Testimony Before the American Bankruptcy Institute Commission to Study the Reform of Chapter 11

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Field Hearing
New York, NY
June 4, 2013

My name is Bob Eisenbach, and I am an attorney at Cooley LLP in the San Francisco office and a member of its Bankruptcy and Restructuring group.[1] I appreciate the Commission's work on the reform of Chapter 11 and the opportunity to discuss changes to the Bankruptcy Code involving intellectual property licenses, in particular from the perspective of debtors, committees, and bankruptcy estates.

For more than 20 years, I have represented technology and other companies in Silicon Valley and around the country in Chapter 11 cases and out-of-court restructurings, unsecured creditors' committees in industries such as semiconductor and storage technology, biotechnology, and healthcare, and buyers and sellers in distressed M&A transactions. I regularly advise clients on the interplay between intellectual property and bankruptcy law, representing licensors, licensees and others. I also frequently speak and write on the intersection of bankruptcy and intellectual property law, including on my *In The (Red)®* blog.

My testimony today focuses on four key issues: (1) resolving the circuit split over the interpretation of section 365(c)(1) when a debtor in possession, as licensee, seeks to assume, but not assign, an in-bound intellectual property license; (2) resolving the circuit split in the application of section 365(g) when an out-bound IP license, and especially a trademark license, is rejected by a debtor licensor; (3) clarifying that a consent to assignment in a prepetition license agreement constitutes the consent required for section 365(c)(1)(B); and (4) removing the uncertainty in the application of section 365(n) due to ambiguity in section 101(35A)'s definition of patents and patent applications.

[1] The views expressed in my testimony are mine alone and do not represent those of my firm or any of its clients.

<u>Debtor Licensee's Assumption of In-Bound IP Licenses</u>

<u>The Issue</u>

Under Bankruptcy Code section 365, a debtor in possession or trustee has the ability to assume an executory contract if defaults are cured and the estate provides adequate assurance of future performance. That power is subject to certain limitations, specifically those set forth in section 365(c)(1):

> (c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—
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> (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and
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> (B) such party does not consent to such assumption or assignment.

Courts generally hold that an intellectual property license is an executory contract. Courts have likewise interpreted the phrase "applicable law" in section 365(c)(1) to mean patent, copyright, and trademark law, holding that these federal intellectual property laws excuse a non-debtor party to an intellectual license from accepting performance from or rendering performance to an entity other than the debtor in bankruptcy. As a result, these courts have held that an intellectual property licensor who does not consent can successfully block a debtor from assigning a patent, copyright, or trademark license to a third party during a bankruptcy case. Most but not all courts hold that consent can be given prior to a bankruptcy case if, for example, an IP license agreement's assignment provision permits assignment in relevant circumstances.

If a debtor or trustee cannot assign an IP license without consent of the licensor, can it at least assume the license? That question has led courts to examine ever so closely the first seven words of section 365(c): "The trustee may not assume or assign..." When the statute says that the trustee may not assume or assign an IP license, does the word "or" really mean "and" too? Put differently, when a debtor is only trying to assume an IP license and is not actually trying to assign it, is it permitted to do so?

One of the three approaches taken by courts in answering these questions is called the "hypothetical test." It involves reading section 365(c)(1)'s language as asking whether the debtor *hypothetically could* assign the license even if it is only proposing to assume it.[2] If the debtor could not assign the license agreement, then it would not be permitted to assume it either, absent consent of the licensor. At least three circuits, the Third, Fourth, and Ninth Circuits, and seemingly the Eleventh Circuit, have adopted this hypothetical test.

A second method, referred to as the "actual test," interprets the statute's language as asking only what the debtor is *actually proposing* to do.[3] If the debtor cannot assign the license agreement, but is proposing only to assume it and not actually assign it, then the debtor would be permitted to assume the agreement. Two circuits, the First and Fifth Circuit, have adopted this actual test.

The third approach came in *In re Footstar, Inc.*, 323 B.R. 566 (Bankr. S.D.N.Y. 2005), a 2005 decision in which the Bankruptcy Court for the Southern District of New York broke new ground. Although it did not involve intellectual property licenses, the court adopted a new "literal" reading of section 365(c)(1), one that the court found was "entirely harmonious with both the objective sought to be obtained in section 365(c)(1) and the overall objectives of the

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[2] *In re Catapult Entm't, Inc.*, 165 F.3d 747, 749-50 (9th Cir. 1999) (citing *City of Jamestown v. James Cable Partners, L.P.* (*In re James Cable Partners*), 27 F.3d 534, 537 (11th Cir. 1994)); *In re West Elec. Inc.*, 852 F.2d 79, 83 (3d Cir. 1988); *Breeden v. Catron* (*In re Catron*), 158 B.R. 629, 633-38 (E.D. Va. 1993); *RCI Tech. Corp. v. Sunterra Corp.* (*In re Sunterra Corp.*), 361 F.3d 257, 266-67 (4th Cir. 2004).

[3] *Institut Pasteur, et al. v. Cambridge Biotech Corp.*, 104 F.3d 489 (1st Cir. 1997); *Bonneville Power Admin. v. Mirant Corp.* (*In re Mirant Corp.*), 440 F.3d 238, 248 (5th Cir. 2006).

Bankruptcy Code, without construing 'or' to mean 'and.'" The court held that section 365(c)(1)'s use of the word "trustee" does not (as other courts had taken for granted) include the debtor or debtor in possession when assumption is sought because assumption does not require the non-debtor party to accept performance from a new party other than the debtor or debtor in possession. A trustee is a new party and the statute logically provides that a trustee may not "assume or assign" such an executory contract. As such, the right of the non-debtor party to object to assignment does not by itself affect the right of the debtor in possession (as opposed to a trustee) to assume an executory contract. Other courts in Southern District of New York have adopted the *Footstar* test.[4]

The Supreme Court expressed an interest in resolving the issue of the proper analysis of section 365(c)(1). In the *N.C.P. Marketing Group* case, the appellant petitioned the Supreme Court for a writ of certiorari, seeking review of the decision denying it the ability to assume a trademark license. Although voting to deny review, Justice Kennedy issued a three-page statement on that decision to express his view, joined by Justice Breyer, that the Supreme Court should considering granting certiorari in a future case on the "significant question" of whether the hypothetical test or the actual test should be applied in interpreting section 365(c)(1) of the Bankruptcy Code.[5]

Justice Kennedy's discussion of the two tests suggests that he (and perhaps Justice Breyer) may be leaning toward the actual test. Although noting that the actual test "may present problems of its own," including that it aligns section 365 "with sound bankruptcy policy only at

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[4] *See In re Adelphia Commc'ns Corp.*, 359 B.R. 65 (Bankr. S.D.N.Y. 2007).

[5] Statement of Kennedy, J., *N.C.P. Mktg. Group, Inc. v. BG Star Prods., Inc*., 129 S.Ct. 1577 (2009), On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, No. 08-463, decided March 23, 2009.

the cost of departing from at least one interpretation of the plain text of the law," Justice Kennedy aimed most of his criticism at the hypothetical test:

> The hypothetical test is not, however, without its detractors. One arguable criticism of the hypothetical approach is that it purchases fidelity to the Bankruptcy Code's text by sacrificing sound bankruptcy policy. For one thing, the hypothetical test may prevent debtors-in-possession from continuing to exercise their rights under nonassignable contracts, such as patent and copyright licenses. Without these contracts, some debtors-in-possession may be unable to effect the successful reorganization that Chapter 11 was designed to promote. For another thing, the hypothetical test provides a windfall to nondebtor parties to valuable executory contracts: If the debtor is outside of bankruptcy, then the nondebtor does not have the option to renege on its agreement; but if the debtor seeks bankruptcy protection, then the nondebtor obtains the power to reclaim—and resell at the prevailing, potentially higher market rate—the rights it sold to the debtor.[6]

Proposed Reform

As Justice Kennedy noted, absent a licensor's consent, the hypothetical test could prevent debtors in possession from keeping their rights under IP licenses; if critical license rights are involved, this could prevent successful reorganizations. To address this issue and resolve the existing circuit split, *I recommend that the Commission propose an amendment to section 365(c)(1) adopting the actual test used in the First and Fifth Circuits, limited to a debtor in possession in a Chapter 11 case*. This reform could be accomplished by providing that notwithstanding section 365(c)(1), a debtor in possession in a Chapter 11 case may assume such an executory contract if it otherwise satisfies the requirements of section 365.

Companies in Chapter 11 need the certainty that they will be able to retain in-bound IP licenses and not face loss of those IP rights just because they are reorganizing in bankruptcy. Technology companies often build entire businesses around critical in-bound IP license rights.

[6] 129 S.Ct. at 1578.

Loss of these rights could severely damage the debtor's ability to reorganize. Outside of bankruptcy, an IP owner could not terminate a license absent a breach; the mere filing of bankruptcy should not impose a different result. Moreover, it is reasonable for an IP owner to expect that its licensee will retain license rights, subject to curing any defaults and providing adequate assurance of future performance, even if the licensee reorganizes in bankruptcy. The proposed reform would strike an appropriate balance preserving the ability of licensees to reorganize in Chapter 11 while not unfairly burdening IP owners.

<u>The Impact of Rejection on Trademark Licenses</u>

<u>The Issue</u>

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. This was the holding in *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). The Fourth Circuit held that Lubrizol, a nonexclusive patent licensee whose patent license was rejected as an executory contract in the bankruptcy case of Lubrizol's licensor, debtor Richmond Metal Finishers, could not "rely on provisions within its agreement with [the debtor] for continued use of the technology."

According to *Lubrizol*, 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," and no specific performance remedy. The Fourth Circuit held that, 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. A special, limited definition of "intellectual property" was also added to the Bankruptcy Code in section 101(35A). This definition includes trade secrets, United States 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 the serious risk of losing all license rights to a trademark if the licensor rejects the trademark license in bankruptcy. 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. Even the 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.

Several recent Court of Appeal decisions have addressed the rights of trademark licensees under a rejected license agreement. Two decisions focused on whether the underlying trademark license was part of an executory contract.[7] However, a third, the Seventh Circuit's 2012 decision in *Sunbeam Prods., Inc. v. Chicago Am. Manuf., LLC*, 686 F.3d 372 (7th Cir. 2012), made a fundamental break with the *Lubrizol* view of rejection under section 365(g), and created a significant circuit split.[8]

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[7] *Compare In re Exide Techs.*, 607 F.3d 957 (3d Cir. 2010) (holding that trademark license, made part of an agreement for sale of a business line, was no longer executory once buyer had substantially performed) *with In re Interstate Bakeries Corp.*, 690 F.3d 1069 (8th Cir. 2012) (holding licensee's obligation to maintain quality standards and licensor's obligations of notice and forbearance with regard to trademarks material and unperformed provisions rendering trademark license executory).

[8] *See* Robert L. Eisenbach III, "There's Something Happening Here: Recent Bankruptcy Developments May Give Trademark Licensees Reason to Hope," *Business Law Today*, posted May 22, 2013 (available at http://apps.americanbar.org/buslaw/blt/content/2013/05/article-02-eisenbach.shtml), for a more detailed discussion of these Court of Appeals decisions.

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.

In its opinion, the Seventh Circuit took aim directly at the 1985 Fourth Circuit *Lubrizol* decision and reasoning.:

> *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 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.

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.

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

> *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.

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).

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."

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.

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 they occupied before the contract was formed.'" It 'merely frees the estate from the obligation to perform' and 'has absolutely no effect upon the contract's continued existence'. *Ibid*. (internal citations omitted)."

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.
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> *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.

The Seventh Circuit's opinion represents the first Court of Appeals decision in 27 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?
- 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?

Proposed Reform

From the perspective of a debtor in possession or committee, I believe the Seventh Circuit's *Sunbeam* decision goes too far. For 27 years, the accepted consequence of a debtor in possession or trustee's rejection of an intellectual property license has been that the licensee loses its rights to the IP, unless, and only to the extent, the licensee is protected by section 365(n). In attempting to provide similar protections to the trademark licensee in *Sunbeam*, the Seventh Circuit unfortunately opened a proverbial can of worms and raised questions whether section 365(n) is even necessary.

Rather than follow that approach, *I recommend that the Commission propose a clarifying amendment to section 365(g) expressly adopting the Lubrizol decision's interpretation of the impact of rejection on an IP licensee*. Such an amendment would leave section 365(n) as the sole protective provision for licensees whose licensors reject the license is in bankruptcy. This reform would resolve the circuit split and restore the relative certainty that had been in place for 27 years until the *Sunbeam* decision last year.

If trademark licensees need protection similar to that provided under section 365(n), those issues should be addressed by Congress directly rather than by reinterpreting section 365(g) and the impact of rejection generally. If section 365(n) is amended to cover trademark licenses, however, it will require more than just a simple insertion of trademarks and service marks into section 101(35A). Unlike patents and copyrights, trademarks implicate issues such as quality control and other consumer protection matters. Those issues were not addressed when section 365(n) was enacted with its focus on intellectual property used in technology.

<u>Pre-Bankruptcy Consent to Assignment of Intellectual Property Licenses</u>

<u>The Issue</u>

As discussed above, courts have generally held that the reference to "applicable law" in section 365(c)(1) means patent, copyright, and trademark law. Under section 365(c)(1)(B), a non-debtor party to an intellectual property license is therefore excused from accepting performance from or rendering performance to an entity other than the debtor in bankruptcy, absent its consent. License agreements often provide for some categories of permitted assignments, sometimes including in conjunction with a sale of all or substantially all of the assets of the licensee. Such a provision, if deemed to constitute consent, would permit the assignment of the license agreement as part of a section 363 sale of substantially all of a debtor's assets, without need for new consent from the licensor. Many courts treat such consent given prior to bankruptcy as the consent required under section 365(c)(1)(B), but the issue remains unsettled.[9]

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9 *See In re Glycogenesys, Inc.*, 352 B.R. 568, 576-7 (Bankr. D. Mass. 2006) (authorizing assignment of license agreement consistent with terms of agreement's assignment provision). *But see RCI Tech. Corp. v. Sunterra Corp.* (*In re Sunterra Corp.*), 361 F.3d 257, 266-67 (4th Cir. 2004) (consent to assignment in license agreement does not constitute consent to assumption).

Proposed Reform

To remove the uncertainty surrounding whether prepetition consent in a license agreement will be treated as the consent required for an assignment under section 365(c)(1)(B), *I recommend that the Commission propose that section 365(c)(1)(B) be amended to clarify that the "consent to such assumption or assignment" includes consent provided prepetition in a license agreement*. An amendment would make clear that prepetition consents to assignment in license agreements will be binding upon the non-debtor party. This would permit debtors and their estates to rely on prepetition consent when proposing assignments of license agreements as part of a section 363 sale in bankruptcy.

Section 365(n) Protection for Non-U.S. Patents

The Issue

Section 101(35A), added to the Bankruptcy Code in 1988 when section 365(n) was enacted, provides:

> The term 'intellectual property' means
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> (A) trade secret;
> (B) invention, process, design, or plant protected under title 35;
> (C) patent application;
> (D) plant variety;
> (E) work of authorship protected under title 17; or
> (F) mask work protected under chapter 9 of title 17;
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> to the extent protected by applicable nonbankruptcy law.

Because only "intellectual property" as defined in section 101(35A) is entitled to the protections provided to licensees under section 365(n), the meaning of these definitional provisions is critical to understanding a licensee's rights.

The reference in section 101(35A) (B) to "protected under title 35," is to the title of the United States Code governing patents. As a result, the law is unsettled whether section

101(35A)'s definition of intellectual property, and thus section 365(n)'s licensee protections, extends to non-U.S. patents. There is no case law on the issue.

Section 101(35A)(B) plainly includes U.S. issued patents within its definition because those patents are issued under title 35 of the United States Code. As such, the protections of Section 365(n) cover U.S. issued patents. One of the main statutory interpretation arguments in favor of protection for foreign patents is that use in using the phrase "protected under title 35" in the definition in section 101(35A)(B), Congress merely clarified that to be bankruptcy "intellectual property," an invention, process, design, or plant must at least be subject to U.S. patent protection. The statute does not limit the definition with "to the extent protected under title 35" or "only under title 35," implying that it extends to an invention, process, design, or plant that could be protected under title 35. Also, section 101(35A)(C) includes a "patent application" without reference to title 35, suggesting that foreign patent applications are included, and it would make little sense to protect a foreign patent application but not an issued foreign patent. One of the main arguments against protection is that the statute could have included language addressing foreign patents directly but did not, and instead makes reference only to title 35.

Although it may not have been as critical in 1988, in today's global economy companies pursue patent protection worldwide, resulting in the issuance of many foreign patents to U.S. companies. With innovation comes the risk of business failure, and parties negotiating out-bound licenses with U.S. companies need certainty that any license granted under non-U.S. patents will have the same section 365(n) protection as licenses of U.S. patents in bankruptcy. The current uncertainty over the scope of section 101(35A)(B) and section 365(n) has led licensees to insist on complicated license structures, sometimes including security interests on non-U.S. patents.

This imposes unnecessary burdens on licensors out of fear that they may become debtors at a future date.

Proposed Reform

To resolve this uncertainty, *I recommend that section 101(35A)(B) be amended to provide express coverage for foreign issued patents, and section 101(35A)(C) be similarly amended to make clear the same coverage applies to foreign patent applications*. This could be accomplished by adding after "protected under title 35" the phrase "or the patent law of another country or international organization authorized to issue patents" or similar language to 101(35A)(B) and by adding "under the laws of the United States or another country or international organization authorized to issue patents." By adopting these reforms, parties would have the certainty that non-U.S. patents and patent applications would have the same protection under section 365(n) as U.S. patents and patent applications. That in turn should protect licensors from overreaching demands by licensees for security interests and other devices designed to provide replacement protection if section 365(n) protections are not available.

Conclusion

Intellectual property is critical to most businesses in today's economy and the treatment of intellectual property licenses in bankruptcy can have profound impacts on a debtor's ability to reorganize. Amendments should be made to section 365 to resolve long-standing circuit splits and remove uncertainty about the rights of licensors and licensees to intellectual property licenses that has, and will continue, to cause disruption and potential loss of value to debtors and their creditors.

Thank you again for your work on the Commission and for the opportunity to discuss these issues with you today.