Working Guidelines

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Q241

IP Licensing and Insolvency

Introduction

1) This question relates to the treatment of IP license agreements during bankruptcy or insolvency proceedings. In particular, this question addresses whether, and under what circumstances, an administrator of such a proceeding may adopt, modify, or terminate such an agreement. In addition, this question addresses under what circumstances, if any, an administrator may liquidate the IP rights underlying a license agreement or sell or transfer the license agreement itself.

2) In most jurisdictions, significant lack of clarity currently exists with regard to how an IP license will be treated by an administrator of a bankruptcy or insolvency proceeding. To the extent statutes or precedent exist, the outcome may nonetheless depend on many factors, including whether the insolvent party is the licensee or the licensor, the existence of sub-licenses, the nature of the IP rights being licensed, and the perceived fairness or value of the license.

3) This lack of clarity is heightened by the lack of international harmonization in this area. IP licenses very often cross borders, both in terms of the scope of the license and in terms of the nationalities of the parties involved. Not knowing which national law will apply in a given case, and how that law would be applied, adds significant uncertainty to IP licenses throughout the world.

4) The recent insolvency of several large, international companies has brought this issue to the forefront. Not only did these companies own substantial patent portfolios themselves, they were also involved in extensive, world-wide cross-licensing arrangements. These cross-licensing arrangements are key to providing freedom to operate for all participants in these markets. Thus, bankruptcy of a single, large player in a given market may have far-reaching effects on an entire industry if existing licenses are extinguished.

5) From a definition standpoint, it is noted for clarity that “insolvency” and “bankruptcy” are not synonymous. “Insolvency” generally refers to a financial state of being, namely, one in which a party either has debts exceeding its assets (balance sheet

insolvency) or can no longer meet its payment obligations as they come due (cash flow insolvency).[1] "Bankruptcy," on the other hand, generally refers to a legal procedure that officially recognizes the insolvency and resolves it through liquidation of assets and/or administration of debts, according to a defined process.[2] Thus, while a party may, for example, become insolvent and be unable to pay a royalty under a license, this is not the concern of this question. Rather, this question addresses the treatment of IP licenses during the bankruptcy process itself. Recognizing that different jurisdictions may use different terminology and may have a variety of different types of proceedings for handling insolvent parties, the process of administering an insolvent party shall be referred to herein broadly as a "bankruptcy or insolvency proceeding."

6) Bankruptcy or insolvency proceedings may be administered by a court, a trustee, or another person so designated for that purpose according to local laws. In light of the many different procedures that exist in the various jurisdictions, the term "bankruptcy administrator" shall be used broadly herein to refer to the person or persons responsible for making decisions concerning the debts and assets of the insolvent party during the bankruptcy or insolvency proceeding, regardless of who that person may be and regardless of the particular process being used.

7) For the above reasons, it is clear that significant uncertainty remains as to the treatment of IP licenses in bankruptcy or insolvency proceedings.

Previous work of AIPPI

8) AIPPI previously considered issues relating to the treatment of IP licenses in bankruptcy or insolvency proceedings in Q190 "Contracts regarding Intellectual Property Rights (assignments and licenses) and third parties." The Q190 Working Guidelines included, *inter alia*, the following introductory statement:

> *Insolvency/bankruptcy is an inevitable part of the business landscape. Some businesses will fail. The state may have a number of responses to this. It may seek to punish bankrupts or to rehabilitate them. It may have a particular view on the protection of creditors and customers. It is therefore important to understand the impact of bankruptcy/insolvency on IP rights and on contracts concerning them. This Question therefore seeks to collect information*

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[1] "Insolvent": (1): unable to pay debts as they fall due in the usual course of business; (2); having liabilities in excess of a reasonable market value of assets held. Merriam-Webster.com. Merriam-Webster, n.d. Web. 18 Jan. 2014. <http://www.merriam-webster.com/dictionary/insolvent>.

[2] "Bankrupt": (1) a: a person who has done any of the acts that by law entitle creditors to have his or her estate administered for their benefit; b: a person judicially declared subject to having his or her estate administered under the bankrupt laws for the benefit of creditors; c: a person who becomes insolvent. Merriam-Webster.com. Merriam-Webster, n.d. Web. 18 Jan. 2014. <http://www.merriam-webster.com/dictionary/bankrupt>.

from national Groups to provide a source of reference. It may also be possible to adopt a Resolution on how external factors should affect contracts regarding IP rights.

A number of the questions in the Q190 Working Guidelines related directly to the effect of bankruptcy on IP licenses:

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7) Does the bankruptcy law explicitly provide for the effect of bankruptcy on IP rights and contracts concerning them?

8) Do all intellectual property rights form part of a bankruptcy, or are some exempted?

9) What is the effect of the insolvency or bankruptcy of the licensor and the licensee on a contract regarding intellectual property?

a) Does one party have a right to terminate on the insolvency of the other?

b) Can the insolvent party assign the rights concerned?

c) What effect do express contractual terms have in this situation?

10) Is there any statutory or other protection for a licensee/licensor in the event of the insolvency of a licensor/licensee?

The Q190 Summary Report reflected the responses of 44 Groups to these questions:

7) Does the bankruptcy law explicitly provide for the effect of bankruptcy on IP rights and contracts concerning them?

The great majority of Groups answered this question in the negative. The following comments were made. In the US, the Intellectual Property Bankruptcy Act of 1988 (11 USC 365n) provides for the effect of bankruptcies on contracts concerning 'intellectual property rights' as defined in the Bankruptcy Code. This does not include trademarks or foreign patents or foreign copyrights. Section 365 applies to executory contracts in general (i.e. those with substantial performance remaining on both sides). As IP contracts are generally considered executory, the Code applies to most IP contracts. The Japanese Group noted that Articles 53 and 56 of the Bankruptcy Law apply in certain cases to allow IP licence agreements to continue despite bankruptcy and the administrator in bankruptcy has no right to rescind. The Dutch Group noted that under s21 of the Dutch Bankruptcy Act copyrights which remain with the author, moral rights and rights in unpublished works remain outside a bankruptcy.

8) Do all intellectual property rights form part of a bankruptcy, or are some exempted?

The major exception to rights forming part of a bankruptcy is copyright and related rights. The Australian, Danish, Dutch, Egyptian, Finnish, Japanese, Mexican and Spanish Groups noted that copyright or related rights may not form part of a bankruptcy. The Greek Group noted that such rights must be transferable.

9) What is the effect of the insolvency or bankruptcy of the licensor and the licensee on a contract regarding intellectual property?

a) Does one party have a right to terminate on the insolvency of the other?

b) Can the insolvent party assign the rights concerned?

c) What effect do express contractual terms have in this situation?

The US Group reported that the trustee in bankruptcy of debtor has 3 options for an executor contract. They are to assume performance of the contract; assume then assign; or reject the contract. So while the trustee may reject the contract, the licensee may retain certain rights and may treat the rejection as a breach giving rise to a right to damages or retain the rights granted under the contract (11 USC 365(g)). An insolvent party cannot assign its rights where the contract is analogous to one for personal services. Under 365(f) most contracts can be assumed and assigned, except where they are personal. In the UK the liquidator has a right to disclaim onerous property. This could be the case where the insolvent licensor has continuing obligations. In Japan, a contractual clause giving a right to terminate may not be valid. This depends on the third party effect of the contract. In the Netherlands the trustee in bankruptcy may rescind the contract. In Australia there is a moratorium on action and the court's consent is needed for action. In Portugal the licensor can terminate on the insolvency of the licensee. If the contract is personal the licensee can too. In Belgium under Article 30 of the Copyright Act an author can terminate an agreement with an insolvent publisher. A similar right arises for audiovisual agreements under Article 20. Under Spanish law, contractual terms allowing termination on insolvency are invalid. In Portugal, attempts to vary the statute are void. In Korea an agreement has no effect on the rights of an insolvent party. On the other hand, many Groups noted that the terms of a contract would be critical here.

10) Is there any statutory or other protection for a licensee/licensor in the event of the insolvency of a licensor/licensee?

Very few Groups answered this question positively. In the US the courts, as courts of equity should not allow significant damage to be done to a licensee particularly where there is no countervailing benefit to the insolvent estate. In Belgium the protections described above apply. In the Netherlands it is possible to seek a usufruct – a right to use property belonging to another and enjoy the fruits of it. The German Group described an interesting dual trust structure that may protect against the effects of insolvency.

Q190 was considered at the Gothenburg Congress, 2006, and a resolution was reached. The sections of the Q190 Resolution that pertain to IP and insolvency are as follows:

> *5) Bankruptcy and insolvency laws should provide for treatment of IPRs and contracts concerning them.*
>
> *6) In case of a bankruptcy or insolvency of licensor, the licensee should be permitted to retain the licensed rights, unless otherwise agreed in the relevant license. The person administering a bankruptcy or insolvency of a licensor should not be able to disclaim or reject a license of IPRs so as to terminate the license. In case of bankruptcy or insolvency of the licensee the transfer of the license should be subject to the licensor's consent.*

9) Thus AIPPI has previously reached a resolution in support of addressing contracts that concern IP rights in the bankruptcy and insolvency laws, and further in support of placing limits on the bankruptcy or insolvency administrator's ability to unilaterally disclaim or terminate such a contract. However, as IP insolvency and licensing has not been considered as a dedicated question, a myriad of details remain for consideration. This is particularly true in light of the continued lack of international harmonization in this area, the increasing importance of this issue to multinational companies and cross-border licenses, and the complex public policy issues that are involved.

Discussion

Existing laws and approaches

10) As noted above, the United States has taken a statutory approach to this issue. The Intellectual Property Bankruptcy Act of 1988, codified at 11 U.S.C. §365(n), specifically provides for how IP rights are to be treated during a bankruptcy proceeding. However, this Act applies only to licenses of "intellectual property" as that term is defined in the Bankruptcy Code, *i.e.,* to include patents, copyrights, trade secrets and semiconductor chip mask works. Thus, U.S. trademarks and foreign IP rights do not explicitly fall under the scope of the Act. Section 365 does, however, apply in general to "executory contracts," *i.e.,* contracts with substantial performance remaining by both parties to the contract. Because IP licenses are generally considered as executory contracts, the general provisions of Section 365 should apply.

11) Under the U.S. system, a bankruptcy trustee has three options for treating an IP license (subject to court approval): the trustee may: 1) assume performance under the contract; 2) assume the contract, and then assign it; or 3) reject the contract.

However, the rights to reject and to assign the contract are not unconditional. If the trustee rejects the contract, a licensee may opt to either treat the rejection as a breach and seek monetary damages, or retain the IP rights granted under the license. With regard to assignment of the license, if the debtor is the licensor, the assignment may be made only if the debtor assumes the license and provides assurances that the assignee will perform under the contract. If the debtor is the licensee, under federal common law the debtor cannot assign its rights under a non-exclusive license without the licensor's consent. These rules apply irrespective of whether the license itself contains language restricting assignment thereof.

12) In contrast to the U.S. system, the German insolvency law (and in fact the insolvency law of most other jurisdictions) does not specifically address protection of IP licenses. Section 103 (1) of the German Insolvency Code provides, with respect to contracts containing a continuing obligation, that the administrator may choose whether to perform under a contract or to refuse it. In the case the contract is refused, the other party is left with a claim for non-performance only as an insolvency creditor. Subject to the question of whether an IP license always contains a continuing obligation (i.e., in the case of a fully paid-up license), this means when applied to IP licenses there are two possible scenarios: 1) the administrator may choose to perform under the license (and later sell the assets); or 2) the administrator may choose to refuse performance, in which case the other party obtains an unsecured claim for damages.

13) In two recent copyright decisions from the Federal Court of Justice in Germany,[3] the court has found that a sub-license will remain valid even after termination of the main license due to insolvency of the main licensee. This has the effect of forcing the rights holder (the licensor) to tolerate the use of its IP by a party with whom it has no direct contractual relation. Similarly, the sub-licensee is deprived of the obligations normally required of a licensor, for example, enforcement and maintenance.

14) The Finnish law in this area is similarly complex. In the case of a bankruptcy proceeding, the bankrupt estate has the right but not the obligation to continue performance under a contract.[4] Thus, if the licensor is the insolvent party in bankruptcy, the license could be terminated. This would not generally be true in the case of a company administration proceeding. If the licensee is the insolvent party in bankruptcy or in company administration, the bankrupt estate has the right to enforce performance by the licensor under the license by providing notice and sufficient security. Alternatively, the license may be terminated upon providing sufficient notice. In either case, a provision of a license agreement giving the solvent party the right to terminate the license upon insolvency of the other party is not enforceable. With regard to assignment of a license by a bankrupt party, the Finnish law contains potentially opposing provisions. The Patents Act, Section 43, specifically provides that a license is assignable only if it expressly so provides. Because this is a statutory

[3] BGH July 19, 1012, I ZR 24/11 (Take Five) and I ZR 70/10 (M2Trade).

[4] Finnish law recognizes three types of insolvency proceedings: bankruptcy, which refers to compulsory liquidation of an insolvent company; company administration, which refers to rehabilitation of a company to allow it to continue operations; and a voluntary, contractual debt restructuring process.

provision and not merely contractual language, this provision is enforceable in bankruptcy. However, the Bankruptcy Act, Chapter 5, Section 3:A provides that "a contractual condition restricting the right of the debtor to assign movable property to a third party shall not be binding on the bankruptcy estate." Thus, it appears that a license clause allowing assignment under certain stated conditions might comply with the Patents Act as expressly allowing assignment, but fall afoul of the Bankruptcy Act by restricting the right to assign to those conditions.

15) Under Australian law, an intellectual property license will be treated as any other asset in the case of bankruptcy. However, for licenses that include a perfected security interest registered under the Personal Properties Securities Act, a winding up order will not affect the right of a secured party to realize or act on that perfected security interest. Section 301 of the Australian Bankruptcy Act provides that any provision in a license agreement purporting to allow termination of a license or security agreement upon bankruptcy, or repossession of property upon bankruptcy, is not enforceable.

16) Japanese law in the area of IP licenses and insolvency has been through several changes in recent years. Prior to 2004, a bankruptcy trustee could terminate a license agreement in accordance with his or her business judgment. In 2004, an amendment to the bankruptcy code was passed restricting the trustee's right to terminate if the license had been registered. However, this was found to be problematic for "comprehensive" licenses that did not identify specific patents and patent applications. Thus, in 2007, a comprehensive license registration scheme was implemented for non-exclusive licenses that did not require identification of individual patents. In 2008, a registration system was created that allowed for registration of licenses for pending patent applications. Also in 2008, the registration requirements were changed to limit disclosure of the name of the licensee and to exclude payment terms from the registration. Then, in 2011, the registration system was abolished in favour of protection without registration: "A non-exclusive license shall have effect on any person who acquires the patent after generation of the non-exclusive license." Patent Law, Article 99. However, open questions remain as to the degree to which a licensee must consent to an assignment by a bankruptcy trustee and the applicability of this rule to cross-license situations.

<u>Issues for consideration</u>

17) The preceding brief survey of several national systems illustrates the variety of approaches that are being taken to this issue, and clearly highlights the lack of uniformity of laws in this area. Cross border licenses add an additional dimension to this dilemma. For example, how is the applicable law to be determined? Is a choice of law provision in a license enforceable if the bankruptcy proceeding is in a different jurisdiction? What law applies if the parties to the license agreement are multi-national companies with operations in many countries? Cross licenses also add complexity to this issue. In some industries, a complex web of cross licenses exists, without which

no company could operate in that space. If one major player in that industry were to go into bankruptcy, and all licenses involving that party extinguished, what is the effect on the remaining licenses that relied on the terminated licenses for consideration? Further, in some industries, such as the music industry, complex chains of licenses are common. If an entity that is one link in a chain goes into bankruptcy, can the termination of that entity's licenses result in destruction of the entire chain? Indeed, these questions underscore the importance of this topic to IP rights holders throughout the world.

18) The brief survey of national laws above shows not only great variety in procedural aspects of bankruptcy procedures as they apply to IP licenses, but also in the rights to which they apply. Sub-licenses may be treated differently from "main" licenses. Copyright licenses may be treated differently from patent licenses and trademark licenses. Exclusive licenses may be treated differently from exclusive licenses. These differences add yet another layer of complexity to this topic.

19) Public policy is another topic for consideration in this context. Consider the case of a sub-licensee at the bottom of a long chain of copyright licenses, who sells popular music or software to the public. If one party in that chain of licenses should enter into a bankruptcy or insolvency proceeding, is it in the public interest that the sub-licensee's rights to sell those products to the public should be suddenly disrupted or terminated?

20) Equitable considerations may also come into play in this context. From a bankruptcy administrator's perspective, the goal is to maximize return to creditors. Thus, without restrictions, the administrator will assume and perform (or sell) an IP license that is considered valuable, and terminate one that is not. From the perspective of a licensee dealing with an insolvent licensor, the amount of risk can vary significantly depending not only on the law, but on the particular facts as well. For example, the licensee is at greater risk if no alternative technologies exist, if the license is a long-term license, if the licensee invested substantial resources to gear up for use or sale of the licensed technology, if the license is a paid-up license, and if the licensor was obligated to provide ongoing know-how or other assistance to the licensee. The licensee is at a lesser risk if the converse is true, for example, if the license is a short term, royalty-per-product based license and if there are alternative technologies available. With regard to assignments, the licensee may not be substantially harmed if the license and the underlying IP rights are transferred to an unobjectionable third party. On the other hand, the licensee may be harmed if the transferee is a competitor or a party who cannot perform under the agreement.

21) In view of the preceding two paragraphs, it may be advisable to consider restrictions on a bankruptcy administrator's ability to assume, assign, modify, or terminate an IP license based in part upon public policy and equitable considerations.

Questions

I. Current law and practice

Groups are invited to answer the following questions under their national laws. If both national and regional laws apply to a set of questions, please answer the questions separately for each set of laws.

Please number your answers with the same numbers used for the corresponding questions.

1) Does your country have a registration system for IP licenses? If yes, please describe this system.

2) Describe the type or types of bankruptcy and insolvency proceedings that are available in your country.

3) Does the law that governs bankruptcy and insolvency proceedings in your country address IP rights or IP licenses as distinct from other types of contracts, assets, and property rights? If yes, is the law statutory, regulatory, or based on precedent? Please identify any relevant statutes or regulations.

4) Please answer the following sub-questions based upon the law and jurisprudence in your country that governs bankruptcy and insolvency proceedings:

    a) Describe the law and its effects on a bankruptcy administrator's ability to adopt, assign, modify, or terminate an IP license.

    b) Are equitable or public policy considerations relevant to how an IP license is treated?

    c) Is the law different for different types of bankruptcy and insolvency proceedings in your country?

    d) Does the law require, or give preference to, IP licenses that have been registered according to a registration scheme?

    e) Would the existence of a pledge of or security interest in the IP rights for the benefit of the licensee affect application of the law in the case of an insolvent licensor?

    f) Is the law limited to or applied differently among certain types of IP rights (*e.g.,* patents versus trademarks or copyrights)? If yes, please explain.

    g) Does the law apply differently to sub-licenses versus "main" licenses?

    h) Does the law apply differently to sole or exclusive licenses versus non-exclusive licenses?

    i) Does the law apply differently if the bankrupt party is the licensee versus the licensor?

j) Please explain any other pertinent aspects of this law that have not been addressed in the sub-questions above.

5) Would a choice of law provision in an IP license agreement be considered during a bankruptcy or insolvency proceeding in your country? Is this affected by the nationalities of the parties to the IP license or by the physical location of the assets involved?

6) Would a clause providing the solvent party in an IP license agreement the right to terminate or alter an IP license be considered enforceable during a bankruptcy or insolvency proceeding in your country? Would the answer be different if the clause provides for automatic termination as opposed to an optional right to terminate?

7) Would a clause in an IP license agreement that restricts or prohibits transfer or assignment of the IP license be considered enforceable during a bankruptcy or insolvency proceeding in your country?

8) In the event of a transfer or assignment of an IP license resulting from a bankruptcy or insolvency proceeding, what are the rights and obligations between the transferee and the remaining, original party or parties to the IP license? Does it matter if the insolvent party is a licensor, a licensee, or a sub-licensee?

9) In the event an IP license is terminated during a bankruptcy or insolvency proceeding in your country, would the licensee be able to continue using the underlying IP rights (and if so, are there any limitations on such use)? Does the (former) licensee have a claim to obtaining a new license?

10) If IP rights that are jointly owned by two parties have been licensed to a licensee by one or both of the joint owners, and one of the joint owners becomes insolvent, how would the IP license be treated in a bankruptcy or insolvency proceeding in your country? Could the IP license be terminated even if this would result in termination of an agreement between the solvent, joint rights owner and the solvent licensee?

11) Are there non-statutory based steps that licensors and licensees should consider in your country to protect themselves in insolvency scenarios, *e.g.,* the creation of a dedicated IP holding company, creation of a pledge or security interest in the licensed IP for the benefit of the licensee, registration of the license, and/or inclusion of certain transfer or license clauses?

II. Policy considerations and proposals for improvements to your current system

12) If your country has a registration system for IP licenses, is it considered useful? Is it considered burdensome? Are there aspects of the system that could be improved?

13) If the law that governs bankruptcy and insolvency proceedings in your country does not address IP rights or IP licenses as distinct from other types of contracts, assets, and property rights, should it do so? If yes, should the law be statutory?

14) With regard to a bankruptcy administrator's ability to adopt, assign, modify, or terminate an IP license under the current law of your country, are there aspects of this law that could or should be improved to limit this ability? Should equitable or public policy considerations be taken into account?

15) Are there other changes to the law in your country that you believe would be advisable to protect IP licenses in bankruptcy? If yes, please explain.

III. Proposals for substantive harmonisation

The Groups are invited to put forward proposals for the adoption of harmonised laws in relation to treatment of IP licenses in bankruptcy and insolvency proceedings. More specifically, the Groups are invited to answer the following questions *without* regard to their existing national laws.

16) Is harmonization of laws relating to treatment of IP licensing in bankruptcy and insolvency proceedings desirable?

17) Please provide a standard that you consider to be best in each of the following areas:

a) What restrictions, if any, should be placed on a bankruptcy administrator's ability to adopt, assign, modify, or terminate an IP license in the event of bankruptcy of a party to that license? Should these restrictions be statutory?

b) With regard to sub-paragraph 17(a) above, to what degree, if at all, should such restrictions depend upon pre-bankruptcy registration of the IP license?

c) With regard to sub-paragraph 17(a) above, to what degree, if at all, should such restrictions depend upon whether the bankrupt party is the licensor or a licensee?

d) With regard to sub-paragraph 17(a) above, to what degree, if at all, should such restrictions depend upon whether the licensee has a security interest in the underlying IP rights?

e) With regard to sub-paragraph 17(a) above, to what degree, if at all, should such restrictions depend upon whether the license is a sub-license or a "main" license?

f) With regard to sub-paragraph 17(a) above, to what degree, if at all, should such restrictions depend upon whether the license is sole, exclusive or non-exclusive?

g) With regard to sub-paragraph 17(a) above, to what degree, if at all, should such restrictions depend upon the type or types of IP rights that are licensed in the IP license?

h) With regard to sub-paragraph 17(a) above, to what degree, if at all, should such restrictions depend upon equitable or public policy considerations?

i) With regard to sub-paragraph 17(a) above, to what degree, if at all, should such restrictions depend upon the language of the license itself, *e.g.,* a right to terminate upon insolvency or a prohibition against assignment?

j) In the event a bankruptcy or insolvency proceeding in your country involves treatment of an IP license between a domestic entity and a foreign entity, which national bankruptcy laws should be applied? Should this depend on the choice of law clause in the IP license? Should this depend on the physical location of the entities or the assets involved?

18) To the extent not already stated above, please propose any other standards that you believe would be appropriate for harmonization of laws relating to treatment of IP licenses in bankruptcy and insolvency proceedings.

The Groups are invited to comment on any additional issues concerning any aspect of IP law and insolvency that they deem relevant.