



Intellectual Property and Bankruptcy

Worlds Collide, But It's Not As Bad As You Think It Is

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Background on Bankruptcy



- Most common types
 - Chapters 7, 11 and 13
- Chapter 15 – Recognition of foreign proceedings
- Most IP issues arise in Chapter 11 where debtor is licensor or licensee of IP

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IP under the Bankruptcy Code

- Not all IP is created equal
- Section 101(35A) defines “intellectual property” as the following
 - A trade secret
 - An invention, process, design, or plant protected under title 35
 - A patent application
 - A plant variety
 - A work of authorship protected under Title 17
 - A mask work protected under Chapter 9 of Title 17
- Note that this definition **does not** include trademarks, trade names or service marks
 - Licensees of trademarks, trade names and service marks are at risk if licensor files bankruptcy

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Treatment of IP under the Bankruptcy Code

- What happens to an IP license agreement if the owner of the intellectual property files a bankruptcy petition
- Is a license agreement an “executory contract”
 - Contract that requires some future or ongoing performance by both parties, where the outstanding obligations for the parties are material
 - Countryman test
- Examples of material obligations for executory purposes
 - The obligation of the intellectual property owner to refrain from suing the licensee
 - The obligation of the licensee to account for and pay royalties to the licensor
 - The duty to maintain confidentiality on the part of the licensee
 - The duty on the part of the licensor to indemnify and defend the licensee from infringement claims
- Nonexclusive license agreements – typically considered executory
- Exclusive license agreements – tantamount to sale and non-executory
- Cannot terminate an executory contract during bankruptcy

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License Agreements as Executory Contracts

- Section 365 permits
 - Rejection
 - Assumption
 - Assumption and assignment
- Assumption requires the debtor to
 - Cure, or provide adequate assurance that it will promptly cure, defaults (subject to certain exceptions not pertinent to this discussion) under the contract
 - Compensate, or provide adequate assurance that it will promptly compensate, the other party to the contract for any actual pecuniary losses resulting from prior defaults
 - Provide adequate assurance of the debtor's ability to fully perform all of its future obligations under the contract
- Assignment requires the assignee to provide adequate assurance of its ability to perform all future obligations under the contract

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What Happens When a Licensor Rejects an IP License Agreement?

- Section 365(n) provides that if a debtor rejects an executory contract under which the debtor is a licensor of IP, the licensee may either
 - Elect to treat the contract as terminated (*i.e.*, breached), and file a proof of claim for damages flowing from the debtor's termination of the contract
 - Retain its rights to use the IP under the contract for the duration of the contract and for any extension periods provided for by the contract
- If non-debtor licensee elects to retain its rights to the IP
 - The licensee must continue to make all royalty payments due under the original term of the contract, and any term extensions that the licensee elects to exercise
 - The licensor must, upon written request, comply with contractual requirement to provide the IP to the licensee and must refrain from interfering with the rights of the licensee to the IP
- Hints for licensee
 - Be proactive
 - Do not wait for rejection to exercise Section 365(n) rights

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Are Any Protections Given to Trademark Licensees?

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- Previously, some courts held that Sections 101(35A) and 365(n) created the inference that Congress did not intend to protect a trademark licensee in the same way in which an IP licensee is protected
- Other courts rejected this “negative inference” and held that bankruptcy courts have the authority to permit a non-debtor to retain a trademark license based upon the equities of the case
- The Seventh Circuit rejected the “negative inference” and relied on Section 365(g) to allow the licensee to continue to use the trademark
- On May 20, 2019, the Supreme Court issued its opinion in *Mission Product Holdings, Inc. v. Tempnology, LLC*
 - Victory for trademark licensees
 - Court rejected the “negative inference” and sided with Seventh Circuit’s holding that rejection of an executory contract simply constitutes a prepetition breach of that contract and does not act as either a contract rescission or a termination
 - Justice Sotomayor opened the door to Congress to tailor post-rejection provisions for trademark licensees

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What Happens When a Licensee Seeks to Assume an IP License Agreement?

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- Contract cannot prohibit its own assignment
- Section 365(c)(1) provides an exception
 - A debtor “may not assume or assign” an executory contract or unexpired lease if “**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” and “such party does not consent to such assumption or assignment”
 - “Applicable law” includes patent laws
 - A nonexclusive IP license is personal and not assignable without patent owner’s consent
- Implications of Section 365(c)(1) vary by Circuit and test employed
- Actual test: Licensor cannot prevent assumption unless the debtor-licensee intends to assume and assign
 - Adopted by First and Fifth Circuits and lower courts in Seventh, Eight and Tenth Circuits

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What Happens When a Licensee Seeks to Assume an IP License Agreement? (cont.)



- Hypothetical test: Asks if debtor-licensee could hypothetically assign contract over objection of licensor
 - Enormous power to the licensor
 - Adopted by the Third, Fourth, Ninth and Eleventh Circuits
- Footstar approach: Debtor can assume the contract over the objections of the licensor, but a trustee cannot
- Supreme Court has noted the conflict but has not yet resolved the split

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Chapter 15 and Foreign Insolvency Proceedings



- Permits U.S. recognition of foreign insolvency proceeding
- What happens if the foreign jurisdiction does not protect IP license rights as per Section 365(n)
- The Fourth Circuit held that Section 365(n) should be applied in Chapter 15 cases to protect a licensee from a foreign debtor-licensor seeking to reject an IP license

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Hints and Strategies

- Prior to any bankruptcy filing, review the company's existing IP license agreements to ensure that the company is protected
- If a bankruptcy is filed, consult with bankruptcy counsel
- If the company is a licensee under an IP license agreement, and if the licensor files
 - Review the agreement and make a determination as to whether it is executory
 - If the agreement is executory, the company must decide whether it wants to retain its rights under the agreement
 - If the company decides to retain its rights under the agreement in accordance with Section 365(n), notice should be sent to the debtor of the company's decision
 - Need to oppose any motion to reject the agreement

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Hints and Strategies (cont.)

- If the company is a licensor under an IP license agreement and the debtor-licensee files
 - Determine if agreement is executory
 - Does company want to object to assumption or assumption and assignment
 - Determine test to be applied
- If negotiating an IP license agreement on behalf of a licensee
 - Ensure that the license agreement specifically provides that the subject of the license agreement is "intellectual property" and that the licensee is entitled to all of the protections afforded licensees under Section 365(n)
 - Negotiate narrowly defined royalty payments and differentiate the royalty payments from other monetary obligations under the agreement
 - Use separate agreements for separate aspects of the transaction
 - Have an SPE hold the IP
 - Negotiate for perpetual, exclusive license

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Hints and Strategies (cont.)

- If negotiating an IP license agreement on behalf of a licensor
 - Goals are to
 - Increase licensor's leverage if the licensee should file for bankruptcy
 - Control the licensee's ability to assume, or assume and assign, the license agreement (e.g., through choice of law provision or by identifying the specific assignments that should be prohibited)
 - Although the enforceability of such provisions is debatable, it is best practice to include in the agreement limitations on assignability and then to litigate the enforceability of the limitations if necessary
 - Include terms to enhance the licensor's ability to terminate the agreement before a bankruptcy is filed
 - If the license agreement is terminated prior to the bankruptcy filing, the agreement cannot be revived
 - It will not be part of the bankruptcy estate and therefore cannot be assumed

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Hints and Strategies (cont.)

- If you are the licensee consider whether or not you need an escrow agreement:
 - Escrow agreements under Section 365(n)
 - The purpose of an escrow agreement
 - What materials should be deposited
 - Periodic updates to the escrow materials
 - Release conditions
 - Release mechanism
 - Post release license rights and other obligations
 - Additional issues.

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Your Squire Patton Boggs Team

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Mark Salzberg is a partner in Squire Patton Boggs' Washington DC office and the firm's Restructuring & Insolvency Practice Group. He focuses his practice on bankruptcy litigation, creditors' rights, debtor reorganizations and complex commercial litigation.

Mark has extensive experience representing debtors, creditors' committees, financial institutions, secured and unsecured creditors, franchisors and distributors in bankruptcy matters throughout the United States. He has served as the lead appellate counsel in multiple bankruptcy appeals at both the district court and bankruptcy appellate panel levels and regularly counsels clients on intellectual property matters arising under the Bankruptcy Code.

In addition to his bankruptcy work, Mark has represented parties in a wide variety of complex commercial litigation cases in both state and federal courts, including lender liability suits and other business tort actions, breach of contract, trade secret and noncompete actions.

Mark was a member of the D.C. Bar Board of Governors from 2014-2015 is currently serving as Chair of the D.C. Bar Regulations/Rules/Board Procedures Committee. Mark was a member of the Law 360 Bankruptcy Editorial Advisory Board from 2014-2017.

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▪ **Ivan Rothman** – Of Counsel, Intellectual Property and Technology Practice Group

Ivan Rothman is Of Counsel in the firm's San Francisco office and a senior member of the firm's Intellectual Property and Technology Group. His practice focuses on IP-related transactions, including license agreements, service agreements, development, manufacturing and supply agreements and outsourcing and joint venture agreements.

Additionally, Ivan attends to general IP matters in the context of M&A transactions and provides general counsel on a wide range of IP and technology-related legal matters, including the protection of trade secrets and the use of open source software components. Ivan also provides general counsel on privacy and data security matters, in particular related to the recent California Consumer Privacy Act.

He has represented both domestic and foreign clients, including start-ups and large public corporations, across multiple industries, in a wide range of legal matters.

Prior to joining the firm in 1998, Ivan worked as a lawyer at a leading intellectual property law firm in Israel where he counseled both national and international companies in a variety of intellectual property matters including licensing, trademark prosecution and enforcement, copyright protection and IP infringement litigation.

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