COMMENTS

Your Licensor Has a License to Kill, and It May Be Yours: Why the Ninth Circuit Should Resist Bankruptcy Law That Threatens Intellectual Property Licensing Rights

Jon Minear[†]

> "[The Intellectual Property Bankruptcy Protection Act of 1989] is intended to restore confidence in the system of intellectual property licensing, and courts interpreting it should be sensitive to the reasonable practices that have and will evolve among parties seeking to add to the technological and creative wealth of America."[1]

I. INTRODUCTION

Imagine, for a moment, that you are the founder and CEO of a small technology company, Squirtech. After several years of putting together the management, facilities, capital, and licensing rights, you have developed a wildly popular product that is rapidly making your firm the industry leader. Although your true passion lies with the technical and creative aspects of your company, you are beginning to assemble a management team so that your company is well positioned to go public. In the past, you have employed outside legal counsel to solve specific problems on a case-by-case basis. Let's face it, you do not encounter

---

[†] J.D. candidate, Seattle University School of Law, May 2008; B.A., Political Science, Emory University, 2003. First and foremost, I am grateful to Professor Rafael I. Pardo, Michael G. Wickstead, and Grant F. Hopper for their constructive criticism of this Comment. Without their suggestions and support none of this would have been possible. All opinions and errors are my own. Thanks also to the tireless efforts of Ryan Carson and the *Seattle University Law Review* staff. Finally, I would like to dedicate this work to my wife, Kristina, for her love and unfailing patience.

1. S. REP. NO. 100-505, at 9 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 3200, 3207.

enough problems to necessitate in-house counsel, nor are you sophisticated enough to put such expertise to good use.

Shortly before the winter holidays, you learn that one of the companies from whom you license technology, Titanic Technologies, has gone into bankruptcy. Back when you were still developing your own product, you contacted this company because you had the good sense to recognize a way to use intellectual property ("IP") owned by Titanic in a profitable, new way. Moreover, you had the foresight to secure a licensing agreement for a substantial length of time. You remember vividly the care you took to finalize all the legal arrangements. It's too bad Titanic management was unable to keep the ship afloat. Shortly thereafter, you receive notice that Titanic is selling all of its assets and closing its doors. "No matter," you surmise, "I'll just continue to work with whoever purchases the intellectual property. But just to be on the safe side, I'll find a bankruptcy attorney after I get back into the office in January."

Too bad for you. A little over three weeks later, while still seeking counsel to review the notice, you have yet to object to the bankruptcy sale. Moreover, you did not realize that this sale was, in fact, a sale extinguishing any and all existing interests in Titanic's IP, including your licensing agreement. When a bankruptcy attorney finally assesses your situation, she must break the bad news: You have lost your rights under the licensing agreement to use that IP, despite the fact that you paid a substantial amount for a binding agreement lasting another fifteen years. Then you realize something truly devastating: Your wildly successful new product uses and depends on that IP, so you must halt production immediately. Because of the nature of the manufacturing design, you cannot engineer around the use of this licensed technology. Furthermore, because your competitor purchased the technology at the bankruptcy sale (for a fire-sale price), there is little chance you can negotiate a new deal. Your competitor probably profits more from putting you out of business than by selling or licensing the IP back to you or anyone else. Your business may not be ruined, but you are certainly in store for a rough New Year.[2]

---

2. This narrative is not based on real events. Instead, this is a "worst case" scenario and is, of course, subject to some exceptions. For example, a licensee can sometimes obtain rights to use similar IP and adapt his or her business model at little cost. While it may be possible to continue operating a business with relatively little interruption, the loss of IP is usually quite damaging to an enterprise because, as a unique property right, IP is difficult to replace.

Furthermore, I am by no means the first author to illustrate the risk of losing one's right to use licensed IP during bankruptcy by placing the reader in the shoes of a licensee. *Cf.* Robert Tamietti, *Technology Licenses Under the Bankruptcy Code: A Licensee's Mine Field*, 62 AM. BANKR. L.J. 295, 295 (1988). Whereas Mr. Tamietti's article predates the Intellectual Property Bankruptcy Protection Act ("IPBPA") and addresses the risk to a licensee that the licensor may reject the licensing

This hypothetical situation may not be a common occurrence, yet the result is entirely possible in certain parts of the country. In recent opinions, the U.S. Court of Appeals for the Seventh Circuit has interpreted the Bankruptcy Code[3] ("the Code") in a manner that makes inaction or ignorance perilous for IP licensees whose licensor declares bankruptcy. Although Congress amended the Code to protect a licensee from losing technology rights in these situations,[4] the Seventh Circuit has narrowly interpreted[5] a strikingly similar bankruptcy provision involving real-estate leases[6] and, in doing so, has cast doubt on the efficacy of the licensee protections found in section 365(n) of the Code. In addition, this circuit has broadly interpreted another Code section dealing with title-clearing sales of a debtor's property, giving wider effect to section 363(f).[7] Such a sale strips all existing interests and conveys a debtor's property "free and clear" at auction.[8] Thus, by checking protective measures and amplifying economic risks, the federal judiciary has seriously threatened the survival of many companies.[9] Unfortunately, this legal equivalent of a one-two punch can knock out even the heavyweights of the business community.

Two factors leave businesses particularly vulnerable to the loss of IP licenses. First, nearly all companies use IP.[10] In fact, dependence on IP pervades the entire economy—conventional merchants and technol-

---

agreement, this Comment explores the risk that the licensor does not reject the license before selling it free and clear.

3. Throughout this Comment, all abbreviated Code sections and references to "the Code" should be understood as referring to Title 11 of the United States Code.

4. *See infra* Part III.A.2 for a discussion of the history and details of the IPBPA.

5. *See* Precision Indus., Inc. v. Qualitech Steel SBQ, L.L.C. (*In re* Qualitech Steel Corp. & Qualitech Steel Holdings Corp.), 327 F.3d 537, 547 (7th Cir. 2003). *See* discussion *infra* Part III.C.2.

6. *See* DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY 139 (2006) ("The specific rules governing technology licenses in § 365(n) are analogous to the specific rules governing real property in § 365(h)."); Michael St. Patrick Baxter, *Section 363 Sales Free and Clear of Interests: Why the Seventh Circuit Erred in* Precision Industries v. Qualitech Steel, 59 BUS. LAW. 475, 499 (2004) ("As a result of the substantial similarity between § 365(h) and § 365(n), the case can be applied easily in § 363(f) sales to extinguish the rights of licensees of intellectual property under § 365(n)."); Christopher C. Genovese, Precision Industries v. Qualitech Steel*: Easing the Tension Between Sections 363 and 365 of the Bankruptcy Code?*, 39 REAL PROP. PROB. & TR. J. 627, 647–48 (2004) ("Similar to section 365(h), the language of section 365(n) does not explicitly refer to situations in which the debtor sells its assets (including intellectual property that it licenses) pursuant to section 363(f).").

7. *See* FutureSource L.L.C. v. Reuters Ltd., 312 F.3d 281, 285 (7th Cir. 2002). *See* discussion *infra* Part III.C.1.

8. 11 U.S.C. § 363(f) (2006).

9. *See* discussion *infra* Part III.C.2.

10. *See* Alberto Torres, *Unlocking the Value of Intellectual Assets*, MCKINSEY Q., 1999 No. 4, at 36.

ogy businesses alike.[11] Second, IP used by a company can be one of its "most valuable assets."[12] Specifically, technology *licenses* generate substantial revenue[13] and "often form the cornerstone of a licensee's business or operations."[14]

While a business may escape severe repercussions following the sudden loss of licensing rights, the "consequences can be devastating, perhaps leading to the licensee's own bankruptcy."[15] In this economic environment, the legal system must be attuned to the significant risks facing all companies.[16] The threat to the technology sector is especially grave because these companies rely more heavily on licensing rights.[17]

Although only the Seventh Circuit has interpreted the Code in this fashion, other circuits may soon follow. Because U.S. technology companies "have taken hold most strongly in [metropolitan areas] in the West,"[18] predominantly in the Ninth Circuit's jurisdiction, this circuit is

---

11. *See* Teresa L. Johnson & Bryce R. Giddens, *The Treatment of Intellectual Property Licenses in Bankruptcy and Secured Transactions*, 831 PRACTICING L. INST. PATENTS COPYRIGHTS TRADEMARK & LITERARY PROP. COURSE HANDBOOK SERIES 447, 455 (2005).

12. NICK VIZY, CORPORATE COUNSEL'S GUIDE TO BANKRUPTCY LAW § 18:1 (2007).

13. Torres, *supra* note 10, at 31 ("[I]ntellectual assets can represent a powerful stream of revenue. Many leaders in the pharmaceuticals industry generate a substantial part of their sales by marketing products licensed from other companies."); *see* ROBERT GOLDSCHEIDER, 1 LICENSING AND THE ART OF TECHNOLOGY MANAGEMENT § 12:8 (2006) (explaining the primacy of licensing transactions to the "new economy" companies); Roger G. Schwartz & Shelley C. Chapman, *Does One Size Fit All?: As E-Commerce Businesses Falter, the Flexibility and Reach of the Bankruptcy Code is Challenged to Meet Varied Needs*, NAT'L. L.J., Feb. 12, 2001, at B9 (noting that assets owned by Internet and e-commerce businesses consist "almost entirely of intellectual property, such as technology licenses and agreements"); Johnson & Giddens, *supra* note 11 ("There are few, if any, businesses today whose operations do not depend on intellectual property licenses, whether as licensors or licensees.").

14. Richard M. Cieri & M. Natasha Labovitz, *License Rights: New Threats to Bankruptcy Protections for IP Licensees*, N.Y. L.J., July 1, 2003, at 5.

15. VIZY, *supra* note 12, § 18:10.

16. *See* Lori E. Lesser, *Bankruptcy and Licensing*, 764 PRACTICING L. INST. PATENTS COPYRIGHTS TRADEMARK & LITERARY PROP. COURSE HANDBOOK SERIES 571, 575 (2003).

17. *See* Stuart P. Meyer, *Exploiting Intellectual Property Assets Through Licensing: Strategic Considerations*, 468 PRACTICING L. INST. PATENTS COPYRIGHTS TRADEMARK & LITERARY PROP. COURSE HANDBOOK SERIES 29, 33 (1996) ("Virtually all high technology companies rely on licenses to achieve their business goals."); *see also* GOLDSCHEIDER, *supra* note 13 (explaining the primacy of licensing transactions to the "new economy" companies); Schwartz & Chapman, *supra* note 13 (noting that assets owned by "new economy" businesses consist "almost entirely of intellectual property, such as technology licenses and agreements").

18. ROBERT D. ATKINSON & PAUL D. GOTTLIEB, THE METROPOLITAN NEW ECONOMY INDEX 1 (2001), *available at* http://www.neweconomyindex.org/metro/summary.html. The high-tech sector, of course, is dominated by companies in California and Silicon Valley, in particular. *Id.* at 5, *available at* http://www.neweconomyindex.org/metro/part5_page5.html (noting that Silicon Valley "remains the technological innovation capital of the globe, with a strong presence in a host of high-tech sectors, including biotech, Internet, telecom, computers, and devices"); Christopher Palmeri, *The Future of California*, BUS. WK., April 30, 2001, at 110 (explaining that Silicon Valley is a leading center of the technology industry). In fact, California has more than twice the number of high-

uniquely positioned to consider Congress's true intent—that courts foster success in the technology industry by issuing rulings that do not carelessly stifle technological growth or terminate successful business ventures.[19]

For the foregoing reasons, the Ninth Circuit should resist the reasoning of its sister circuit. Instead, as the circuit whose jurisdiction encompasses the lion's share of the "new economy,"[20] the Ninth Circuit should broadly read IP licensee protections and suppress hazards lurking in sales "free and clear." More precisely, it should continue to make section 363(f) title-clearing sales subject to section 365(n) protections and require affirmative consent of licensees before extinguishing valuable technology licenses in a title-clearing sale.

Part II of this Comment explores the underpinnings of IP and bankruptcy law. Part III discusses a pair of recent opinions by the Seventh Circuit that lay the foundation for examining licensee protections in bankruptcy. In Part IV, this Comment provides reasons why courts should resist the reasoning of the Seventh Circuit. Moreover, a possible solution for IP licensees facing "free and clear" bankruptcy sales is presented. Finally, Part V concludes that the Ninth Circuit, in particular, must break with its sister circuit by effectuating Congress's intent to protect and honor the rights of licensees.

---

tech workers as second-ranked Texas. *Compare* American Electronics Association, Texas's Tech Industry Adds 10,300 Jobs, http://www.aeanet.org/PressRoom/prjj_cs2007_texas.asp (last visited July 31, 2007) (noting a total of 445,800 high-tech workers in Texas in 2005), *with* American Electronics Association, California's Tech Industry Rebounds, Adding 14,400 Jobs, http://www.aeanet.org/PressRoom/prjj_cs2007_california_ba.asp (last visited July 31, 2007) (noting that an astonishing 919,300 Californians worked in high technology in 2005).

19. *See infra* Part V. Not all business headquartered in the jurisdiction of the Ninth Circuit, however, will necessarily file for bankruptcy there. Many companies based in, for example, California are incorporated in New York or Delaware and may choose to file in the state of incorporation. Interview with Michael G. Wickstead, Member, Ogden Murphy Wallace, P.L.L.C., in Seattle, Wash. (Feb. 16, 2007); *see* BAIRD, *supra* note 6, at 24 ("Proper venue for filing a bankruptcy petition includes state of incorporation, and because many large businesses are incorporated under or have an affiliate incorporated under Delaware or New York law, large bankruptcy cases are often filed there."). *But see* David A. Skeel, Jr., *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 TEX. L. REV. 471, 522 (1994) (arguing that the internal affairs doctrine would not force a bankruptcy court to apply the bankruptcy law of the federal appellate circuit wherein the business is incorporated).

20. *See* GOLDSCHEIDER, *supra* note 13 (defining "new economy" companies as those which are technology-based).

II. BACKGROUND

A. U.S. Intellectual Property Law

1. Overview

The law of intellectual property delineates the "property rights of owners of intangible assets."[21] These assets include, among other things, trademarks, patents, copyrights, trade secrets, and publicity rights.[22] Many well-known products, computer program source code for example,[23] consist primarily of intellectual assets. Moreover, growth in many new industries, such as biotechnology, is driven in part by the expansion of intellectual property law.[24] Unlike real property, the use of which is limited by its tangible nature, intangible assets are indivisible; that is, an infinite number of individuals may use the same "information without depleting it."[25] The ability to license IP to many separate individuals or companies multiplies the potential use, and thus economic value, of the IP.[26] For example, over forty-five companies have licensed the same scientific "technique developed for making proteins in bacteria."[27]

Intellectual assets are primarily conveyed either by assignment or license.[28] While assigning an information asset transfers most of its

---

21. ROCHELLE COOPER DREYFUSS & ROBERTA ROSENTHAL KWALL, INTELLECTUAL PROPERTY: CASES AND MATERIALS ON TRADEMARK, COPYRIGHT AND PATENT LAW 4 (2d ed. 2004).

22. *See id.* at 1–5.

23. H. WARD CLASSEN, A PRACTICAL GUIDE TO SOFTWARE LICENSING FOR LICENSEES AND LICENSORS 5 (2005).

24. Craig J. Madson, *Patents*, *in* THE INTELLECTUAL PROPERTY HANDBOOK: A PRACTICAL GUIDE FOR FRANCHISE, BUSINESS, AND IP COUNSEL 237, 241–42 (William A Finkelstein & James R. Sims III eds., 2005). Madson writes passionately about the scientific advances made possible by the evolution of IP jurisprudence:

> [Following the U.S. Supreme Court's decision in Diamond v. Chakrabarty, 447 U.S. 303 (1980),] broad new classes of patentable subject matter, including human genes, animal and plant genes, novel nucleotide and oligonucleotide molecules, transgenic animals, transgenic plants, and gene therapies, have been subjects of patent applications. Patents granted from such applications have helped to render research and development into many biotechnology applications profitable, thus supporting research, and the growth of new industries is bound to bring about bold changes in the future of mankind. Entire industries have been built around the hope of commercializing the data derived from the Human Genome Project and other genetic research.

Id.

25. PAUL GOLDSTEIN, COPYRIGHT, PATENT, TRADEMARK AND RELATED STATE DOCTRINES: CASES AND MATERIALS ON THE LAW OF INTELLECTUAL PROPERTY 18 (5th ed. 2004).

26. *See id.*

27. Andrew Pollack, *It's Alive! Meet One of Biotech's Zombies*, N.Y. TIMES, Feb. 11, 2007, at 31.

28. CLASSEN, *supra* note 23.

property rights, much like a "sale,"[29] some IP owners choose instead to license the use of their IP to others in exchange for a fee or royalties.[30] Typical licensing agreements, however, restrict a licensee's use to either a "specific application or geographic market."[31]

Demands of the market often dictate the use of licensing agreements over full assignments of IP.[32] Technology company managers who intend to both develop and market IP "run[] the risk of not realizing its full value."[33] This is true because the two activities require different specialized skills: "Many large companies are much more proficient at commercializing their products than at developing them."[34] In fact, exchange markets have sprung up where technology developers can license their intellectual assets to other companies.[35] Research and development departments need not abandon unusable IP; rather, the company can license these assets and turn a profit.[36] In all, IP licensing activities form a significant part of the U.S. economy.[37]

2. Bankruptcy Law Narrows the Intellectual Property Field

While the term "intellectual property" properly describes various types of assets, the Bankruptcy Code defines the term narrowly to include only trade secrets, patents, patent applications, plant varieties, copyrights, and mask works.[38] Such a definition captures, for example,

---

29. *See id.* Property rights in the intellectual asset not transferred by assignment "include, for example, the rights of performance or preparation of derivative works rights." *Id.* Another type of licensing agreement, the "exclusive license," is more akin in character to a sale than a license. *Id.* Note, however, that "for copyrights, non-exclusive licenses prevail over a purchaser so long as the license is evidenced in a signed writing and was either made before the ownership transfer or was taken in good faith and without notice before the transfer recorded." Gary H. Moore, *Buying and Licensing Intellectual Property from Troubled Companies*, 779 PRACTICING L. INST. PATENTS COPYRIGHTS TRADEMARK & LITERARY PROP. COURSE HANDBOOK SERIES 303, 340 n.55 (2004) (citing 17 U.S.C. § 205(e) (2006)).

30. Meyer, *supra* note 17, at 41 ("License revenue is typically sought either through up-front license fees or through periodic fees, or both. The term 'royalty' is commonly used to refer to periodic fees that are due and payable upon dispensing a product or service including the licensed technology.").

31. S. REP. NO. 100-505, at 4 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 3200, 3202.

32. *See* Meyer, *supra* note 17, at 41 ("Revenue is generally the prime motivator for most licensors. Typically, a licensor has expended a great deal of time and money to develop a valuable technology and a license is a common tool by which the licensor can exploit the value in that technology.").

33. Torres, *supra* note 10, at 30.

34. *Id.* at 32.

35. *Id.* at 30.

36. *See id.* at 34.

37. Johnson & Giddens, *supra* note 11, at 461.

38. *See* 11 U.S.C. § 101(35A) (2006). According to statute,

(2) [a] "mask work" is a series of related images, however fixed or encoded—

computer software code,[39] but excludes trademarks, trade names, service marks,[40] rights of publicity, unpatented inventions that are not trade secrets, and contingent licenses.[41] Notably, Congress excluded trademarks,[42] one of the three central forms of intellectual property law alongside copyrights and patents.[43] Although legislative history indicates that trademarks were intentionally excluded because of quality control issues unique to this form of IP,[44] their omission may have simply been a product of political horse trading.[45] Because the Code defines "intellectual property" narrowly, the scope of this Comment will encompass only those particular intellectual assets covered therein.

B. U.S. Bankruptcy Law

1. The Framework: Navigating the Code

Bankruptcy law supports twin public policy concerns: Giving the honest debtor a fresh start and instituting an orderly debt collection procedure to satisfy the claims of creditors when insufficient assets exist for repayment in full.[46] These concerns apply with equal force to industries built on IP, even though the technology industry is risky by nature.[47]

Bankruptcy proceedings are governed by federal law organized under Title 11 of the United States Code.[48] Congress set forth a system of bankruptcy procedures and divided them by chapter.[49] The form of bankruptcy entered "depends on the goals of the person filing the peti-

---

(A) having or representing the predetermined, three-dimensional pattern of metallic, insulating, or semiconductor material present or removed from the layers of a semiconductor chip product; and

(B) in which series the relation of the images to one another is that each image has the pattern of the surface of one form of the semiconductor chip product.

17 U.S.C. § 901 (2006).

39. CLASSEN, *supra* note 23, at 77.

40. THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE § 4:1, at 344 (rev. ed. 2005).

41. Lesser, *supra* note 16, at 590–91.

42. 11 U.S.C. § 101(35A) (2006).

43. *See* DREYFUSS & KWALL, *supra* note 21, at 1.

44. S. REP. NO. 100-505, at 5 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 3200, 3204.

45. WARD, *supra* note 40, § 4:1, at 343–44 (explaining that "[t]he definition is artificially constructed to serve the legislative purpose of allowing some, but not all, nonbankrupt licensees to retain rights that might otherwise be rejected as executory by bankrupt licensors"). Some scholars advocate that trademarks should take their rightful place as IP entitled to this bankruptcy protection. *See* Xuan-Thao N. Nguyen, *Bankrupting Trademarks*, 37 U.C. DAVIS L. REV. 1267, 1270 (2004).

46. *E.g.*, DAVID G. EPSTEIN ET AL., BANKRUPTCY 2–3 (1993).

47. Jens Wüstemann, *Evaluation and Response to Risk in International Accounting and Audit Systems: Framework and German Experiences*, 29 J. CORP. L. 449, 458 (2004).

48. *E.g.*, EPSTEIN ET AL., *supra* note 46, at 3–4.

49. *E.g.*, *id.* at 4; BAIRD, *supra* note 6, at 6.

tion."[50] The early chapters—Chapters 1, 3, and 5—form the general rules governing all routes through bankruptcy,[51] while the "remaining chapters set out different procedures for distinct kinds of bankruptcy cases."[52]

Generally speaking, bankruptcy law acts to pay off creditors either by (1) liquidating a debtor's assets or (2) rehabilitating a debtor's ability to earn profits in the future.[53] The first type of bankruptcy involves the liquidation of assets under Chapter 7. In such cases, a federal official, the U.S. Trustee,[54] appoints a trustee[55] to administer the process for the debtor,[56] be it an individual person or a corporation.[57] The Chapter 7 process is relatively straightforward for debtors who are individuals:[58] "[T]he trustee collects the nonexempt property of the debtor, converts that property to cash, and distributes the cash to the creditors."[59] Once this is completed, a debtor receives a discharge "releas[ing] . . . the debtor from any further personal liability for his or her pre-bankruptcy debts."[60] With discharge in hand, the individual is off to a fresh start,[61] albeit with fewer belongings. Corporations, on the other hand, do not receive a discharge[62] and are not entitled to a fresh start.[63] In the case of a corporation, "[t]he purpose of . . . Chapter 7 petitions is not to give creditors assets but to assure creditors that the corporation has no assets."[64]

The second type of bankruptcy operates to restructure the debtor's finances.[65] Chapters 11, 12, and 13[66] each function in this way,[67] and a

---

50. BAIRD, *supra* note 6, at 18.

51. 11 U.S.C. § 103(a) (2006); *see* BAIRD, *supra* note 6, at 6.

52. BAIRD, *supra* note 6, at 6.

53. EPSTEIN ET AL., *supra* note 46, at 8.

54. *Id.* at 7.

55. *Id.* Because the form of the bankruptcy proceeding matters little in regards to the substantive issues addressed in this Comment, the term "trustee" will be used to indicate any bankruptcy "actors"—both trustees and debtors in possession—who are charged with administering a debtor's bankruptcy.

56. 11 U.S.C. § 101(13) (2006) ("The term 'debtor' means person or municipality concerning which a case under this title has been commenced.").

57. *E.g.*, BAIRD, *supra* note 6, at 9. Throughout this Comment, an "individual" may refer to either a natural person or a corporate entity.

58. *See* EPSTEIN ET AL., *supra* note 46, at 9.

59. *Id.* at 8.

60. *Id.* at 11; BAIRD, *supra* note 6, at 18 ("Section 727 gives the honest but unfortunate debtor a discharge. Because future income of an individual does not become property of the estate under § 541, the effect of § 727 is to give the individual debtor the right to enjoy future income free of creditors' claims.").

61. EPSTEIN ET AL., *supra* note 46, at 6; BAIRD, *supra* note 6, at 1.

62. BAIRD, *supra* note 6, at 19.

63. *Id.*

64. *Id.*

65. *See* EPSTEIN ET AL., *supra* note 46, at 8; *see* WARD, *supra* note 40, § 4:1, at 342.

debtor's circumstances will determine which form of bankruptcy is available.[68] The Chapter 11 process is "designed for the restructuring of business organizations."[69] Instead of calling on a trustee to liquidate the debtor's assets, as is the case in Chapter 7, the procedures of Chapter 11 ordinarily allow a debtor in possession[70] to continue to operate his or her business.[71]

Business owners and managers will generally prefer to reorganize rather than liquidate a company.[72] Whereas an individual debtor generally seeks a fresh start free of personal liability, corporate owners are by nature shielded from personal liability.[73] Free of such risk, they are generally motivated to reorganize under Chapter 11 by personal incentives to both keep their jobs[74] and maintain control over the bankrupt business.[75]

2. Licensing Agreements are Executory Contracts

Bankruptcy is a complex process with detailed rules neatly covering most situations. Importantly, a bankruptcy trustee has the power to "use, sell, or lease . . . property" on behalf of the debtor.[76] Such expansive power authorizes a trustee to maximize the value of the estate, regardless of whether the debtor is in liquidation or rehabilitation proceedings, in keeping with bankruptcy's function as an orderly "debt collection system."[77]

When a debtor enters bankruptcy with unfinished contractual obligations, bankruptcy law authorizes the "trustee, subject to the court's approval, [to] assume or reject any *executory contract* . . . of the

---

66. "Chapter 12 . . . deals with the rehabilitation of family farmers and family fishermen. Chapter 13 deals with the rehabilitation of individuals with regular incomes." WARD, *supra* note 40, § 4:1, at 342. As such, these chapters are beyond the scope of this Comment.

67. *See id.*

68. BAIRD, *supra* note 6, at 8.

69. *Id.* at 21; WARD, *supra* note 40, § 4:1, at 342.

70. *See* BAIRD, *supra* note 6, at 13 ("[U]nder § 1107 the debtor in possession takes on the duties and responsibilities of the trustee. Code provisions authorizing the trustee to take certain actions apply with equal force to the debtor in possession. In the case of a corporation, the old managers of the debtor corporation act as debtor in possession."); EPSTEIN ET AL., *supra* note 46, at 7.

71. EPSTEIN ET AL., *supra* note 46, at 13.

72. BAIRD, *supra* note 6, at 19 ("In many cases, a corporation finds itself in Chapter 7 only after first having tried unsuccessfully to reorganize under Chapter 11.").

73. *E.g.*, ERIC A. CHIAPPINELLI, CASES AND MATERIALS ON BUSINESS ENTITIES 276 (2006) (noting that, generally, "shareholders are not liable for corporate debts").

74. MICHAEL J. HERBERT, UNDERSTANDING BANKRUPTCY § 9.01 (1995).

75. BAIRD, *supra* note 6, at 20 ("Those in control of the corporation outside of bankruptcy usually want to retain that control in bankruptcy. Chapter 11 allows the retention of control, while Chapter 7 requires the appointment of a trustee to manage the affairs of the business.").

76. 11 U.S.C. § 363(b)(1) (2006); *see also* BAIRD, *supra* note 6, at 14.

77. EPSTEIN ET AL., *supra* note 46, at 2.

debtor."[78] Although the Code fails to define an "executory contract," most, but not all, courts follow Professor Countryman's definition:[79] "a contract under which the obligation of both the [debtor] and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."[80]

In the IP context, legal scholars generally consider IP licenses to be executory contracts,[81] and the Ninth Circuit has adopted that view as well.[82] So universal is this judgment that "[t]here are no reported decisions holding that an intellectual property license is not an executory contract."[83] These agreements are considered executory because parties on both sides generally have "material ongoing obligations [of] quality control, use of notice and legends, duty to defend and enforce IP rights, duty not to sue each other, [and] exclusivity obligations."[84]

Trustees have an obligation to "'assume' advantageous executory contracts and 'reject' burdensome ones."[85] To "assume" means to "bind[] the bankruptcy estate to the debtor's prepetition performance obligation under the terms of the contract assumed."[86] To "reject," however, means that "the [bankruptcy] estate . . . is not and never was bound by the contractual obligations of the debtor."[87] Such a decision, of

78. 11 U.S.C. § 365(a) (2006) (emphasis added).

79. *E.g.*, BAIRD, *supra* note 6, at 129; EPSTEIN ET AL., *supra* note 46, at 231.

80. Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973).

81. *See, e.g.*, *In re* Patient Educ. Media, Inc., 210 B.R. 237, 241 (Bankr. S.D.N.Y. 1997) (noting that nonexclusive copyright and patent licenses are executory contracts); VIZY, *supra* note 12, § 18:7; Johnson & Giddens, *supra* note 11, at 458; Stuart M. Riback, *Intellectual Property Licenses: The Impact of Bankruptcy*, 845 PRACTICING L. INST. PATENTS COPYRIGHTS TRADEMARK & LITERARY PROP. COURSE HANDBOOK SERIES 755, 761 (2005); Philip S. Warden & Kenneth A MacKay, *Drafting Technology Licenses in a Down Market*, 801 PRACTICING L. INST. PATENTS COPYRIGHTS TRADEMARK & LITERARY PROP. COURSE HANDBOOK SERIES 299, 304 (2004); *see also* Tap Pub'ns, Inc. v. Chinese Yellow Pages (N.Y.) Inc., 925 F. Supp. 212, 217 (S.D.N.Y. 1996) (noting that trademark licenses are essentially executory contracts).

82. Everex Sys., Inc. v. Cadtrak Corp. (*In re* CFLC, Inc.), 89 F.3d 673, 677 (9th Cir. 1996) (holding patent licenses are executory contracts).

83. James A. Beldner, *Intellectual Property Agreements and Bankruptcy: Issues Facing Non-Debtor Licensors and Licensees*, 893 PRACTICING L. INST. PATENTS COPYRIGHTS TRADEMARK & LITERARY PROP. COURSE HANDBOOK SERIES 229, 231 (2007). *But see* Schuyler M. Moore, *Entertainment Bankruptcies: The Copyright Act Meets the Bankruptcy Code*, 48 BUS. LAW. 567, 583 (1993) (noting that in the example of television rights, the copyright license should not be executory under the Countryman test because "the consideration for the license is a fixed advanced payment," and therefore no continuing material obligations exist).

84. Lesser, *supra* note 16, at 581.

85. WARD, *supra* note 40, § 4:1, at 342.

86. *Id.* § 4:83.

87. *Id.* § 4:99, at 528.

course, can be interpreted as debtor's breach.[88] The time period following a bankruptcy's commencement and before the trustee's decision to assume or reject executory contracts is known as the "gap period."[89]

III. CONTRARY OR COOPERATIVE CODE?: THE STORY OF SECTIONS 365(N) AND 363(F)

A. The Origins of Section 365(n) Licensee Protections

Legal advances are often made when courts find themselves in the gray areas of legal uncertainty, such as cases of first impression, and an unpopular judicial decision may force the legislator's hand. This is the origin of the licensee protections embodied in section 365(n) of the Code.[90]

1. The *Lubrizol Enterprises* Case

In 1985 the U.S. Court of Appeals for the Fourth Circuit decided *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc,*[91] a bankruptcy case wherein a debtor-licensor had licensed to another company the right to use its patented technology for coating metal.[92] In Chapter 11 proceedings, the debtor-licensor rejected the licensing agreement.[93] The bankruptcy court approved the rejection,[94] but the district court ruled that the debtor-licensor's decision did not terminate the licensee's rights to use the technology under the contract.[95]

On appeal, the Fourth Circuit reversed, holding that the rejection of an IP licensing agreement terminated all rights of the licensee to use the debtor-licensor's IP,[96] "despite the 'serious burden' it caused to the licensee."[97] In addition, the appellate court suggested that its hands were tied because Congress failed to provide protections to technology licensees

88. *Id.*

89. EPSTEIN ET AL., *supra* note 46, at 266. *But see* BLACK'S LAW DICTIONARY 702 (8th ed. 2004) (defining the "gap period" as "[t]he duration of time between the filing of an involuntary bankruptcy petition and the entry of the order for relief"). In this Comment, I will use this the term to refer to this time period in both voluntary and involuntary bankruptcies because intellectual assets can be sold "free and clear," regardless of the form of proceeding.

90. EPSTEIN ET AL., *supra* note 46, at 238.

91. 756 F.2d 1043 (4th Cir. 1985).

92. *Id.* at 1045.

93. *Id.*

94. *Id.*

95. *See id.*

96. *Id.* at 1048.

97. Lesser, *supra* note 16, at 590 (quoting *Lubrizol*, 756 F.2d at 1048).

similar to those given to real-property lessees.[98] Without such statutory protection, the *Lubrizol* licensee was forced to "share the general hazards created by § 365 for all business entities dealing with potential bankrupts in the respects at issue here."[99]

Nevertheless, characterizing the resulting circumstances of this IP licensee as a "serious burden"[100] was an understatement. Under the then-existing Code, termination of an executory licensing contract left a licensee with nothing but an unsecured claim in bankruptcy.[101] This is an unfavorable position because bankruptcy courts prioritize creditors and pay them according to their class.[102] Secured creditors generally fare better than unsecured creditors because they are "entitled to be paid to the extent of the value of the collateral before other creditors."[103] On the other hand, unsecured creditors are paid a pro rata share of the remaining assets,[104] generally constituting mere "cents on the dollar."[105] Thus, characterization as an unsecured creditor carries tremendous significance with regard to a licensee-creditor's ability to recover from the debtor-licensor's decision to reject.

In addition to ruling that the licensee lost its right to use *intellectual property*, the court deemed the licensee to be an unsecured creditor entitled only to monetary damages,[106] despite the fact that IP is a "unique property right[]."[107] The loss of irreplaceable property rights falls heavily on industries that significantly depend on these rights.[108] This burdensome position is where the *Lubrizol* court left the IP licensee.[109]

---

98. *Lubrizol*, 756 F.2d at 1045. Specifically, the court explained:

> Congress has plainly provided for the rejection of executory contracts, notwithstanding the obvious adverse consequences for contracting parties thereby made inevitable. Awareness by Congress of those consequences is indeed specifically reflected in the special treatment accorded to union members under collective bargaining contracts . . . and to lessees of real property [under] 11 U.S.C. § 365(h). *But no comparable special treatment is provided for technology licensees* such as Lubrizol.

Id. (emphasis added).

99. *Id.* at 1048.

100. *Id.*

101. *See* VIZY, *supra* note 12, § 18:9 (discussing *Lubrizol*).

102. *See* BAIRD, *supra* note 6, at 15.

103. *Id.*; *see also* EPSTEIN ET AL., *supra* note 46, at 6.

104. *See* EPSTEIN ET AL., *supra* note 46, at 11.

105. Johnson & Giddens, *supra* note 11, at 457.

106. *Id.* at 461 ("Because the licensee relied heavily on this technology in its operations, an unsecured claim for damages (without the ability to enforce specific performance by the debtor licensor) was a small consolation.").

107. S. REP. NO. 100-505, at 4 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 3200, 3203.

108. *See* VIZY, *supra* note 12, § 18:10; Johnson & Giddens, *supra* note 11, at 461.

109. VIZY, *supra* note 12, § 18:9.

The *Lubrizol* decision alarmed the technology industry.[110] Unable to depend on courts to enforce licensing agreements in such situations, technology companies contemplating future licenses found themselves forced to make a difficult choice: To secure the ability to use valuable intellectual assets, they would need either to continue to depend on licensing agreements without any assurances against unexpected loss[111] or purchase the IP outright.[112]

Each constituted an equally poor solution.[113] On the one hand, businesses must be able to marshal assets and depend on them for future use. On the other hand, full assignment of the underlying IP is unduly expensive and thus economically inefficient.[114] Because intellectual assets are indivisible, an owner has a financial obligation to fully exploit such property, by licensing its use to multiple companies, for example, whereas a licensee can concentrate its efforts on bringing a product to market.[115] The difference in cost between a licensing agreement and outright sale of the underlying asset can be substantial.[116] Faced with nothing but bad alternatives, many in the technology industry lobbied Congress for relief.[117]

2. Congress Weighs In

Congress responded quickly. As its name suggests, the Intellectual Property Bankruptcy Protection Act of 1989 ("IPBPA")[118] fashioned significant safeguards for technology licensees facing rejection by a debtor-licensor in bankruptcy.[119] Modeled after existing protections for real-property lessees under section 365(h),[120] the newly minted section 365(n)[121] provided licensees a choice of two options following a debtor-licensor's rejection of an executory contract.[122]

---

110. *See* CLASSEN, *supra* note 23, at 76. *See generally* VIZY, *supra* note 12, § 18:10.

111. *See* Johnson & Giddens, *supra* note 11, at 461.

112. *See* VIZY, *supra* note 12, § 18:10.

113. *See id.*

114. *See id.*

115. *See id.*

116. *See id.*

117. *See* Johnson & Giddens, *supra* note 11, at 461.

118. The central provision of this Act is codified in § 365(n). *Id.*

119. *See* 11 U.S.C. § 365(n)(1) (2006); *see also* Lesser, *supra* note 16, at 590.

120. *See* BAIRD, *supra* note 6.

121. According to section 365(n)(1),

(1) *[i]f the trustee rejects* an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—

(A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contact as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by licensee with another entity; or

Under the first option, a licensee may treat the rejection as a terminable breach by the licensor[123] and "bring a claim for damages to the extent the rejection caused the licensor to fail to meet the licensor's obligations."[124] Such action, however, forecloses all future use by the licensee.[125] Alternatively, a licensee can keep the right to use the IP for the length of the contract and any extensions available thereunder.[126] This second choice allows a licensee to continue using the intellectual asset,[127] which dramatically shifts power back to the licensee.[128] Commentators agree that this is the section's central feature.[129]

(B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for—

(i) the duration of such contract; and

(ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.

Id. (emphasis added).

122. *See id.*

123. Lesser, *supra* note 16, at 589 ("Section 365(n) provides that if the trustee rejects an executory contract for intellectual property, the licensee may . . . treat the contract as terminated if such rejection amounts to a terminable breach.").

124. CLASSEN, *supra* note 23, at 77.

125. *Id.*

126. *See* 11 U.S.C. § 365(n) (2006); Lesser, *supra* note 16, at 589–90.

127. *See* 11 U.S.C. § 365(n) (2006).

128. Wickstead, *supra* note 19. Although a licensee may continue to use the IP, a licensor need not perform any ancillary duties, such as maintenance or troubleshooting, features that may be necessary if a licensee seeks continued use for the length of the agreement. *Id.* Thus, a licensee of software should only enter a licensing agreement that allows its employees or outside professionals to troubleshoot and fix the IP if the need arises. *Id.* For example, a source-code escrow could give the licensee the ability to troubleshoot if the licensor were ever to go through such a situation. *Id.*

129. *See, e.g.*, VIZY, *supra* note 12, § 18:10 (calling the effect of this election the "heart of the Act"); Warden & MacKay, *supra* note 81, at 305 (calling it the "essence of section 365(n)"). Although section 365(n) provides some protection to licensees during the gap period, this protection is quite limited. *See* 11 U.S.C. § 365(n)(4) (2006). This section provides the following:

(4) Unless and until the trustee rejects such contract, on the written request of the licensee the trustee shall—

(A) to the extent provided in such contract or any agreement supplementary to such contract—

(i) perform such contract; or

(ii) provide to the licensee such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law) held by the trustee; and

(B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment), including any right to obtain such intellectual property (or such embodiment) from another entity.

Id. As such, when this Comment subsequently discusses the licensee protections of section 365, it will be referencing the protections embodied in section 365(n)(1).

Even so, the second option offers only partial relief.[130] While a licensee may continue use, all ancillary rights normally subject to specific performance are statutorily excluded.[131] Thus, the licensee retains only an unsecured claim for damages for the loss of these potentially necessary rights.[132] Such ancillary rights include, for example, the increasingly fundamental right to receive maintenance and troubleshooting from the licensor.[133]

In summary, section 365(n) gives rise to two important observations.[134] First, these protections begin only *following rejection* by a debtor-licensor.[135] Second, once this statute is triggered, licensees have a *choice* of options: they may either terminate or continue the contract.[136]

B. Section 363(f) Sales Free and Clear

Although the connection is not immediately obvious,[137] a second Code section may either cooperate with, or eviscerate, the protections available to licensees under section 365(n). As noted previously, trustees may "sell . . . property of the [debtor's] estate."[138] The rights and obligations of executory contracts become property of the bankruptcy estate and are subject to such sales.[139] If a transaction is outside the ordinary course of business,[140] then "[n]otice, hearing and a court order is required before any use, sale, or license can occur."[141] In most situations, the sale of IP by a debtor-company would indeed be outside the ordinary course of business.[142] Under such situations, if a trustee were to sell a debtor's IP, license agreements with third parties would normally remain intact.[143]

---

130. *See id.*

131. Wickstead, *supra* note 19.

132. *Id.*

133. *See* Meyer, *supra* note 17, at 46–47 ("[L]icensees will be concerned with their ability to obtain assistance from the licensor in fixing defects discovered in the technology . . . to obtain periodic upgrades and other maintenance services from the licensor . . . and to continue enjoying the technology even if the licensor becomes bankrupt."). *Id.*

134. 11 U.S.C. § 365(n) (2006).

135. *See id.* As discussed *supra* in note 129, the pre-rejection protections found in § 365(n)(4) are too limited to be considered adequate and thus are not addressed.

136. *See id.*

137. 6A WILLIAM HOUSTON BROWN ET AL., WEST'S FEDERAL FORMS § 10015, at 213 (4th ed. 2007) ("A superficial glance at sections 363 and 365 of the Bankruptcy Code may lead one to conclude that the two bankruptcy statutes are largely independent of one another.").

138. 11 U.S.C. § 363(b)(1) (2006).

139. WARD, *supra* note 40, § 4:14 ("Section 541 of the Bankruptcy Code casts a wide net over the debtor's rights for purposes of defining 'property' that passes to the 'estate' created on the date of bankruptcy. The broad definition of 'property' includes both proprietary and contractual rights.").

140. 11 U.S.C. § 363(b)(1) (2006).

141. WARD, *supra* note 40, § 4:68.

142. Wickstead, *supra* note 19.

143. *See* EPSTEIN ET AL., *supra* note 46, at 192.

Under certain circumstances, however, trustees have a statutory power to sell assets "free and clear" of all existing property interests.[144] According to section 363(f), "[t]he trustee may sell property . . . free and clear of any interest in such property of an entity other than the estate," but only if at least one of five requirements is met.[145] This Comment will focus on the condition allowing such sales when entities with an interest in the property give their "consent."

C. Interaction Between Section 365(n) Protections and Section 363(f) Title-Clearing Sales

Traditionally, advocates and courts have understood section 365(n) to mean that a licensee's rights are protected in the event that a licensor sells the underlying IP in bankruptcy.[146] In recent years, however, the Seventh Circuit decided a pair of cases that calls this understanding into doubt.[147]

1. *FutureSource*: Opening the Door

In 2002 the Seventh Circuit decided *FutureSource L.L.C. v. Reuters Ltd.*,[148] a case involving a debtor-licensor of IP in bankruptcy.[149] The debtor-licensor, Bridge Information Services, competed with Reuters in the subscription news market.[150] FutureSource, the licensee, had contracted with Bridge to receive "continuously updated, consolidated, rearranged, and reformatted financial-markets data for resale to FutureSource's customers."[151] Within two years, however, Bridge sought bank-

---

144. *See* 11 U.S.C. § 363(f) (2006). According to the statute,

> [t]he trustee may sell property . . . free and clear of *any interest* in such property of an entity other than the estate, only if—
>
> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> (2) *such entity consents*;
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

Id. (emphasis added).

145. *See id.*

146. Genovese, *supra* note 6, at 648 ("[T]he general assumption among courts and practitioners has been that the section 365(n) protections would apply in a sale context to protect the licensee.").

147. *See id.*

148. 312 F.3d 281 (7th Cir. 2002).

149. *Id.* at 283.

150. *See id.*

151. *Id.*

ruptcy protection.[152] Before Bridge decided to assume or reject the licensing agreement, it sold the IP assets used in its data service to Reuters.[153] Under the sale, Reuters "assum[ed] no contractual or other obligations" regarding the licensing agreement with FutureSource.[154] Instead, the licensor's obligations were sold separately to another company called Moneyline Network.[155] FutureSource, the licensee, was given notice of these title-clearing sales but failed to object to them.[156]

The district court granted FutureSource a preliminary injunction to halt the sale of the debtor-licensor's IP, but the Seventh Circuit reversed.[157] Although it did not address licensee protections under section 365(n), the court, in an opinion authored by Judge Posner, held that the language in section 363(f) stating that "any interest" could be included in the sale of IP license agreements.[158] As for what condition authorized the section 363(f) sale, Judge Posner explained that "one of those conditions is the consent of the interest holder, and lack of objection (provided there is notice, of course) counts as consent."[159] For the sake of efficiency, he argued that reading "implied consent" into the Code is necessary to reduce overall transaction costs leading up to these sales.[160]

Curiously, the *FutureSource* decision did not address the licensee protections of section 365(n). Instead, the court decided the case on the lone ground that section 363(f) sales have an expansive title-clearing force that extinguishes IP licenses.[161]

2. *Qualitech*: New Territory

Unanswered questions lingering after *FutureSource* seem to have been answered the following year.[162] In *Precision Industries, Inc. v. Qualitech Steel SBQ, L.L.C. (In re Qualitech Steel Corp. & Qualitech Steel Holdings Corp.)*,[163] the Seventh Circuit held, in a case of first im-

152. *Id.*

153. *Id.*

154. *Id.* at 284.

155. *Id.*

156. *Id.*

157. *Id.* at 287.

158. *Id.* at 285.

159. *Id.*

160. *Id.* at 285–86. *See* discussion of the merits of the court's efficiency argument *infra* Part IV.B.2.

161. *See* WARD, *supra* note 40, § 4:70 ("[*FutureSource*] . . . relies on the similarities between a lease and a license and concludes that a license on arguably copyrightable compilations of financial data and related software is an interest extinguishable in a § 363(f) 'free and clear' sale.").

162. *See id.* ("[*Qualitech*] . . . makes clear that, in the case of a lease, the lessee's right to retain the leasehold . . . after the debtor landlord rejects the lease does not prevent the sale of the property 'free and clear' of the lease if the requirements of § 363(f) are met.").

163. 327 F.3d 537 (7th Cir. 2003).

pression,[164] that a debtor-lessor of real estate may sell the underlying property "free and clear" of encumbrances, despite the lessee protections of section 365(h).[165] As a real estate case, the legal issues raised did not directly implicate IP licenses; the court's analysis, however, "may by extension deny licensees the protections of § 365(n) in the event of an [IP] asset sale."[166]

The debtor-lessor in this case, Qualitech Steel, ran a steel mill on a large tract of land and entered into two contracts: a supply agreement and a ground lease.[167] In exchange for the lease, the lessee, Precision Industries, constructed an on-site warehouse and agreed to operate it for ten years in conjunction with Qualitech's business operations.[168] Under the lease, Precision had "exclusive possession of the warehouse and any improvements it installed on the land for the term of the lease,"[169] in addition to the right to remove such improvements in the event of an early termination or default.[170] Accordingly, Precision constructed the warehouse on the property.[171]

Debtor-lessor Qualitech subsequently filed for Chapter 11 and sold most of its assets, including the real property, at a bankruptcy auction.[172] Precision, which had notice of the section 363(f) sale, never objected.[173] The asset purchaser transferred its interests to a newly-formed corporation, which assumed the rights of the purchaser and took title to the real property.[174] The terms of the sale also gave the purchaser the debtor-landlord's "right to assume and assign executory contracts pursuant to 11 U.S.C. § 365."[175] Instead, the purchaser abruptly changed the locks on the lessee's warehouse.[176] This action sparked the "dispute over whether Precision's possessory interest in the leased property, pursuant to section 365(h), survived the bankruptcy sale."[177]

---

164. *Id.* at 540.

165. *Id.* at 547 ("[W]e conclude that the terms of section 365(h) do not supersede those of section 363(f).").

166. Cieri & Labovitz, *supra* note 14; *see also* BAIRD, *supra* note 6 ("The specific rules governing technology licenses in § 365(n) are analogous to the specific rules governing real property in § 365(h).").

167. *Qualitech*, 327 F.3d at 540.

168. See *id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *See id.*

173. *Id.* at 541.

174. *See id.*

175. *Id.*

176. *See id.*

177. *Id.*

The bankruptcy court ruled for the new purchaser, but the district court reversed.[178] On appeal, the Seventh Circuit reversed the district court's decision.[179] In this case, the Seventh Circuit finally addressed the potential conflict between section 363(f) sales and protections afforded to lessees under section 365(h).[180] The lessee argued that section 365(h) preserved its leasehold interest, despite the debtor-lessor's sale during the gap period.[181]

The Seventh Circuit disagreed.[182] Instead, the court found no conflict between the Code sections;[183] rather, it reconciled the two sections by limiting the scope of lessee protections because "nothing in the express terms of section 365(h) suggest that it applies to any and all events that threaten the lessee's possessory rights."[184] Thus, citing *FutureSource*, the court held that the section 363(f) language extinguishing "any interest" upon sale was "sufficiently broad to include Precision's possessory interest as a lessee."[185]

The *Qualitech* decision "sent shock waves through the real estate industry"[186] and caused a collective uproar from bankruptcy practitioners.[187] The case was seen by many as a "substantively flawed decision completely opposite to the existing precedents."[188] Even more insidiously, the decision "creates an incentive for debtors to accomplish a stealth rejection" of unwanted interests, thereby profiting the estate from proceeds of the sale.[189] Although controversial, these decisions comprise the current body of federal appellate case law regarding the interaction between sections 363(f) and 365(n) of the Code. "Taken together, these

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.* at 547. In addition, the court found that "adequate protection" under § 363(e) provided the lessee with sufficient relief from the sale. *Id.* at 547–48. "'Adequate protection' does not necessarily guarantee a lessee's continued possession of the property, but it does demand, in the alternative, that the lessee be compensated for the value of its leasehold—typically from the proceeds of the sale." *Id.* at 548.

185. *Id.* at 545.

186. John C. Murray, *Precision Industries Part 1: Debtor-Lessor's Property May Be Sold "Free and Clear" of Unexpired Lease*, PROB. & PROP., Mar./Apr. 2004, at 10.

187. Genovese, *supra* note 6, at 641 ("[S]everal commentators have characterized the . . . case as a bankruptcy bombshell."). *But see* Joshua Stein, *Is the Sky Really Falling on Leasehold Mortgagees?: Ground-Lease Financing After* Qualitech, 24 SHOPPING CENTER LEGAL UPDATE 6 (2004), *available at* http://www.real-estate-law.com/infoFrame.php?pdf=Qualitech_Case_44.pdf (observing that the reaction to this case was overblown inasmuch as "Precision lost only because it 'sat on its rights' under § 363(f)").

188. Baxter, *supra* note 6, at 477.

189. *Id.*

two Circuit level cases seem to stand for the proposition that a licensee, even one who elects to retain use rights after rejection under § 365(n)(1)(B), can be forced to take 'adequate protection' for its retained interest that will then be extinguished in a 'free and clear' sale under § 363(f)."[190]

For IP licensees several important questions remain. First, how secure is a technology licensing agreement if the licensor goes into bankruptcy? Second, now that the Seventh Circuit has taken this troubling position, what can be done to alleviate the problem?

IV. ERRORS BY THE SEVENTH CIRCUIT

Legal scholars dispute the Seventh Circuit's conclusion in *Qualitech* that the protections of section 365(h), and by analogy section 365(n), are subject to section 363(f) sales.[191] Also controversial was the decision that such sales could be authorized by a lack of response by the interested licensee.[192] Next, each of these two issues will be examined in turn.

A. Section 365(n) Licensee Protections Trump Section 363(f) Sales

Although "free and clear" sales generally serve an important function in bankruptcy by maximizing the value of the estate, such sales give greater cause for concern when debtor-licensors sell their IP prior to rejection. The main concern lies in the timing: Licensees have statutory protections available, so long as they can survive attempts by the debtor-licensor to extinguish their property rights before section 365(n) protections are triggered.

While the IPBPA was enacted to provide relief to IP licensees, the precise extent of that relief is uncertain. The plain language of section 365(n) only authorizes protection upon rejection: "If the trustee *rejects* an executory contract . . . , the licensee . . . may elect [one of two options]."[193]

---

190. WARD, *supra* note 40, § 4:70, at 467. The language of section 363(e) states that

> [o]n request of a person who has an interest in any property that is being used, sold, or leased, . . . the court must prohibit or condition [it] to the extent necessary to provide adequate protection . . . . Broadly speaking, the claimant with the interest in the property is entitled to have the value of the interest protected from diminution.

HERBERT, *supra* note 74, § 9.03[D], at 137 (1995); *see also* 11 U.S.C. § 363(e) (2006).

191. *E.g.*, Baxter, *supra* note 6, at 481–85; *Genovese*, *supra* note 6, at 641.

192. *See infra* Part IV.B.

193. 11 U.S.C. § 365(n) (2006) (emphasis added). Some commentators have concluded that the Seventh Circuit misread the statutory language. *E.g.*, Baxter, *supra* note 6, at 501. Baxter asserts that § 363(*l*) "clearly subordinates all sales under §§ 363(b) and (c) to the provisions of § 365."

A close reading of the IPBPA's legislative history, however, indicates that Congress probably intended these protections to apply regardless of the debtor's decision to assume or reject the licensing agreement. According to the Senate report, "[t]his bill is intended to restore confidence in the system of intellectual property licensing, and courts interpreting it should be sensitive to the reasonable practices that have and will evolve among parties seeking to add to the technological and creative wealth of America."[194] This important language "advises the bankruptcy courts to recognize agreements that foster the development of intellectual property, even at the expense of fundamental bankruptcy policies"[195]—including policies such as maximizing the return to creditors through section 363(f) sales. Notice, too, the primacy given to the important policy of "add[ing] to the technological and creative wealth of America."[196]

Here again, lawmakers conveyed the desired effect of this bill:

> Congress *never anticipated* that the presence of executory obligations in an intellectual property license would subject the licensee to the risk that, upon bankruptcy of the licensor, the licensee would lose not only any future affirmative performance required of the licensor under the license, *but also any right of the licensee to continue to use the IP as originally agreed in the license agreement.*[197]

To restate it affirmatively, Congress intended to secure the rights of licensees under every conceivable circumstance in a licensor's bankruptcy, even if the licensor had no further obligations to perform under the contract.[198] And such an impulse makes rational sense: aside from the passage of time, there is no distinction between the licensee's precarious position before rejection and his or her much-relieved situation following rejection. Why then would Congress sympathetically grant a licensee protection on the day after rejection, but deliberately withhold it the day before?

Recall that the IPBPA was passed in reaction to *Lubrizol*,[199] where a licensee lost all rights when its debtor-licensor rejected the licensing

---

Id. Thus, he concludes that title-clearing sales under § 363(f) are "expressly limited by § 365(h)." *Id.*

194. S. REP. NO. 100-505, at 9 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 3200, 3207.

195. Walter Benzija et al., *Survey: The Treatment of Intellectual Property Interests in Bankruptcy*, 4 J. BANKR. L. & PRAC. 391, 436 (1995).

196. S. REP. NO. 100-505, at 9 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 3200, 3207.

197. *Id.* at 3, 1988 U.S.C.C.A.N. at 3201–02 (emphasis added).

198. *See id.*; *see also* VIZY, *supra* note 12, § 18:10 ("The purpose of the [IPBPA was] to encourage the licensing of technology by ensuring that licensees receive the benefit of their bargains, even after their licensors file for bankruptcy.").

199. *See* Johnson & Giddens, *supra* note 11, at 461.

agreement.[200] Using this case as a lens, congressional intent "to restore confidence in the system"[201] can be viewed broadly or narrowly. Viewed broadly, Congress could have understood the injustice of *Lubrizol* to be the loss of valuable license rights by a nonbankrupt third-party technology company. Viewed narrowly, however, lawmakers could have understood the injustice to be the loss of valuable license rights by the same technology company, *but only when a debtor-licensor first rejected the executory contract.* Although the former view is the more plausible, lawmakers nevertheless expressed themselves statutorily in rigid terms of "rejection."[202]

Thus, if bankruptcy judges are to give effect to the manifest intention of federal policymakers, they should deem outstanding IP licenses to be "rejected" by the debtor-licensor in the event of a section 363(f) sale. First, the licensor's decision to sell is substantively a decision to reject the unfavorable licensing agreement anyway, so such a decision by the court would merely state the realities of the situation. Moreover, doing so would ensure that technology companies that fail to realize the significance of a title-clearing sale and to make their objection known to the court would not lose their valuable IP licenses.

If, in fact, jurists are ultimately persuaded that these title-clearing sales are not bound by section 365(n), then the only protection for licensees against a sale are the bare prerequisites of section 363(f). Thus, it is necessary to examine whether "failure to object" is sufficient to satisfy the section 363(f)(2) "consent" requirement—the prong most likely to cause hardship to an uninformed technology licensee.

B. Implied Consent

As the technical argument goes, if "rejection" never occurs, then section 365(n)(1) is never implicated.[203] Accordingly, licensees must simply rely on existing safeguards found in section 363(f). These safeguards come in the form of required conditions before a debtor-licensor may sell IP free and clear of existing licensing agreements under section 363(f):

> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

---

200. *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1044 (4th Cir. 1985).

201. S. REP. NO. 100-505, at 9 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 3200, 3207.

202. 11 U.S.C. § 365(n)(1) (2006).

203. *See* Precision Indus., Inc. v. Qualitech Steel SBQ, L.L.C. (*In re* Qualitech Steel Corp. & Qualitech Steel Holdings Corp.), 327 F.3d 537, 547 (7th Cir. 2003).

> (2) *such entity consents*;
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[204]

These conditions are disjunctive, so any one of the five is sufficient to authorize a sale.[205] Subsections (1), (3), (4), and (5) of section 363(f) are arguably less likely than subsection (2), the consent requirement, to lead to involuntary transfers of property rights. Of these, one requirement allows sales when permitted under "applicable nonbankruptcy law."[206] Another describes situations where property is "used to foreclose a lien out of proceeds where the sale price is sufficient to discharge all liens."[207] The language of subsection (4) grants judges the power to allow sales to resolve an interest in dispute.[208] Lastly, in subsection (5), sales are "authorized because the interest can be compelled in law or equity to take a monetary substitute."[209]

Section 363(f)(2), however, presents a more challenging question: Under which situations is the consent requirement satisfied?[210] If a licensee were to affirmatively agree to the loss of licensing rights by allowing a debtor-licensor to sell the underlying IP, such affirmative consent would easily satisfy the requirement. However,

> the controversy centers on the . . . sufficiency of so called "implied consent." In various places, the Bankruptcy Code provides for the expedited finding of "implied consent" by parties in interest wherever the Code authorizes activities only "after notice and hearing." This phrase is defined in § 102(1)(B)(i) so as to authorize an act without an actual hearing if a party with an interest is properly notified and fails to request a hearing. However, where the Bankruptcy Code requires actual "consent" [as in section 363(f)(2)], a higher

---

204. 11 U.S.C. § 363(f) (2006) (emphasis added).

205. 3 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY ¶ 363.06 (15th ed. rev. 2006) ("It should be remembered that the language of section 363(f) is in the disjunctive, that is, that the sale of the interest concerned can occur if any one of the conditions of section 363(f) has been met.").

206. WARD, *supra* note 40, § 4:70, at 466.

207. *Id.*

208. *See id.*

209. *Id.*

210. *See id.*

> level of assent seems to be required. Despite the structural arguments for requiring some positive manifestation of assent from an entity before a "free and clear" sale extinguishes that entity's interest, the trend in the recent cases has been toward finding "implied consent" whenever an entity has notice of the proposed § 363(f) sale and does not object or insist on adequate protection under § 363(e).[211]

Professor Ward contends that, because section 363(f)(2) calls for "consent," rather than "implied consent," Congress seems to require "a higher level of assent" than mere inaction by a licensee.[212]

To date, the only federal appellate court to address this issue has been the Seventh Circuit, and it has regrettably embraced the rule of "implied consent" for section 363(f)(2) sales. Yet there are forceful opinions to the contrary from bankruptcy courts in other circuits.[213] For example, in *In re Roberts*,[214] a Michigan bankruptcy court held that silence is insufficient consent for section 363(f)(2) sales.[215] The court relied heavily on the semantic difference between the word "consent" in section 363(f)(2) and the phrase "does not object" in section 363(c)(2).[216] That the two formations would follow so closely in the Code "establishes beyond doubt that these are two separate and distinct concepts."[217] According to the court,

> [h]ad Congress substituted "does not object" for "consents" in Section 363(f)(2), there would be no question that the lienholder had the obligation to act if it did not want the property to be sold free and clear of its lien. However, the concept of consent (i.e., to give assent) imposes no such duty upon the lienholder. To the contrary, "consent" obligates the trustee to approach the lienholder and secure the lienholder's assent if the trustee wishes to sell the property free and clear of the lien.[218]

---

211. *Id.* at 468 (citations omitted).

212. *Id.*

213. *See In re* DeCelis, 349 B.R. 465, 470 (Bankr. E.D. Va. 2006) (arguing that the central holding in *FutureSource* barred collateral attack of the sale order by the licensee and holding implied consent insufficient); *In re* Roberts, 249 B.R. 152, 155 (Bankr. W.D. Mich. 2000) (holding that implied consent is insufficient because the statutory language says an entity must "consent," rather than requiring that an entity does not object).

214. 249 B.R. 152 (Bankr. W.D. Mich. 2000).

215. *Id.* at 153.

216. *Id.*

217. *Id.* at 156.

218. *Id.*

Unfortunately, such decisions represent a minority view; generally, bankruptcy courts follow the contrary holding in *FutureSource*: Failure to object will be understood as consent.[219]

1. The Policy Implications of Section 363(f) Consent

Even though the Seventh Circuit has accepted "implied consent" for section 363(f) sales, there are strong policy arguments in favor of mandating affirmative consent. First, arguments that transaction costs are reduced under an implied-consent regime[220] presuppose that a sale should occur. Despite the likelihood that parties who do not care about losing title will not object to such sales, it is equally important to note that an absence of responses from interested parties under an affirmative-consent regime could indicate an equally overwhelming preference to halt a sale. Besides, the onus to establish affirmative consent should be on the trustee (or debtor in possession, depending on the circumstances) who is trying to alter the existing state of affairs by extinguishing possibly valuable interests in IP. As the party who stands to gain monetarily from such a transaction, the trustee has a financial incentive to secure (or even purchase, if necessary) affirmative consent from any parties with property interests.

Second, the failure of an interested party to object to a title-clearing sale does not necessarily indicate a lack of objection. Despite the fact that notices are mailed to interested parties, a title-clearing sale could be held with as little as twenty-days notice.[221] As in the earlier hypothetical involving our protagonist Squirtech, not all businesses are represented by counsel or, particularly, counsel with expertise in the nuances of bank-

---

219. David F. Heroy & Steven A. Domanowski, *The Purchase and Sale of Assets in Bankruptcy*, 849 PRACTICING L. INST. COM. L. & PRAC. COURSE HANDBOOK SERIES 957, 1000–01 (2003). The majority of courts

> have refused to follow the reasoning of *In re Roberts*. Instead, these courts have recognized that . . . silence or the failure to object constitutes consent. These courts have reasoned[] that to hold otherwise would be to increase the transaction costs of any section 363 sale by requiring anyone who might have an interest in the debtor's assets to execute a formal written expression of consent.

Id. (citations omitted).

220. *See* FutureSource L.L.C. v. Reuters Ltd., 312 F.3d 281, 285–86 (7th Cir. 2002).

221. FED. R. BANKR. P. 2002(a)(2). Specifically, this rule directs that,

> [with exceptions], the clerk, or some other person as the court may direct, shall give the debtor, the trustee, all creditors and indenture trustees at least 20 days' notice by mail of:
>
> . . . .
>
> (2) a proposed use, sale, or lease of property of the estate other than in the ordinary course of business, unless the court for cause shown shortens the time or directs another method of giving notice . . . .

Id.

ruptcy law. During certain times of the year, such as the winter holidays, twenty days is not a meaningful time period to secure counsel and appreciate the full ramifications of a section 363(f) sale. Moreover, unlike the heightened notice requirements of federal district court requiring service of process,[222] "free and clear" sale notices need only be mailed to a manager, officer, or other company agent.[223] Thus, especially in larger companies, the company's "receipt" of mail may occur long before management is given an opportunity to read and forward it to the legal department or outside counsel for evaluation and explanation.[224] Given these circumstances, a company's failure to object cannot be understood as sleeping on its rights, so no equitable justification exists for imposing the potentially harsh consequences of a title-clearing sale.

Finally, an affirmative-consent requirement is a fairer solution because no one will be surprised by a loss of rights in a sale without a hearing. Even though a licensee need only object to the sale to protect his or her rights,[225] the effects of bankruptcy should be minimized so as not to spill over and do additional financial harm to third-party licensees. While the sudden loss of licensing rights may have little impact on a company, such "consequences can be devastating, perhaps leading to the licensee's own bankruptcy."[226] Although an implied-consent requirement may often capture the intentions of interested parties, there is a better solution. Even if requiring affirmative consent hints at unnecessary judicial paternalism, on the whole, such shortcomings can be tolerated in the pursuit of a more-just legal system.

2. Revisiting the "Efficiency" of Implied Consent

Judge Posner, author of *FutureSource*,[227] grounded his decision on the efficiency argument that stated implied consent was necessary to reduce transaction costs for section 363(f) sales.[228] "It could not be otherwise; transaction costs would be prohibitive if everyone who might have an interest in the bankrupt's assets had to execute a formal consent before they could be sold."[229] In his view, such sales are important because

---

222. *See* FED. R. CIV. P. 4(e)(1) (2006); *see also* 62B AM. JUR. 2D *Process* § 214 (2005) ("The Federal Rules of Civil Procedure authorize service of federal court process upon an individual pursuant to the law of the state in which the district court is held.").

223. Wickstead Interview, *supra* note 19.

224. *Id.*

225. *See* 11 U.S.C. § 365(n)(1); *see also* Stein, *supra* note 187.

226. VIZY, *supra* note 12, § 18:10.

227. FutureSource L.L.C. v. Reuters Ltd., 312 F.3d 281, 285–86 (7th Cir. 2002).

228. *Id.*

229. *Id.*

they increase the size of the estate and maximize the return to creditors, many of whom will ultimately fail to fully recover their debts.

But this view seems to conflict with his recurrent[230] theme that the law should, above all, maximize societal wealth.[231] While Judge Posner's opinion favors a rule of implied consent,[232] efficiency considerations also countenance an interpretation of the Code that limits harm to nonbankrupt third-parties,[233] such as technology licensees. After all, to quote Judge Posner himself,

> [insofar as] bankruptcy . . . causes not just a transfer of wealth from shareholders, managers, and some creditors to other creditors but also the consumption of valuable resources (lawyers' and bankers' and judges' time, suppliers' expectations, etc.) as well as the reductions in the efficiency of asset use . . . *anything that increases the risk of bankruptcy imposes a social cost.*[234]

To Judge Posner and other law-and-economics theorists, a "social cost" is one which "diminishes the wealth of society."[235]

An implied-consent rule causes very real social costs in terms of spillover third-party bankruptcies, just as it no doubt saves some debtors money that would otherwise be spent contacting parties with licensing rights. Perhaps one day these costs may outweigh the concomitant benefits, but as it stands today, this rule of implied consent may very well be more efficient. While an efficiency analysis should generally guide bankruptcy law to maximize the return to creditors, unbridled efficiency should not be allowed to masquerade as justice in cases where bankruptcy causes catastrophic economic damage to unwitting third parties.

C. Caveat Emptor: A Better Way Forward

There are several solutions to the dilemma facing technology licensees. One clear solution would be a statutory amendment to the Code

---

230. Judge Richard A. Posner Brief Biological Sketch, http://home.uchicago.edu/~rposner/biography.html (last visited July 31, 2007). At last count, Judge Posner has authored "30 books and more than 300 articles and book reviews." *Id.* Primarily, these works have "explor[ed] the application of economics to a variety of legal subjects." *Id.*

231. *See* JAMES A. HENDERSON, JR. ET AL., THE TORTS PROCESS 35 (5th ed. 1998) (stating that under Judge Posner's school of legal thought, the central social good to be furthered by the law is the maximization of society's total wealth). *See generally* Judge Richard A. Posner Brief Biological Sketch, http://home.uchicago.edu/~rposner/biography.html (last visited July 31, 2007) ("[Judge Posner] urged wealth maximization as a goal of legal and social policy, contributed to the economic theory of regulation and legislation, and extended the economic analysis of law into fields new to such analysis, such as family law, primitive law, racial discrimination, jurisprudence, and privacy.").

232. *FutureSource*, 312 F.3d at 285–86.

233. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 435 (7th ed. 2007).

234. *Id.* (emphasis added).

235. *Id.* at 6.

explicitly subjecting section 363(f) sales to section 365(n) licensee protections. Another would be for the Ninth Circuit, in particular, to give full effect to the protections of section 365(n) by deeming any "free and clear" sales to automatically reject the license immediately prior to sale. Also, courts could demand "affirmative consent" before authorizing such sales. Finally, reform may be available through rulemaking at the national or local level.

But short of such clear, and perhaps unlikely,[236] solutions, bankruptcy courts can still hold purchasers of IP, in "free and clear" consent sales, accountable to the rights of third-party licensees by using the doctrine of caveat emptor.[237] Roughly translated as "let the buyer beware,"[238] this doctrine generally states that a purchaser of property takes title "subject to the defects, liens, and encumbrances of which he has notice or of which he could obtain knowledge under a duty to inform himself."[239]

Similarly, courts should place the onus on the IP buyer at bankruptcy "free and clear" sales. Potential purchasers of IP should inform themselves of all encumbrances on the property and the circumstances leading up to its sale. In cases where a title-clearing sale is authorized by the implied consent of a licensee who appears to be making productive use of an IP license, a purchaser should understand that such a sale would likely constitute an involuntary transfer of rights.[240] Whereas some courts, like the Seventh Circuit, could tolerate this situation on the theory that transaction costs are kept at a minimum, the doctrine of caveat emptor should act as a powerful counterargument that these purchasers knew, or should have known, *ex ante* that there was a serious risk the licensee would challenge the sale.

Even if the debtor-licensor did not forewarn the buyer of these interests, judges should impose these liabilities on the buyer nevertheless. Accordingly, the buyer would have no ancillary service obligations, but the licensee could continue use; this system would mirror the protections

---

236. Jennifer S. Bisk, *Software Licenses Through the Looking Glass: Drafting Individually Negotiated Software Licenses That Protect the Client's Interests in Bankruptcy*, 17 FORDHAM INTELL. PROP. MEDIA & ENT. L. J. 611, 649 (2007) (predicting that "the amendment of the bankruptcy code is unlikely in the short term").

237. Wickstead, *supra* note 19. The author would like to thank Mr. Wickstead for suggesting this doctrine as a possible avenue of thought.

238. BLACK'S LAW DICTIONARY 236 (8th ed. 2004). Caveat emptor is a "doctrine holding that purchasers buy at their own risk." *Id.*

239. 50A C.J.S. *Judicial Sales* § 61 (1997).

240. Of course, sales for which all interested parties gave affirmative consent would remain unaffected. True consent would, after all, obviate the need for any protection for an uninformed or unaware licensee.

provided in section 365(n)(1). At that point, the buyer could then decide under the terms of the sale what action to take, if any, against the debtor.

Moreover, saddling purchasers with the risk that a licensee's "failure to object" did not in fact mean "consent" is not unduly burdensome in this situation because many buyers obtain counsel to conduct due diligence investigations of these assets prior to the sale; otherwise, they would be stuck with overvalued IP.[241] There is no assurance that licensees, on the other hand, are even aware of the ramifications of this type of sale.[242] Accordingly, this increased knowledge would better position these purchasers to handle risk. Finally, such application of caveat emptor is not unprecedented: at least one federal district court has applied this doctrine to purchasers at bankruptcy "free and clear" sales.[243]

In sum, the application of this doctrine simply provides a fairer and more equitable way for jurists to balance the rights of an IP licensee vis-à-vis the rights of a potential IP purchaser.

V. CONCLUSION

We live in an increasingly interconnected society, and people have found ways to work together like never before. Although businesses do sometimes fail and seek the relief of bankruptcy, unwitting third parties need not share in this failure. If the judiciary is to demonstrate any modicum of sensitivity to IP companies and entrepreneurs "seeking to add to the technological and creative wealth of America,"[244] then courts should not follow the misguided line of cases produced by the Seventh Circuit. By checking deliberate safeguards and amplifying economic risks, this circuit seriously threatens the survival of many companies.

Instead, bankruptcy judges must follow Congress's efforts to protect and honor the rights of licensees. As such, the Ninth Circuit should break with the Seventh Circuit's recent bankruptcy rulings. Although more is at stake in this jurisdiction, the Ninth Circuit need not succumb to result-oriented jurisprudence to arrive at this conclusion. Rather, as the home to a disproportionately large number of licensing transactions,[245] this jurisdiction's increased familiarity with the problem should enable it to look more closely at the issues involved in this conflict of statutory interpretation, weigh the equities in this type of case, and give

241. Wickstead, *supra* note 19.

242. *See* discussion *supra* Part IV.B.1.

243. Silverman v. Ankari (*In re* Oyster Bay Cove, Ltd.), 196 B.R. 251, 256 (E.D.N.Y. 1996) (rejecting, under the doctrine of caveat emptor, a purchaser's claim that easements rendered the title unmarketable in a "free and clear" sale of real estate).

244. S. REP. NO. 100-505, at 9 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 3200, 3207.

245. *See* discussion *supra* Part I.

full effect to the protections Congress clearly intended for technology licensees.

Therefore, the Ninth Circuit should not allow interpretations of the Code that casually extinguish the property interests of licensees. Instead, sales "free and clear" must be made subject to these protections. Such important sales should follow only affirmative, not implied, consent. Finally, even if the Ninth Circuit follows the rocky path laid by the Seventh Circuit, it should apply the doctrine of caveat emptor in limited cases of technology sales following implied consent in order to effectuate a licensee's inchoate statutory protections. Surely, entrepreneurs who start and build technology companies like Squirtech embody this technological and creative wealth. Courts should heed Congress's clear warning not to fail these individuals.