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Selling, Buying and Keeping Technology Licenses in Bankruptcy

Moderator:

H. Jason Gold, Esq.
Wiley Rein LLP
McLean, Virginia

Presenters:

Douglas R. Gooding, Esq.
Choate, Hall & Stewart LLP
Boston, Massachusetts

Christopher A. Jones, Esq.
Whiteford, Taylor & Preston LLP
Falls Church, Virginia

I. Introduction

The contract rights to use intellectual property are often among the most valuable of the debtor's assets. The assignability of these technology licenses is the subject of both legal and business concerns of virtually all stakeholders in reorganization (and liquidation) cases. This program will cover the current state of the law, including a discussion of cases decided under the "hypothetical" test and the "actual" test. Additionally, we will cover the strategies most often employed by parties to enhance the likelihood of success in completing an assignment transaction.

II. Definitions and Key Terminology.

a. Copyright[1]

i. Definition – Copyright is a form of protection provided to the authors of "original works of authorship" including literary, dramatic, musical, artistic, and certain other intellectual works, both published and unpublished. The 1976 Copyright Act generally gives the owner of copyright the exclusive right to reproduce the copyrighted work, to prepare derivative works, to distribute copies or phonorecords of the copyrighted work, to perform the copyrighted work publicly, or to display the copyrighted work publicly. Copyrights are registered by the Copyright Office of the Library of Congress.

ii. Rights Conferred by Copyright – The copyright protects the form of expression rather than the subject matter of the writing. For example, a description of a machine could be copyrighted, but this would only prevent others from copying the description; it would not prevent others from writing a description of their own or from making and using the machine.

iii. Term – For works created after January 1, 1978, the term of the copy right is the life of the author plus 70 years. For works created before 1978, the term is 75 years. For works made for hire, and for anonymous and pseudonymous works (unless the author's identity is revealed in Copyright Office records), the duration of copyright will be 95 years from publication or 120 years from creation, whichever is shorter.

[1] This information has been taken from the publication "Copyright Basics", published by the United States Copyright Office (http://www.copyright.gov/circs/circ1.pdf).

b. Patent[2]

i. Definition – According to the United States Patent and Trademark Office, a patent for a process, design, plant or new invention is "the grant of a property right to the inventor, issued by the Patent and Trademark Office."

ii. Rights Conferred by Patent – The "right to exclude others from making, using, offering for sale, or selling" the process, design, plant or new invention. It does not grant the exclusive right to do certain acts but rather grants the right to prohibit others from doing them.

iii. Term – A new patent has a term of 20 years from the date on which the application for the patent was filed in the United States or, in special cases, from the date an earlier related application was filed, subject to the payment of maintenance fees.

iv. Geographic Scope – Patents issues by the United States are effective only within the U.S, U.S. territories, and U.S. possessions.

v. Rights Conferred by Patent – "the right to exclude others from making, using, offering for sale, or selling" the invention in the United States or "importing" the invention into the United States. What is granted is not the right to make, use, offer for sale, sell or import, but the right to exclude others from making, using, offering for sale, selling or importing the invention.

c. Trademark or Servicemark[3]

i. Definition of Trademark – A trademark is a word, name, symbol or device which is used in trade with goods to indicate the source of the goods and to distinguish them from the goods of others.

ii. Definition of Servicemark – A servicemark is the same as a trademark except that it identifies and distinguishes the source of a service rather than a product. The terms "trademark" and "mark" are commonly used to refer to both trademarks and servicemarks.

iii. Rights Conferred by Trademark or Servicemark – Trademark rights may be used to prevent others from using a confusingly similar mark, but not to prevent others from making the same goods or from selling the same goods or services under a clearly different mark. Trademarks which are used in interstate or foreign commerce may be registered with the Patent and Trademark Office.

[2] This information has been taken from the official website of the United States Patent and Trademark Office (http://www.uspto.gov/web/offices/pac/doc/general/whatis.htm)
[3] This information has been taken from the official website of the United States Patent and Trademark Office (http://www.uspto.gov/web/offices/pac/doc/general/whatis.htm)

d. License

i. Definition of License – A license is an agreement by the holder of the intellectual property, usually for a consideration, to allow the licensee to use the intellectual property without fear of being sued for infringement. It does not transfer ownership to the licensee. See Classen Immunotherapies, Inc. v. King Pharms., Inc., 403 F. Supp. 2d 451, 456 (D. Md. 2003).

ii. Exclusive License – The holder of an exclusive license has all rights of owner (e.g., to sue for infringement) and the licensor cannot grant any rights to other parties. See Morris v Business Concepts, Inc., 259 F3d 65 (2nd Cir. 2001) (copyright context).

iii. Non-Exclusive License – also called a "bare license"; a licensee does not have the exclusive right to use the intellectual property and, thus, cannot sue for infringement. See Rite-Hite Corp. v. Kelley Co., Inc., 56 F.3d 1538, 1544 (Fed. Cir. 1995).

Legal Considerations Relevant To Licensing Issues In Bankruptcy

I. Are licenses of intellectual property executory contracts under § 365(a) of the Bankruptcy Code?

a. A contract is typically executory if performance is still due from both parties to the contract, and the failure of either party to perform would constitute a material breach.

b. Courts usually find that material ongoing obligations are due on both sides of an intellectual property license.

- In re Exide Tech., 340 B.R. 222, 249-50 (Bankr. D. Del. 2006).
- In re Kmart Corp., 290 B.R. 614, 618-19 (Bankr. N.D. Ill. 2003).
- In re Gencor Indus., Inc., 298 B.R. 902, 910-13 (Bankr. M.D. Fla. 2003).

i. Examples of Licensee Obligations:

(1) Accounting for and paying royalties;
(2) Sharing technology with Licensor;
(3) Reporting problems with the technology; and
(4) Marking all products sold under the License with statutory patent notice.

ii. Examples of Licensor Obligations:

(1) Providing non-exclusive licensee with notice of patent infringement suits;
(2) Refraining from licensing technology to another party at a lower royalty rate;
(3) Reasonably approving grants for sublicenses;
(4) Indemnifying licensee for loses;
(5) Defending claims of infringement; and
(6) Forbearance from suing licensee for infringement.

- (In re Access Beyond Tech., Inc., 237 B.R. 32, 43 (Bankr. D. Del. 1999) (finding forbearance one of the licensor's implicit obligations).

II. Can the DIP/Trustee assume an executory intellectual property license?

a. Executory contracts, including licenses, are generally subject to § 365(a).

b. However, § 365(c) provides that "the trustee may not assume *or* assign any executory contract . . ." under certain conditions, including where "applicable law excuses a party, other than the debtor, to such contract or lease from accepting

performance from or rendering performance to an entity other than the debtor or the debtor in possession . . . ."

c. Majority Rule: "Hypothetical Test" (3d, 4th, 9th, and 11th Circuits).

i. The DIP or Trustee cannot assume a license if applicable non-bankruptcy law would prohibit the debtor from assigning it to a hypothetical third party; i.e. even if the debtor has no actual intent to assign the license.

- In re Aerobox Composite Structures, LLC, 373 B.R. 135, 138, 140-42 (Bankr. M.D. NM 2007) (noting the circuit split).
- In re Access Beyond Tech., Inc., 237 B.R. at 48.
- Perlman v. Catapult Entertainment, 165 F.3d 747, 749-50 (9th Cir. 1999).
- City of Jamestown v. James Cable Partners LP, 27 F.3d 534, 537 (11th Cir. 1994).
- In re West Elec., Inc., 852 F.2d 79, 83 (3d. Cir. 1988).
- In re Catron, 158 B.R. 629, 633-38 (E.D. Va. 1993), aff'd sub nom., Catron v. Breeden, 25 F.3d 1038 (4th Cir. 1994).

d. Minority Rule: "Actual Test" (1st and 5th Circuits, and lower courts in 8th and 10th Circuits)

- Bonneville Power Admin. v. Mirant Corp., 440 F.3d 238 (5th Cir. 2006).
- In re Footstar, Inc., 323 B.R. 566, 569 (Bankr. S.D.N.Y. 2005).

i. The DIP or Trustee can assume a license if the debtor has no intent to assign it.

ii. The test focuses on whether the non-debtor would actually be forced to accept performance from someone other than the debtor with whom it contracted.

iii. Courts have even applied the actual test to allow assumption where a debtor planned to sell itself to a competitor of the non-debtor licensor.

- Institut Pasteur v. Cambridge Biotech. Corp., 104 F.3d 489, 493-94 (1st Cir. 1997) (holding that the debtor's proposed sale of stock to the non-debtor licensor's competitor did not constitute a de-facto assignment but was rather an assumption of the licenses by the reorganized debtor under new ownership).

- In re Aerobox Composite Structures, LLC, 373 B.R. at 138, 140-42 (finding it appropriate to determine whether the non-debtor is *actually* being asked to accept performance from an entity distinct from the debtor).

e. The U.S. Supreme Court has noted the circuit split but is waiting for a "suitable" case before addressing it. N.C.P. Marketing Group, Inc. v. BG Star Prod., Inc., 129 S.Ct. 1577 (2009) (denying certiorari).

III. Can the DIP or trustee assign an intellectual property license once it is assumed?

a. Section 365(c) permits the assignment of a license only if it is: 1) permitted under "applicable law", or 2) the non-debtor consents to the assignment.

i. What is "applicable law"?

(1) Federal IP law

- RCI Tech. Corp. v. Sunterra Corp., 361 F.3d 257, 266 (4th Cir. 2004).

(2) State law prohibitions on assignment

- In re Rooster, Inc., 100 B.R. 228, 232 (Bankr. E.D. Pa. 1989).

ii. Consent

(1) Parties can contract around applicable law.

- In re Supernatural Foods, LLC, 268 B.R. 759, 805 (Bankr.M.D. La.2001) (holding that, generally, § 365(c)(1) is not applicable to prohibit assignment when the licensor and licensee have contractually opted out of generally applicable law prohibiting assignment).

(2) Courts look to the licensing agreement to determine whether the non-debtor has granted consent to assign.

(3) Courts interpret the license in accordance with the license's choice of law provision to the extent it is not in conflict with Federal law.

- In re Valley Media, Inc., 279 B.R. 105, 140 (Bankr. D. Del. 2002).

b. Applicable law: Assignment based on the subject matter of the license

i. Patents

(1) Courts look to Federal patent law to determine assignability.

(2) Depends whether the license is exclusive or non-exclusive.

(3) Exclusive

(a) Assignment is generally permitted.
(b) Courts view exclusive licenses as conferring a property interest rather than mere personal rights.

- In re Hernandez, 285 B.R. 435, 439 (Bankr. D. Ariz. 2002) (applying the "hypothetical test" in holding, however, that debtor-licensee could not assume the license).

(4) Non-Exclusive

(a) Assignment is generally not permitted.

- Perlman v. Catapult Entertainment, 165 F.3d at 749-50.

(b) The licensee's rights are personal to the licensee and not freely assignable unless the right to assign is expressly granted in the agreement.

- Everex Sys., Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996).
- Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 148-49 (1989).

ii. Copyrights

(1) Courts look to Federal copyright law to determine assignability.

(2) Like patents, assignability depends on whether license is exclusive or non-exclusive.

(3) Exclusive

(a) Courts split on whether exclusive licenses are assignable when the agreement is silent.

- Gardner v. Nike, 279 F.3d 774, 780-81 (9th Cir. 2002) (holding that consent of licensor is required for assignment).
- In re Golden Books, 269 B.R. 300, 309 (Bankr. D. Del. 2001) (opining in dicta that, except as otherwise provided in the license, the holder of an exclusive license is entitled to all of the rights and protections of the copyright owner and has the right to assign such rights).

(b) An exclusive license is a transfer of copyright ownership to the licensee (17 U.S.C. § 101).

(4) Non-exclusive

(a) Assignment is generally not permitted.

(b) The licensee's rights are personal to the licensee.

(c) No transfer of rights of ownership, so the copyright holder retains the exclusive right to use or authorize the use of the copyrighted material.

iii. Trademarks

(1) Goal of trademark law is to prevent consumer confusion and unfair competition.

(2) Exclusive v. Non-exclusive:

(a) Courts have generally permitted the assignment of exclusive trademark licenses, either by finding that they are not analogous to personal service contracts, or because a licensor's interest in the quality of the work bearing the mark can be protected by increased supervision over the license.

- See, e.g., In re Rooster, Inc., 100 B.R. at 232-235 (holding that the control exercised by a non-debtor sublicensor over sub-licensee's product was evidence that the trademark sublicense was not personal and allowing debtor–sublicensor to assume and assign it).

(b) Non-exclusive trademarks may be non-assignable under applicable law.

- In re Wellington Vision, Inc., 364 B.R. 129 (S.D. Fla. 2007) (holding that the Lanham Act, 15 U.S.C. § 1051 et seq., provides licensors of non-exclusive licenses with certain protections, including restrictions on assignment).

(3) However, the Ninth Circuit affirmed a district court's holding that the trademark licensor's need to control the identity of the licensee extends from the licensor's right and duty to control the quality of goods sold under the mark and thus prohibits assignment absent consent (regardless of exclusivity).

- In re N.C.P. Marketing Groups, 337 B.R. 230, 236 (D. Nev. 2005) (finding that, under the Lanham Act, all trademark licenses are personal and non-assignable), aff'd sub nom., N.C.P. Marketing Group, Inc. v. BG Star Productions, Inc., 279 Fed.Appx. 561 (9th Cir 2008), cert. denied, 129 S.Ct. 1577 (2009).

IV. What are a licensee's options when a debtor-licensor rejects a license?

a. Section 365(n) gives a licensee of "intellectual property" two options:

i. Treat rejection as a breach of contract (§ 365(n)(1)(A)):

(1) Breach gives licensee a general unsecured claim against the debtor's estate.

- In re Centura Software Corp., 281 B.R. 660, 668 (Bankr. N.D. Cal. 2002).
- Medical Malpractice Ins. Assoc. v. Hirsch, 114 F.3d 379, 387 (2d Cir. 1997).

ii. Retain rights under the license as such rights existed immediately prior to commencement of the bankruptcy for the duration of the contract *plus* any extension to which the licensee may be entitled under applicable non-bankruptcy law (§ 365(n)(1)(B)):

(1) Licensee must continue to pay royalties due under the contract and waive the right to setoff and the right to assert an administrative expense claim for obligations under the license.

- "Royalty payments" include any fees to be paid by the licensee (In re Prize Frize, Inc., 150 B.R. 456, 459-60 (B.A.P. 9th Cir. 1993)).

(2) Debtor-licensor must:

- Provide licensee with access to the IP that is subject to the license;
- Refrain from interfering with licensee's exercise of its rights; and
- If the license is exclusive, refrain from licensing it to others.

(3) Debtor-licensor has no other affirmative duties and is not required to update, maintain, or improve IP.

- Biosafe Int'l, Inc. v. Controlled Shredders, Inc., 1996 WL 417121 (Bankr. N.D. Ill. 1996), rev'd in part on other grounds, Szombathy v. Controlled Shredders, Inc., 1997 WL 189314 (N.D. Ill. 1997).

b. However, note that "intellectual property," as defined in Bankruptcy Code §101(35A), **does not include trademarks**.

- In re Centura Software Corp., 281 B.R. at 669-670.

i. Upon rejection, non-debtor licensee loses its right to use the mark and is left with a general unsecured claim against the estate for breach of contract.

- In re Exide Tech., 340 B.R. at 247, 249-50.

c. Licenses bundling trademark and copyrights or patents

i. A court may allow a debtor to retain its rights under a trademark license that is coupled with a license to other intellectual property.

- In re Centura Software Corp., 281 B.R. at 671-73 (finding that § 365(n) only becomes controlling once rejection is authorized and that, until then, the court can be persuaded to exercise its equitable powers in allowing a debtor to retain rights under a trademark license that is essential to the debtor's ability to exercise the rights that Sec. 365 does allow it to retain under related licenses).

Legal Considerations Relevant To Patent Infringement In Bankruptcy

I. Impact of automatic stay of 11 U.S.C. § 362.

a. Automatic stay prohibits "the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title . . . ." 11 U.S.C. § 362

b. Each act of infringement may give rise to a separate cause of action. See Hazelquist v. Guchi Moochie Tackle Co., Inc., 437 F.3d 1178, 1180-81 (Fed. Cir. 2006); Augustine Med., Inc. v. Progressive Dynamics, Inc., 194 F.3d 1367, 1371 (Fed. Cir. 1999).

c. Pre-petition patent infringement actions are subject to the automatic stay. See Seiko Epson Corp. v. Nu-Kote Int'l, Inc., 190 F.3d 1360, 1364 (Fed. Cir. 1999); In re Spansion, Inc., 418 B.R. 84, 91 (Bankr. D. Del. 2009).

d. Automatic stay does not impact pre-petition injunctions related to infringement. Seiko Epson Corp, 190 F.3d at 1365. May be able to seek contempt of court ruling based on continuing violation of injunction while in bankruptcy. Id. At minimum, court will likely grant relief from stay to pursue contempt charge. In re Rudaw/Empirical Software Products, Ltd., 83 B.R. 241 (Bankr. S.D.N.Y. 1988).

II. Impact of discharge.

a. To the extent that infringement continues after a debtor receives a discharge, the holder of the patent may sue for post-discharge infringement. See Hazelquist, 437 F.3d at 1180-81.

III. What should the patent holder do?

a. Seek relief from stay so that you can enforce your non-bankruptcy rights. In re Rudaw/Empirical Software Products, Ltd., 83 B.R. 241 (Bankr. S.D.N.Y. 1988) ("The automatic stay imposed under 11 U.S.C. § 362(a) may not be used as a shield to sanction contumacious conduct in violation of a prepetition order enjoining a debtor from violating a party's property rights"); In re Cinnabar 2000 Haircutters, Inc., 20 B.R. 575 (Bankr. S.D.N.Y. 1982) (granting relief from stay because "the bankruptcy laws should not be a haven for contumacious conduct in violation of a party's judicially-determined tradename rights which will be diluted by a continuation of such conduct behind the shield of the automatic stay.").

b. Some courts have held that automatic stay does not apply to suits seeking to prevent post-petition infringement. Larami Ltd. v. Yes! Entertainment Corp., 244

B.R. 56, 58-59 (Bankr. D.N.J. 2000) ("automatic stay of § 362(a)(3) does not impede a plaintiff's post-petition claim for damages."); but see In re Spansion, Inc., 418 at 91 (holding that litigation to stop post-petition infringement subject to automatic stay).

c. Seek administrative claim for damages related post-petition infringement of patent. In re Spansion, Inc., 418 at 92.