales. According to Reese, IP asset sales in bankruptcy follow the traditional business judgment rule and are subject to liens and other encumbrances. If a debtor fulfills the notice and hearing requirements, the sale can proceed subject to encumbrances, he explained.

IP asset sales that are free and clear of all encumbrances under Section 363(b), however, are becoming more popular, Reese said. In order to gain bankruptcy court approval, a debtor must meet at least one special requirement under Section 363(f), Reese said. The five special requirements are as follows: (1) non-bankruptcy law permits the sale free and clear of the license; (2) the licensee either expressly or impliedly consents; (3) the license is in bona fide dispute; (4) the licensee could be compelled in a legal or equitable proceeding to accept a monetary substitute; or (4) the proceeds are used to

foreclose a lien where the sale price is sufficient to discharge all liens.

The effect of a bankruptcy court ordering a free and clear sale, Reese explained, is that there is termination without rejection. In other words, the license could be extinguished, Reese said, but an objecting party may be entitled to adequate protection under Section 363(e). “Make sure you object and ask the court for adequate protection,” Reese said. With regard to protections on appeal, Reese said try to obtain a stay pending appeal, but noted that this is hard to do because actual prejudice must be shown.

IP Licenses as Executory Contracts. According to Reese, most IP licenses are executory contracts because both parties’ failures to perform would be considered material breaches. Reese said executory contracts may be assumed or rejected by a debtor under Section 365. He suggested aiming for non-executory contracts. Write broad licenses that are more like an assignment, Reese said. He also suggested using a “paid-up, or paid-in-full license” so that the contract is not rejectable.

If you aim for an executory contract, Reese said to state that “failure to perform continuing obligations constitutes a material breach of the contract excusing performance by the other party, or otherwise define events constituting a material breach.” He also encouraged adding obligatory provisions such as notice, reporting, policing, royalty payments, and arbitration.

If the debtor is a licensor and assumes the license, Reese explained, it should cure all monetary defaults under the agreement and pay for all damages. In addition, the debtor should provide adequate assurance of future performance, he said. Reese also noted that court approval is required with a motion and order approving assumption, and that breach post-assumption results in damages that would be considered administrative expenses rather than unsecured debt from rejection.

He noted, however, that if the debtor as licensor rejects the license, the licensee may treat the rejection as a pre-petition breach and file a claim, or retain rights under the IP license for the rest of the term and keep up with royalty payments and non-monetary obligations. Retention rights were enacted in response to the landmark case of *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc.* (*In re Richmond Metal Finishers Inc.*), 756 F.2d 1043 (4th Cir. 1985), Reese added.

Noting the definition of IP under Section 101(35A), Reese explained that if a debtor as licensor rejects a license, there are retention rights under Section 365(n). He also noted that IP excludes trademarks. Reese encouraged licensees to file a claim, hold a security interest, and put a transition period in their license agreements, but acknowledged that there is not much case law on that issue.

Practice Tips for Licensors/Licensees. In situations involving the debtor as licensor, the debtor may file a motion to reject the license as bargaining leverage in negotiations for new terms that the debtor will assume, Reese said. It is also worth asking, “is the licensee a prospective purchaser of the IP?” he said. If so, they may want to sell the license through a Section 363 sale or other means, Reese said.

According to Reese, a licensee might want to include in the license agreement that the debtor agrees to “assume” the license, and make sure that IP is broadly defined to include foreign patents. Sometimes it is helpful

to give the debtor an incentive not to reject the license by loading royalties at the end of the license and allocating payments between royalty and maintenance, Reese said. He also encouraged obtaining and perfecting

any security interests whenever possible. Finally, Reese recommended asserting a right to continue under Section 365(n).

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