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Help! My Licensor/Licensee Has Gone Insolvent – What Can I Do?

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Insolvency in the US

Review Your IP License Agreements to Determine Whether or Not Subject to the Bankruptcy Code

- The Bankruptcy Code (11 USC Section 365) governs “executory ” contacts.
- Courts examine the practical effect of the agreement to determine if "essential rights" in the underlying intellectual property have transferred an ownership interest, rendering the agreement "non-executory". In determining whether "essential rights" have been transferred under an agreement, courts generally look at 3 bundle of rights:
 1. the right of exclusivity in the intellectual property;
 2. the right to transfer; and
 3. the right to sue infringers.
- If these 3 rights have been transferred, then the Licensee is imputed to have "title" to the intellectual property and the license is generally outside of the scope of a Bankruptcy debtor or Trustee's rejection.
- If less than all 3 rights have been transferred, courts generally hold the rights merely contractual and the agreement executory, and subject to being assumed or rejected in bankruptcy.

Assuming Contract is Found to be Executory

Section 365(n) specifically addresses intellectual property licenses, granting the Trustee the right to reject or assume the intellectual property license agreement. Section 365(n) defines "intellectual property" to include only patents, copyrights, and trade secrets -- only these specific types of intellectual property are addressed by the terms of the Code. Note, that trademarks are **not** included in the Bankruptcy Code's definition of Intellectual Property.

What Happens If Your Licensor Files for Bankruptcy?

The Licensor or Trustee can either: assume or reject the license --

If the Trustee assumes the license –

- The nature of the parties' relationship does not change much. However, it is important to note that if the Trustee decides to assume the license, then, despite any language in the agreement to the contrary, the Licensee may not terminate the license and will be required to continue to perform its obligations under the license.

What Happens If Your Licensor Files for Bankruptcy? (cont.)

If the Trustee decides to reject the license--

- The Licensee then has a choice to make -- the Licensee must decide whether to: 1. treat the license as terminated by virtue of the Trustee's rejection and file a claim for monetary damages arising out of the terminated agreement (may not be an option if Licensee requires the licensed technology for its business); or 2. Licensee can retain its rights under the license and continue to use the licensed intellectual property, even though the Trustee has rejected the license. The Licensee would retain the right to use the licensed intellectual property and enjoy any exclusivity provision for the duration of the license, including any extensions available under the license, so long as Licensee meets its obligations under the license.
- Sounds like even if the Trustee rejects the license, but the Licensee decides to retain its rights under the license, there should be no problem for the Licensee -- Right? ... Not quite ...

Limitations On Licensees

Limitation to only existing IP - Even though the Licensee may decide to continue to use the licensed intellectual property, and retain its licensing rights, the Trustee is permitted to reject, separately, all other ancillary, affirmative obligations of the Licensor. For example, the Trustee can reject any obligation requiring the Licensor to provide technical support, or updates or improvements to the licensed intellectual property. This limitation can create serious problems for a Licensee when dealing with intellectual property that is in the process of being created when a bankruptcy proceeding is filed, or intellectual property which may be upgraded after the date of filing of the Debtor-Licensor's bankruptcy petition. The Licensee will be powerless to require the bankrupt Licensor to fulfill these obligations.

Watch out for Trademarks!

Remember that under Section 365(n), intellectual property is limited to only patents, copyrights and trade secrets. Thus, trademark Licensees enjoy none of Section 365(n)'s special protections and those Licensees are at risk of losing their trademark rights in a Licensor's bankruptcy.

Practical tips for a Licensee to Protect Themselves

What can a Licensee do to protect themselves?

- Consider including language in the license agreement which provides a disincentive for rejection, such as liquidated damages.
- Require specific renewal options and extensions of the license rights to maximize the term of the Licensee's rights to the licensed intellectual property.
- Specify what rights the Licensee has with respect to exclusivity (territorial vs. field-of-use); transfer; and ability to bring suit against infringers. Be aware that if a Licensee continues to use the intellectual property under an executory license which was rejected by the Bankruptcy Trustee, Licensee may not have the ability to stop infringers from exploiting the intellectual property.
- Consider placing any sensitive trade secret or proprietary information which is integral to the licensed intellectual property into escrow allowing Licensee to access upon certain triggering events, such as the filing of a bankruptcy proceeding either by or against the Licensor.
- Consider a security interest in the underlying intellectual property.

What Happens if Your Licensee Files for Bankruptcy?

The law is different when an IP Licensee files for bankruptcy. The Bankruptcy Code, Section 365(c)(1), contains an exception to the general rule that executory contracts can be assumed and assigned to third parties if defaults are cured and adequate assurance of future performance can be demonstrated. This exception applies when "applicable law" precludes an assignment absent consent of the non-debtor party.

Can the Debtor-Licensee Assume or Assign Its IP License Over the IP Licensor's Objection?

- Bankruptcy Code Section 365(c)(1) -- limits on the Debtor-Licensee's ability to assign or even assume licenses.
- Section 365(c)(1) states: (c) The trustee may not assume or assign any executory contract . . . whether or not such contract . . . prohibits or restricts assignment of rights . . . if --
 - (1)(A) applicable law excuses a party, other than the debtor, to such contract . . . from accepting performance from or rendering performance to an entity other than the debtor . . . whether or not such contract . . . prohibits or restricts assignment . . . ; and
 - (B) such party **does not consent** to such assumption and assignment.

What's “Applicable Law”?

Courts have generally interpreted the phrase "applicable law" to mean patent, trademark, copyright law and held that these federal intellectual property laws excuse a non-debtor party (Licensor) from accepting performance from or rendering performance to any entity other than the Debtor (Licensee). As a general rule, intellectual property licenses are inherently non-assignable without consent. Thus, a Licensor who does not consent can successfully block a Debtor-Licensee from assigning a patent, copyright or trademark license to a third party. Applies to non-exclusive IP licenses, and may also apply to exclusive licenses.

What Constitutes Consent?

- Consent to the assignment or assumption of a license can be found either:
 - when the Licensor consents in writing;
 - when a Licensor fails to object after a motion has been filed seeking to assume or assign the license; or
 - when the license itself contains a provision allowing assignment.

If the Debtor-Licensee Cannot Assign the License Without Consent, Can They Assume the License?

It Depends -- Courts are literally all over the map on this issue. A Debtor-Licensee's ability to assume an IP license over the objection of the Licensor can be radically different depending upon the rights licensed and where the bankruptcy case is pending.

Practical Tips

- Address Licensor consent to assumption during negotiation process. Licensor may consent if no change of control over Licensee occurs.
- Prior to filing bankruptcy, Licensee should audit all licenses. Licensee may consider alternatives to bankruptcy or best venue for filing.

Insolvency in the UK

Outline

1. The main UK insolvency procedures

2. Licensor insolvency:

- Can the IP rights be sold off without the licence?
- What if the licensor just fails to renew the IP rights?
- The liquidator's power to disclaim "onerous" licences
- Practical tips

3. Licensee insolvency

- CVAs (company voluntary arrangements) and risks for licensors
- Other risks and practical tips

Overview of UK Terminology and Procedures

"Insolvency" – a generic term covering (amongst other things):

- **administration** (where there is a prospect that the company could be rescued as a going concern) – the most popular procedure;
- **company voluntary arrangement** (the directors make a proposal which the creditors may vote on) – offers flexibility;
- **liquidation** or "winding up" (the assets are sold off and the company is usually dissolved); now used less than administration; power to "disclaim" onerous property;
- bankruptcy (individuals, not corporates)

"Insolvency practitioner" – a professional who may act e.g. as an administrator or liquidator.

What Happens to the Licence if the Insolvency Practitioner Sells Off the IP?

General principle under UK law – a purchaser in good faith for valuable consideration, **without actual or constructive knowledge** of the licence, takes free of the licence.

So for registered IP rights (patents, registered trade marks, registered designs), it is important to **register** the licence.

Especially where registration is not possible (e.g. copyright, unregistered designs, confidential information, unregistered trade marks), ensure the insolvency practitioner is **put on notice** of your licence. Write a formal letter.

Be ready to make an offer to **buy** the licensed IP (which should help keep you informed of plans, too).

What if the Licensor Breaches the Licence, eg by Failing To Pay Renewal Fees?

The licensee may have a claim for breach of contract – but may never recover damages as it will be an unsecured creditor.

The licensee may be able to pay the fee itself to keep the IP right alive (but risks having paid for nothing if the liquidator disclaims – see below).

What if the Licensor is Dissolved When it Still Owns the IP?

The IP goes to the Crown as "*bona vacantia*" (goods without an owner) and the licensee may be able to buy it – at "full market value". www.bonavacantia.gov.uk

The Crown may disclaim, so act quickly.

The licence has no effect as the licensor no longer exists.

The Liquidator's Power to Disclaim - 1

A liquidator has the power to disclaim (reject) "onerous property", namely:

- "(a) *any unprofitable contract, and*
- (b) *any other property of the company which is unsaleable or not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act."*

An IP licence could be considered "onerous property" e.g. if the licensor is obliged to pay renewal fees / to provide technical assistance or improvements / to sue third party infringers.

Royalties do not stop the licence being "onerous property" (but if there are e.g. minimum royalties, the liquidator may be more interested in selling off the licence along with the IP rights).

The Liquidator's Power to Disclaim - 2

Effect of disclaimer (section 178(4) UK Insolvency Act 1986):

"A disclaimer ...

- (a) operates so as to determine, as from the date of the disclaimer, the rights, interests and liabilities **of the company** in or in respect of the property disclaimed; but

- (b) does not, **except** so far as is necessary for the purpose of releasing the company from any liability, affect the rights or liabilities of any **other** person."

The Liquidator's Power to Disclaim - 3

Section 178(6): "Any person sustaining loss or damage in consequence of the operation of a disclaimer under this section is deemed a creditor of the company to the extent of the loss or damage and accordingly may prove for the loss or damage in the winding up."

So the licensee becomes a creditor (but may never recoup its loss).

Following a disclaimer, the licensee could apply to have ownership of the IP rights transferred to it (under section 181).

Licensors Insolvency - Practical Tips – Before the Insolvency

- Can you get an **assignment (or co-ownership)** instead? Beware of assignments shortly before an insolvency. Co-ownership can be complex.
- Can the IP be assigned to an "**insolvency remote**" vehicle?
- Can you include in the licence an **option to acquire ownership** of the IP should an insolvency arise later? You must pay full market value to exercise the option.
- Can you **take security** over the licensed IP (and register the security interest)?
- Ensure the licence is **registered** e.g. at the relevant patent office.
- Put materials (e.g. software source code) into **escrow** for release to licensee upon insolvency.
- Ensure regular communication of **improvements**.
- Try to **phase payments** over the life of the licence, to make it more attractive for the insolvency practitioner to keep the licence in existence.
- If appropriate, agree to pay the **renewal fees** and e.g. deduct them from royalties, to make it less likely that the licence is regarded as "onerous property".
- Consider **separating out the positive obligations** on the licensor (e.g. suing infringers, providing technical assistance) into a separate document, to make it less likely that the licence document itself will be disclaimed.

Licensor Insolvency - Practical Tips – After the Insolvency

- Monitor the licensor.
- As above, ensure the licence is registered e.g. at the relevant patent office.
- Keep an eye out for notices from an insolvency practitioner.
- Make sure the insolvency practitioner knows about your licence.
- Consider making an offer to buy the IP rights.

Licensee Insolvency – Company Voluntary Arrangements ("CVAs")

A CVA is a composition in satisfaction of a company's debts, or a scheme of arrangement of its affairs the implementation of which is supervised by an insolvency practitioner.

The directors make a "proposal" for a CVA - e.g. to pay only 70% of licence fees and pay other creditors off in full.

If shareholders and creditors vote in favour by more than 75%:

- the insolvency practitioner will implement the proposal
- (depending on its terms) the current management may remain in place
- the proposal will be **binding on all unsecured creditors** – even those who did not attend the meeting (but for secured creditors, only those who voted in favour).

So: it is important to look out for a notice of a meeting and to attend. A licensor may find that its royalty stream is reduced without its consent.

Licensee Insolvency - General

The licensor is likely to have the right to terminate the licence for insolvency (or for breach e.g. when the licensee fails to pay the next royalty instalment).

If there are e.g. minimum royalty payments, consider instead leaving the licence in effect and making a claim for the loss, as a creditor. But you may get nothing, if there are insufficient assets.

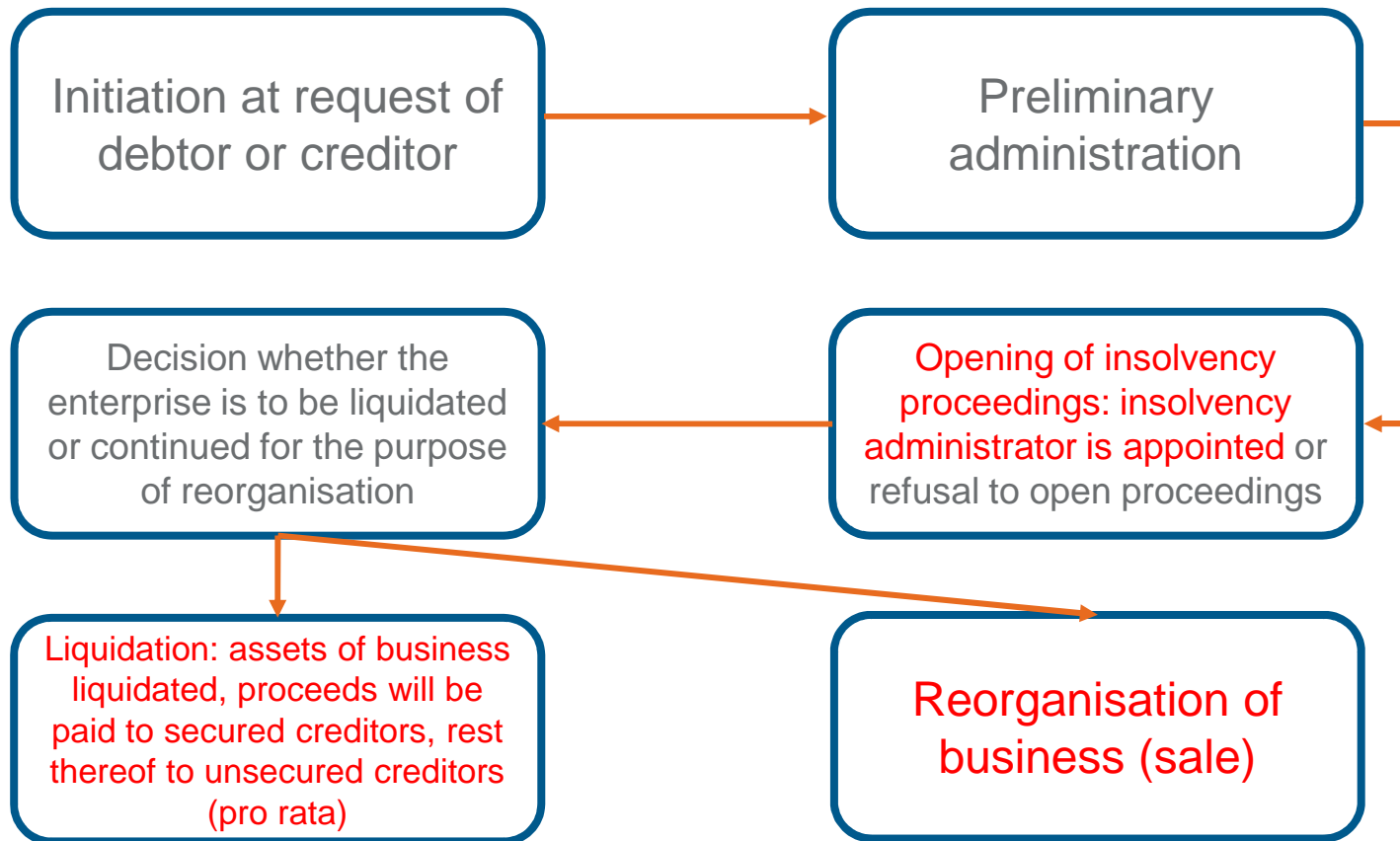
Whether you terminate will also depend on reputational issues e.g. where the licence covers trade marks.

If the licensee is obliged to pay renewal fees, the licensor should pay them rather than risk the rights lapsing.

The insolvency practitioner cannot assign the licence if the licence itself does not permit this.

Insolvency in Germany

Course of the Insolvency Proceedings in the Case of the Insolvency of A Company



Legal Consequences of the Opening of the Insolvency Proceedings - I

German Insolvency Act, s. 35

The insolvency proceedings shall involve all of the assets owned by the debtor on the date when the proceedings were opened and those acquired by him during the proceedings (assets involved in the insolvency proceedings).

Legal Consequences of the Opening of the Insolvency Proceedings - II

German Insolvency Act, s. 80

(1) Upon the opening of the insolvency proceedings the debtor's right to manage and transfer the assets involved in the insolvency proceedings shall be vested in the insolvency administrator.

Legal Consequences of the Opening of the Insolvency Proceedings - III

German Insolvency Act, s. 103

(1) If a mutual contract was not (or not completely) performed by the debtor and its other party at the date when the insolvency proceedings were opened the insolvency administrator may perform such contract replacing the debtor and claim the other party's consideration.

Insolvency of Licensor

Insolvency of Licensor

- IPR¹ becomes part of the assets involved in the insolvency proceedings, German Insolvency Act, s. 35.
- Non-exclusive and exclusive licenses are subject to the option to be exercised by the insolvency administrator, German Insolvency Act, s. 103 (1).
 - ➔ in case of insolvency the insolvency administrator may refuse to perform the license agreement.
 - ➔ other party shall be entitled to its claims for non-performance only as a creditor of the insolvency proceedings. BUT: only pro rata payment.
 - ➔ be prepared!

Solutions – if any ...

Rule: Section 35

The insolvency proceedings shall involve all of the assets owned by the debtor on the date when the proceedings were opened and those acquired by him during the proceedings (assets involved in the insolvency proceedings).

Exception1: Section 47

Anyone entitled to **claim the separation of an object** from the assets involved in the insolvency proceedings under a right in rem or in personam shall not form part of the creditors of the insolvency proceedings.

Exception2: Section 49

Creditors with a **right to satisfaction** from objects subject to execution into immovables (immovable objects) shall be entitled to **separate satisfaction**

Solution 1-A: Security Assignment of IPR + License

Section 49

Creditors with a **right to satisfaction** from objects subject to execution into immovables (immovable objects) shall be entitled to **separate satisfaction**

Section 50

(1) Creditors holding a contractual pledge, ... in an object forming part of the assets involved in the insolvency proceedings shall be entitled to **separate satisfaction in respect of main claim**, interest and costs from the pledged object under sections 166-173.

Section 51

The following creditors shall be deemed equal with those specified under section 50:

- 1. creditors to whom the debtor has assigned a movable item or a right in order to secure a claim; ...**

Solution 1-B: Security Assignment of IPR + License

- Under German Insolvency Act, s. 166, the insolvency administrator may dispose of a movable item subject to a right to separate satisfaction without restriction if he holds its possession.
 - ➔ licensee may try to buy the IPR from the insolvency administrator.

Solution 1-C: Security Assignment of IPR + License

- Under German Insolvency Act, s. 173, the creditor's right to dispose of such object shall remain unaffected if the insolvency administrator is not entitled to dispose of a movable item or a claim subject to a claim to separate satisfaction.
 - ➔ assignment agreement should include an accession clause, provisions stipulating transfer of IPR or the license.

Solution 1-D: Security Assignment of IPR + License

- Caveat:
 - it is uncertain, whether German Insolvency Act, s. 166 or s. 173 applies.
 - is licensor willing to assign the IPR?
- Maybe agreeable for licensor:
 - agent holds IPR for the benefit and on behalf of each of the parties (Doppeltreuhand).
 - pledge of IPR: German Insolvency Act, s. 50 applies.

Solution 2-A: Usufruct + License

German Civil Code, s. 1030

- (1) A thing can be encumbered in such a way that the person for whose benefit the encumbrance is made is entitled to take the benefit of the thing (usufruct).

German Civil Code, s. 1068

- (1) The subject of the usufruct may also be a right.
- (2) Usufruct in rights is governed by the provisions on usufruct in things with the necessary modifications, except to the extent that sections 1069 to 1084 provide otherwise.

Solution 2-B: Usufruct + License

- German Insolvency Act, s. 47, applies.
 - **claim for the separation of an object** from the assets involved in the insolvency proceedings.
- Caveat:
 - limitation of use maybe void or without effect vis-à-vis third parties.
 - according to German Insolvency Act, s. 119, agreements excluding or limiting the application of ss. 103 to 118 in advance shall be invalid.

Solution 3-A: Creation of A(n already) Performed License Agreement

- Remember German Insolvency Act, s. 103

Section 103

(1) If a mutual contract **was not (or not completely) performed by the debtor and its other party at the date when the insolvency proceedings were opened** the insolvency administrator may perform such contract replacing the debtor and claim the other party's consideration.

Solution 3-B: Creation of A(n already) Performed License Agreement

- How to create the already performed license agreement - when is an agreement performed?

German Civil Code, s. 320

(1) Unless the contract requires him to perform first, a person bound by a reciprocal contract may refuse to perform his part until the other party effects counterperformance. ...

German Civil Code, s. 321

(1) A person bound by a reciprocal contract to perform first may refuse to perform his part, if after conclusion of the contract it becomes apparent that his claim for counterperformance is endangered by the other party's lack of ability to perform.

Solution 3-C: Creation of A(n already) Performed License Agreement

- waive defence under German Civil Code, ss. 320, 321.
- further, exclude right of licensor to terminate agreement for a certain period of time and replace it by a right to withdrawal from the agreement.
- Caveat:
 - according to German Insolvency Act, s. 119, agreements excluding or limiting the application of ss. 103 to 118 in advance shall be invalid.

Solution 4: Federal Supreme Court case IX ZR 162/04

“This Agreement may be terminated by either party for good cause ... Good cause shall exist if circumstances occur which, taking into consideration the substance and purpose of this Agreement, would make it unreasonable for one or both of the parties to continue the contractual relationship.

Upon the termination of this Agreement, the licensee shall acquire title and interest in the [IPR]...”

- ➔ transfer of title under a suspensive condition (here: termination) is outside the scope of German Insolvency Act, ss. 103 and 119.
- Caveat: there is no general rule that insolvency constitutes a “good cause.” ⁴³

Insolvency of the Licensee

Insolvency of the Licensee - I

- Risks: E.g.
 - license fees may be paid only pro rata.
 - deterioration of licensee's financial situation is no cause for terminating the contract if there is already an application for opening the insolvency proceedings, German Insolvency Act, s. 112 No. 2.
- Licensor's likely interest: terminate the agreement

Insolvency of the Licensee - II

- How to draft the license agreement?
 - ➔ caveat: According to German Insolvency Act, s. 119, agreements excluding or limiting the application of ss. 103 to 118 in advance shall be invalid.
- Provisions stipulating termination of the agreement should
 - not refer to the opening of insolvency proceeding or to request to open the proceedings.
 - may refer to illiquidity or to over-indebtedness.
 - should contain severability clauses.

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Questions & Answers



Thank you