

**Bankruptcy and Intellectual Property: Trademark Licenses,
Chapter 15, and Pending Legislation**

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Introduction

Recent cases have addressed the interplay between intellectual property and bankruptcy, including trademark licenses and Section 365(n)'s application in Chapter 15 cases. Proposed legislation could change how trademarks and other intellectual property are treated in bankruptcy. This paper examines key cases and the proposed legislation pending in Congress.

Intellectual Property Licenses and Section 365(n)

Prior to the enactment of Section 365(n) of the Bankruptcy Code, 11 U.S.C. § 365(n), licensees whose intellectual property licenses were rejected as executory contracts lost their rights under the license. In *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), the Fourth Circuit held that when Congress enacted Section 365(g) of the Bankruptcy Code, governing the effect of rejection of an executory contract, “the legislative history of § 365(g) makes clear that the purpose of the provision is to provide only a damages remedy for the non-bankrupt party,”¹ and no specific performance remedy. As a result, when the debtor rejected the contract, Lubrizol, as patent licensee, lost its rights under the license.

In reaction to *Lubrizol* and the concerns about the decision's potential impact on patent and other technology licensees, Congress enacted the Intellectual Property Bankruptcy Act of 1988, adding Section 365(n) to the Bankruptcy Code to give licensees special protections. When Section 365(n) was enacted, Congress added a special, limited definition of “intellectual property” to the Bankruptcy Code in Section 101(35A). This definition includes trade secrets, U.S. patents, patent applications, copyrights, plant variety, and mask works — but not trademarks. With no Section 365(n) protection, and in the face of the *Lubrizol* decision, trademark licensees have long faced a serious risk of losing all license rights to a trademark if the licensor files bankruptcy and rejects the trademark license as an executory contract. Even the

¹ *Lubrizol*, 756 F.2d at 1048.

enforceability of phase-out provisions, allowing a licensee to continue to use a mark for a limited time period after the license is terminated, is unclear. If the trademark owner decides that the license is now unfavorable and a better deal can be had under a new license agreement with someone else, the trademark owner likely will reject the existing trademark license agreement.

Recent decisions have attempted to fill the gap created by *Lubrizol*, Section 365(n), and the Bankruptcy Code's definition of "intellectual property," and offer rays of hope to trademark licensees and notes of caution to trademark licensors in bankruptcy. Three decisions in particular warrant further discussion.

The Third Circuit Treats a Trademark License as Non-Executory

In *In re Exide Techs.*, 607 F.3d 957 (3d Cir. 2010), the United States Court of Appeals for the Third Circuit examined a series of agreements, determined to constitute one integrated agreement, pursuant to which Exide Technologies sold an industrial battery business, and licensed certain trademark rights, to EnerSys.

Exide filed for bankruptcy in 2002, and the bankruptcy court granted Exide's motion to reject the agreement as an executory contract, a decision that was affirmed by the district court. On appeal, the Third Circuit held that under New York law, which governed the agreement, once a party has substantially performed, a later breach by that party does not excuse performance. EnerSys had substantially performed by paying the full purchase price and operating under the agreement for 10 years, as well as by assuming certain liabilities related to the business. As such, the agreement was no longer executory. EnerSys's obligation not to use the trademark outside of the licensed business was not a material obligation because it was a condition subsequent and, in any event, did not relate to the agreement's purpose - the transfer of the industrial battery business in return for a \$135 million payment. Likewise, a quality standards provision was

minor because it related only to the standards of the mark for each battery produced and not to the transfer of industrial battery business that was the agreement's purpose. An indemnity obligation that had subsequently expired, and a further assurances obligation where no remaining required cooperation was identified, were held not to outweigh the factors supporting a finding of substantial performance.

Judge Ambro wrote a concurring opinion to address the bankruptcy court's conclusion that rejection of a trademark license left EnerSys without the right to use the Exide mark. Analyzing the history of Section 365(n), he disagreed that the exclusion of trademarks from its reach created a negative inference that rejection of a trademark license should be tantamount to termination. He stated that courts should be able to prevent the extinguishment of all rights upon rejection:

Courts may use § 365 to free a bankrupt trademark licensor from burdensome duties that hinder its reorganization. They should not - as occurred in this case - use it to let a licensor take back trademark rights it bargained away. This makes bankruptcy more a sword than a shield, putting debtor-licensors in a catbird seat they often do not deserve.

Id at 967-68.

The Seventh Circuit Rejects *Lubrizol's* Holding

In *Sunbeam Prods., Inc. v. Chicago Am. Manuf., LLC*, 686 F.3d 372 (7th Cir. 2012), the Seventh Circuit issued a decision hailed as a major victory for trademark licensees. The facts of *Sunbeam* are straightforward. Lakewood Engineering & Manufacturing Co. made various consumer products, including box fans, which were covered by its patents and trademarks. Lakewood contracted with Chicago American Manufacturing (“CAM”) to make its fans for 2009, granting CAM a license to the relevant patents and trademarks. In recognition of both the investment CAM would have to make to manufacture the fans and Lakewood's own distressed

financial condition, the agreement authorized CAM to sell directly any of the 2009 production of box fans that Lakewood did not purchase.

A few months after the agreement was signed, Lakewood was forced into an involuntary bankruptcy and a trustee was appointed. The trustee sold Lakewood's assets, including the patents and trademarks, to Sunbeam Consumer Products, which wanted to sell its own fans and not have to compete with CAM's sales. The trustee rejected the CAM agreement and, when CAM continued to sell the remaining fans, Sunbeam sued CAM for infringement.

The bankruptcy court in *In re Lakewood Engineering & Manufacturing Co., Inc.*, 459 B.R. 306 (Bankr. N.D. Ill. 2011), decided to "step into the breach,"² follow Judge Ambro's reasoning in *Exide*, and begin the "development of equitable treatment"³ of trademark licensees that it concluded Congress had anticipated would occur. It held that despite rejection of a manufacturing and supply agreement that included a trademark license, the licensee could continue to sell trademarked goods as it had been licensed to do. On appeal, the Seventh Circuit disagreed with the bankruptcy court's analysis but ultimately affirmed its decision. In its opinion, however, the Seventh Circuit took aim directly at the 1985 Fourth Circuit *Lubrizol* decision and reasoning.

The issue on appeal was the effect of the trustee's rejection of the CAM agreement, and specifically the trademark license, on CAM's ability to sell the fans. The Seventh Circuit's focus on the *Lubrizol* decision was apparent:

Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985), holds that, when an intellectual-property license is rejected in bankruptcy, the licensee loses the ability to use any licensed copyrights, trademarks, and patents. Three years after *Lubrizol*, Congress added § 365(n) to the Bankruptcy Code. It allows licensees to continue using the intellectual property after rejection, provided they meet certain conditions. The bankruptcy

² *Lakewood*, 459 B.R. at 345.

³ *Id.*

judge held that § 365(n) allowed CAM to practice Lakewood's patents when making box fans for the 2009 season. That ruling is no longer contested. But 'intellectual property' is a defined term in the Bankruptcy Code: 11 U.S.C. §101(35A) provides that "intellectual property" includes patents, copyrights, and trade secrets. It does not mention trademarks. Some bankruptcy judges have inferred from the omission that Congress codified *Lubrizol* with respect to trademarks, but an omission is just an omission. The limited definition in § 101(35A) means that § 365(n) does not affect trademarks one way or the other. According to the Senate committee report on the bill that included § 365(n), the omission was designed to allow more time for study, not to approve *Lubrizol*. See S. Rep. No. 100-505, 100th Cong., 2d Sess. 5 (1988). See also *In re Exide Technologies*, 607 F.3d 957, 966-67 (3d Cir. 2010) (Ambro, J., concurring) (concluding that § 365(n) neither codifies nor disapproves *Lubrizol* as applied to trademarks). The subject seems to have fallen off the legislative agenda, but this does not change the effect of what Congress did in 1988.

Sunbeam, 686 F.3d at 375.

Chief Judge Easterbrook's opinion noted that the bankruptcy court had permitted CAM to continue using the trademarks on equitable grounds, but rejected that approach as going beyond what the Bankruptcy Code permits. The Seventh Circuit then directly addressed the *Lubrizol* decision:

We need to determine whether *Lubrizol* correctly understood § 365(g), which specifies the consequences of a rejection under § 365(a). No other court of appeals has agreed with *Lubrizol* - or for that matter disagreed with it.

Sunbeam, 686 F.3d at 376.

The Court turned to the Third Circuit's *Exide* decision, and specifically Judge Ambro's concurring opinion:

Exide, the only other appellate case in which the subject came up, was resolved on the ground that the contract was not executory and therefore could not be rejected. (*Lubrizol* has been cited in other appellate opinions, none of which concerns the effect of rejection on intellectual-property licenses.) Judge Ambro, who filed a concurring opinion in *Exide*, concluded that, had the contract been eligible for rejection under § 365(a), the licensee could have continued using the trademarks. 607 F.3d at 964-68. Like Judge Ambro, we too think *Lubrizol* mistaken.

Sunbeam, 686 F.3d at 376.

After observing that outside of bankruptcy a licensor's breach does not terminate a licensee's right to use intellectual property, the Seventh Circuit explained that under Section 365(g), rejection is considered a breach but without the possibility of specific performance:

What § 365(g) does by classifying rejection as breach is establish that in bankruptcy, as outside of it, the other party's rights remain in place. After rejecting a contract, a debtor is not subject to an order of specific performance. See *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 531 (1984); *Midway Motor Lodge of Elk Grove v. Innkeepers' Telemanagement & Equipment Corp.*, 54 F.3d 406, 407 (7th Cir. 1995).

Sunbeam, 686 F.3d at 377.

The Seventh Circuit then described the impact of Section 365(g) and rejection in bankruptcy. “The debtor's unfulfilled obligations are converted to damages; when a debtor does not assume the contract before rejecting it, these damages are treated as a pre-petition obligation, which may be written down in common with other debts of the same class. But nothing about this process implies that any rights of the other contracting party have been vaporized.”⁴

Turning to an analogous situation, the court summarized what happens when a lease is rejected:

Consider how rejection works for leases. A lessee that enters bankruptcy may reject the lease and pay damages for abandoning the premises, but rejection does not abrogate the lease (which would absolve the debtor of the need to pay damages). Similarly a lessor that enters bankruptcy could not, by rejecting the lease, end the tenant's right to possession and thus re-acquire premises that might be rented out for a higher price. The bankrupt lessor might substitute damages for an obligation to make repairs, but not rescind the lease altogether.

Id.

The court distinguished rejection from avoidance powers, which might lead to rescission or termination of an agreement, observing that “rejection is not ‘the functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions

⁴ *Id.*

they occupied before the contract was formed.’⁵ It ‘merely frees the estate from the obligation to perform’⁶ and ‘has absolutely no effect upon the contract's continued existence.’ *Ibid.*” (Internal citations omitted.)⁷

The Seventh Circuit referenced scholarly criticism of the *Lubrizol* decision before turning back to the Fourth Circuit's opinion:

Lubrizol itself devoted scant attention to the question whether rejection cancels a contract, worrying instead about the right way to identify executory contracts to which the rejection power applies.

Lubrizol does not persuade us. This opinion, which creates a conflict among the circuits, was circulated to all active judges under Circuit Rule 40(e). No judge favored a hearing en banc. Because the trustee's rejection of Lakewood's contract with CAM did not abrogate CAM's contractual rights, this adversary proceeding properly ended with a judgment in CAM's favor.

Id. at 377-78.

Intriguing but Unanswered Questions Raised by *Sunbeam*

The Seventh Circuit's opinion represents the first court of appeals decision in twenty-seven years to challenge *Lubrizol's* view of how rejection impacts an intellectual property license under Section 365(g). The U.S. Supreme Court denied review, leaving in place the circuit split *Sunbeam* created.

Sunbeam and its potential interplay with Section 365(n) raises a number of interesting questions, including:

- Aside from the right to use the licensed trademarks, does the licensee keep other rights under its agreement, such as exclusivity if applicable?
- Would a liquidated damages provision in favor of the licensee, payable on breach, cut against the licensee's right under *Sunbeam* to continue to use the licensed trademarks?
- How long does the right to the trademarks continue, the full term of the license agreement plus any extensions, or some shorter period?

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

- If royalties are required under a trademark license, must the trademark licensee continue to pay them post-rejection to use the licensed trademarks, as an intellectual property licensee covered by Section 365(n) is required to do, or can the trademark licensee argue that rejection is a material breach excusing that performance?
- Since under *Sunbeam* rejection does not terminate trademark license rights, does the same analysis apply to intellectual property other than trademarks, including those covered by Section 365(n)?
- Are licensees of patents, copyrights, or trade secrets, otherwise protected by Section 365(n), required to follow Section 365(n)'s statutory scheme to retain their rights, including payment of royalties, or can they rely on the *Sunbeam* decision's analysis of the effect of rejection as an alternative approach?
- How will purchasers of trademarks and other assets react to the potential continued use of the marks by licensees under rejected trademark licenses?

Eighth Circuit, In En Banc Decision, Holds Trademark License Not Executory

Just when the Third Circuit decision was starting to give hope to trademark licensees in asset sales, the Eighth Circuit went the other way and held that a trademark license entered into as part of an asset sale was executory and could be rejected. In *In re Interstate Bakeries Corp.*, 690 F.3d 1069 (8th Cir. 2012), a case with facts very similar to *Exide*, a three-judge panel of the U.S. Court of Appeals for the Eighth Circuit examined whether an exclusive license to use brands and trademarks belonging to Interstate Brands Corporation (“IBC”), which subsequently filed for bankruptcy, was an executory contract.

Prior to bankruptcy, IBC entered into a \$20 million asset purchase agreement and license agreement with Lewis Brothers Bakeries (“LBB”), and certain baking and business operations in the Chicago area to LBB. Following IBC’s bankruptcy, LBB sought a declaratory judgment that the license agreement was not an executory contract. The bankruptcy court and district court both found the agreement executory, with unperformed obligations on both sides. Although the relevant aspects of the license agreement appeared at first blush to be nearly identical to those in *Exide*, the Eighth Circuit panel found the license agreement in *Interstate Bakeries* to be materially different. Specifically, the Eighth Circuit panel found LBB’s obligation to maintain

quality standards, and IBC’s obligations of notice and forbearance with regard to the trademarks, material and unperformed. As such, it held the license agreement was executory and could be rejected. The Eighth Circuit panel distinguished *Exide* because there, “the parties had not even contemplated or discussed any quality standards. . . . Here, it cannot be argued the parties did not contemplate any quality standards, as it is an explicit provision of the License Agreement. Moreover, the plain language of the agreement provides a breach of the quality provision would be material.”⁸

The panel decision was split 2 to 1, and the Eighth Circuit ultimately granted a rehearing *en banc*. On June 6, 2014, the full Eighth Circuit issued an 8-3 decision holding that the license agreement was no longer executory. *In re Interstate Bakeries Corp.*, 751 F.3d 955, (8th Cir. 2014). After concluding that intervening events had not rendered the appeal moot, the Eighth Circuit held the proper focus to be on the entire transaction, not just on the license agreement:

The essence of the agreement here was the sale of IBC’s Butternut bread and Sunbeam bread business operations in specific territories, not merely the licensing of IBC’s trademark. The agreement called for LBB to pay \$20 million for IBC’s assets. The parties allocated \$11.88 million for tangible assets, such as real property, machinery and equipment, computers and licensed computer software, vehicles, office equipment, and inventory. They allocated another \$8.12 million toward intangible assets, including the license. IBC has transferred all of the tangible assets and inventory to LBB, executed the License Agreement, and received the full \$20 million purchase price from LBB.

IBC’s remaining obligations concern only one of the assets included in the sale—the license. They involve such matters as obligations of notice and forbearance with regard to the trademarks, obligations relating to maintenance and defense of the marks, and other infringement-related obligations. When considered in the context of the entire agreement, these remaining obligations are relatively minor and do not relate to the central purpose of the agreement to sell the Butternut and Sunbeam bread operations and assets to LBB in certain territories.

Id. at 963-64.

⁸ *Interstate Bakeries*, 690 F.3d at 1075.

Unlike the three-judge panel, the full Eighth Circuit commented on the similarity of the facts to the *Exide* case and found the Third Circuit’s decision persuasive:

We find useful guidance on analogous facts in the Third Circuit’s decision in *In re Exide*. At issue there was the \$135 million sale of Exide’s industrial battery business to EnerSys, which included a trademark license agreement. 607 F.3d at 960. Along with the license, Exide sold to EnerSys physical manufacturing plants, equipment, inventory, and certain items of intellectual property. *Id.* The Third Circuit held that Exide’s remaining obligations, which included duties to maintain quality standards, to refrain from use of the trademark outside the industrial battery business, and to indemnify EnerSys, did not “outweigh the substantial performance rendered and benefits received by EnerSys.” *Id.* at 963–64. The court observed that the remaining contractual obligations did not relate to the purpose of the agreement—the sale of Exide’s industrial battery business—and that the trademark license agreement was therefore not executory. *Id.* at 964. For similar reasons, we conclude that the License Agreement between IBC and LBB is not executory.

In re Interstate Bakeries Corp., 751 F.3d at 964.

In a footnote, the Eighth Circuit noted the circuit split between the Fourth Circuit’s *Lubrizol* decision and the Seventh Circuit’s *Sunbeam* decision on whether rejection of a trademark license terminates the licensee’s rights to use the trademark. However, given its holding that the license agreement was not executory, the Eighth Circuit did not need to reach the rejection issue.

The full Eighth Circuit’s decision in *Interstate Bakeries* is yet another ray of hope for trademark licensees. It continues the recent trend of Courts of Appeals finding ways to protect trademark licensees from the harsh result of losing all rights to use a trademark via rejection. Still, unless the *Sunbeam* decision is adopted broadly or Congress passes one of the bills proposing to include trademarks within Section 365(n)’s protections, trademark licensees whose licensors file bankruptcy — and especially those whose licenses were granted outside of an asset sale context — are by no means out of the woods.

**Chapter 15 and Section 365(n):
The Fourth Circuit’s *Qimonda* Decision**

In *In re Qimonda AG*, 462 B.R. 165 (Bankr. E.D. Va. 2011), *Qimonda*, a German company that manufactured semiconductor devices, was in an insolvency proceeding in Germany. The principal assets of *Qimonda*’s estate were approximately 10,000 patents, of which roughly 4,000 were U.S. patents. It had issued licenses of rights under those U.S. patents to third party licensees. *Qimonda*’s German insolvency administrator had filed the Chapter 15 case to seek recognition by the Bankruptcy Court of the pending German insolvency proceeding as a “foreign main proceeding.” The Bankruptcy Court granted recognition and, at the request of the administrator, granted him discretionary relief under Section 1521(a)(5) of the Bankruptcy Code, entrusting to him the administration of all of *Qimonda*’s assets within the United States, primarily the 4,000 U.S. patents. In its supplemental order granting relief under Section 1521, the Bankruptcy Court on its own provided that, among other things, Section 365 of the U.S. Bankruptcy Code would apply to the Chapter 15 case (it does not apply automatically in Chapter 15 cases).

Certain U.S. licensees asserted Section 365(n) rights in an attempt to retain their rights to the intellectual property that *Qimonda* had licensed them. On remand after an appeal to the District Court, the Bankruptcy Court held a four-day evidentiary hearing, with testimony on the likely impact of applying, or not applying, Section 365(n) to licenses under *Qimonda*’s U.S. patents. At the outset, the administrator had committed to re-license the licensees under a “reasonable and nondiscriminatory” royalty license (known as RAND), but the licensees pressed to keep their existing license rights without having to negotiate and pay a new royalty. At stake for the *Qimonda* estate was approximately \$47 million in estimated re-licensing fees. The licensees argued the stakes were far higher on their side. They contended that a failure to

apply Section 365(n) would destabilize the system of licensing and cross-licensing in place to address the “thicket” of multiple patents held by different parties in the semiconductor industry, and in turn that would reduce investment and innovation.

The Bankruptcy Court issued its decision and, under Section 1522(a), balanced the interests of *Qimonda* and the licensees in favor of requiring that Section 365(n) apply to the administration of *Qimonda*'s U.S. patents. The Bankruptcy Court independently held that “deferring to German law, to the extent it allows cancellation of the U.S. patent licenses, would be manifestly contrary to U.S. public policy.”⁹ Under Section 1506, the Bankruptcy Court concluded that U.S. public policy required that Section 365(n)'s protections apply to *Qimonda*'s U.S. patents. A direct appeal to the Fourth Circuit followed.

On December 3, 2013, the Fourth Circuit issued an opinion affirming the Bankruptcy Court's decision to apply Section 365(n). *Jaffe v. Samsung Electronics Co. Ltd.*, 737 F.3d. 14 (4th Cir. 2013). After first examining the history, purpose, and structure of Chapter 15, the Fourth Circuit turned to the three arguments the German administrator had advanced on appeal.

- No request for Section 365(n) to apply. The administrator argued that in seeking discretionary relief under Section 1521, he had never asked for either Section 365 or 365(n) to apply; since relief under Section 1521 has to be requested by the foreign representative, he asserted that his decision not to request it should resolve the question. The Fourth Circuit rejected the argument, holding his view of the relationship between Sections 1521(a) and 1522(a) “too myopic.” Instead, it held that if any discretionary relief is granted under Section 1521(a), the interests of creditors and the debtor must be “sufficiently protected” under Section 1522(a).
- Erroneous test under Section 1522(a). The administrator next argued that the “sufficiently protected” standard is designed only to make sure that all creditors can participate in the foreign proceeding on an equal footing, not to change the substantive outcome in that foreign proceeding. Reviewing the Guide to Enactment of the Model Law on which Chapter 15 is based, the Fourth Circuit also rejected this argument. It held that Section 1522(a) requires a balancing of interests before discretionary relief is granted, and anticipates a particularized analysis of the impacts on creditors and the debtor from the relief sought.

⁹ *Qimonda AG*, 462 B.R. at 185.

- Faulty balancing analysis. Finally, the administrator argued that the Bankruptcy Court abused its discretion in balancing the interests involved. Specifically, he asserted that the lower court overstated the risk to the licensees' investments made in reliance on the licenses that *Qimonda* had granted, especially given the administrator's RAND license offer. The Fourth Circuit rejected this argument as well, agreeing with the Bankruptcy Court's assessment of the risks. These included the risks to investments already made and the threat of infringement litigation contrary to the *Qimonda* licenses. The Fourth Circuit also held that although the RAND proposal would reduce the licensees' risks, it would not sufficiently protect them. The outcome of those negotiations were uncertain, there were significant hold-up risks in the RAND license negotiations. Moreover, it was unclear whether even new RAND licenses would survive if the administrator sold the patents in the German proceeding – and the purchaser later filed an insolvency proceeding under German law.

The Fourth Circuit did not reach Section 1506. Unlike the Bankruptcy Court, the Fourth Circuit did not hold that subordinating Section 365(n) to Section 103 of the German Insolvency Code would be manifestly contrary to the public policy of the United States. On April 30, 2014, the German administrator filed a petition for certiorari with the United States Supreme Court, which remains pending as of mid-July 2014.

Analysis of the Fourth Circuit Decision

Is a decision allowing a foreign representative to reject licenses without applying Section 365(n) protection "manifestly contrary to the public policy of the United States" under Section 1506?

The Bankruptcy Court thought it was, but the Fourth Circuit carefully chose not to reach the issue. It remains an open question even in the Fourth Circuit, much less in Chapter 15 cases filed in the rest of the country. Section 1506, quoted below, is so important because it is Chapter 15's local law trump card:

Nothing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States.

11 U.S.C. § 1506.

By declining to reach the question, the Fourth Circuit kept the Section 1506 trump card in the deck. That leaves licensees with continued uncertainty about whether Section 365(n) will in fact be applied in the next Chapter 15 case.

Must courts apply Section 365(n) every time a foreign representative requests any discretionary relief under Section 1521?

The Fourth Circuit's decision required courts to balance the particular interests of creditors and the debtor under Section 1522(a), not just their access to the foreign court. To coin a phrase, this means "substantive sufficient protection" instead of just "procedural sufficient protection." The *Qimonda* decision should help licensees tip the balance in their favor, especially when a foreign representative is asking to administer U.S. patents. However, the Fourth Circuit holding was that the Bankruptcy Court's exercise of discretion was reasonable. It did not hold that no other decision was possible. That makes it a little less clear whether the Fourth Circuit would allow this particularized balancing to go the other way – a refusal to apply Section 365(n) — in another case.

What if the foreign representative doesn't seek any discretionary relief?

The Fourth Circuit affirmed the Bankruptcy Court only under Section 1522(a), which in turn applies only when a foreign representative requests discretionary relief under Section 1521 (or relief under Section 1519 before recognition). Most foreign representatives will seek discretionary relief, and specifically seek to have U.S. assets entrusted to them. That is what *Qimonda's* German administrator did. However, if a foreign representative decided not to request any such relief, the balancing of interests called for by the Fourth Circuit would not be triggered. That could leave licensees with only Section 1506's public policy trump card, which the Fourth Circuit did not invoke.

What if the foreign representative doesn't file a Chapter 15 case at all?

If the foreign representative chooses not file a Chapter 15 case in the first place (or of course a Chapter 11 or Chapter 7 case), then there would be no U.S. bankruptcy case in which to try to invoke Section 365(n). That's one of Section 365(n)'s major limitations, and one licensees — and the attorneys who draft their licenses — should remember.

Pending Legislation and Its Potential Impact on Section 365(n) and Chapter 15 Cases

On December 5, 2013, the U.S. House of Representatives passed a significant patent reform bill known as the "Innovation Act." Although the focus of the legislation is on patent infringement litigation and other patent law revisions, the Innovation Act, H.R. 3309, would also make major changes to Section 365(n) of the Bankruptcy Code.

Proposed Changes In The House-Passed Innovation Act

The Innovation Act would make four major changes to Section 365(n)'s protections for licensees.

- First, it would extend Section 365(n)'s protections, including through an amendment to Section 101(35A) of the Bankruptcy Code's definition of **intellectual property**, to licenses of trademarks, service marks, and trade names.
- Second, rejection of a trademark, service mark, or trade name license would not relieve the trustee (or presumably a debtor in possession in a Chapter 11 case) of the debtor's contractual obligations to monitor and control the quality of a licensed product or service.
- Third, it would expand the payments that a licensee would have to continue to make to the estate, if it elected to retain its license rights, to include not only "royalty" payments but also "other" payments under the license.
- Fourth, it would amend Section 1522 of the Bankruptcy Code to make Section 365(n) directly applicable to Chapter 15 cases, providing that if a foreign representative rejects or repudiates an IP license, the licensee would be entitled to elect to retain its IP rights under Section 365(n).

If enacted and signed by the President, the Innovation Act's revisions would apply as of the date of enactment to pending and future cases.

Potential Impact Of Innovation Act's Changes To Section 365(n)

If the changes to Section 365(n) do become law, they would be the most significant revisions since its enactment in 1988. The biggest changes would be the extension of Section 365(n)'s protections to trademarks, service marks, and trade names, together with the monitoring obligations on a trustee. In the twenty-five years since Section 365(n) was enacted, trademark licensees have lived under the specter of losing trademark license rights in bankruptcy. These revisions would be a sea change in the trademark area. In addition, the Innovation Act provides that the trustee or debtor in possession would not be relieved of a contractual obligation to continue to monitor the quality of goods or services using a mark, in effect limiting the benefits of rejection to an estate for the protection of consumers. However, it is unclear how a trustee would be able to meet such an obligation, particularly if an estate had no assets, and how a trustee could meet a long-term obligation to monitor quality given that the Chapter 7 case would eventually be closed. These were some of the difficult issues that led Congress to leave trademarks out of Section 365(n) originally.

Another significant change is the requirement that a licensee that elects to retain its IP rights under Section 365(n) essentially continue to make all payments under the license agreement and not simply those determined to be “royalty” payments. If this provision becomes law, drafters of license agreements will need to consider how rejection and the non-performance of the licensor's obligations would impact payments otherwise required under the license agreement. As a timely anticipation of the Fourth Circuit's *Jaffe* decision, the Innovation Act would apply Section 365(n) in all Chapter 15 cases through an amendment to Section 1522. The language used — applying when a foreign representative rejects or “repudiates” a license agreement — suggests that the House intended this to cover not only rejection under Section 365

of the Bankruptcy Code but also equivalent foreign law powers to repudiate or disclaim contracts. By placing the Section 365(n) reference in a new, separate subsection of Section 1522 governing protection of creditors and other interested persons, it seems that Section 365(n) would apply in all Chapter 15 cases, regardless of whether the foreign representative sought preliminary or discretionary relief under Sections 1519 or 1521.

The Innovation Act Stalls In The Senate

After passing the House, the Innovation Act moved to the Senate and was referred to the Senate Committee on the Judiciary. Senator Patrick Leahy, the Senate Judiciary Committee Chairman, had introduced a similar bill, S. 1720, the “Patent Transparency and Improvements Act of 2013.” As introduced, that bill would have made many of the same changes to Section 365(n) and the Bankruptcy Code definition of intellectual property (specifically, adding in coverage of trademarks as discussed above) as in the House-passed Innovation Act. The Senate bill would have also addressed the applicability of Section 365(n) in Chapter 15 cases, but by amending a different section of Chapter 15.

The Senate Judiciary Committee held a hearing on S. 1720, and a number of discussions and negotiations involving companies affected by patent litigation ensued. However, those efforts reached an impasse and on May 21, 2014, Senator Leahy announced:

Because there is not sufficient support behind any comprehensive deal, I am taking the patent bill off the Senate Judiciary Committee agenda. If the stakeholders are able to reach a more targeted agreement that focuses on the problem of patent trolls, there will be a path for passage this year and I will bring it immediately to the Committee.

We can all agree that patent trolls abuse the current patent system. I hope we are able to return to this issue this year.

Senator Leahy’s statement makes clear that the focus of this legislation is on patent litigation reform, not bankruptcy and intellectual property licenses. The fate of the legislation

will depend on whether the interested parties can reach agreement on those patent issues. However, the stalling of the patent legislation also means the bankruptcy provisions, at least for now, will stay on hold; it seems unlikely the bankruptcy provisions would move forward in legislation separate from the overall patent reform effort. The odds now seem considerably lower that these changes to the treatment of intellectual property licenses in bankruptcy will be enacted.