Unsolved Mysteries of Section 365(n) — When a Bankrupt Technology Licensor Rejects an Agreement Granting Rights To Future Improvements

I. INTRODUCTION

A hypothetical automaker intends to manufacture a new electronic steering system developed by Independent Technologies, Inc. ("Independent"). The automaker wishes to use the steering system in an upcoming model. Independent, wishing to retain an interest in its system, refuses to make a complete assignment of rights in the patented[1] hardware and copyrighted[2] software.[3] Instead, the automaker and Independent negotiate a technology licensing agreement granting the automaker certain rights to manufacture and distribute the steering system in return

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[1] The scope of patent assignment was described by the Supreme Court in Waterman v. Mackenzie, 138 U.S. 252 (1891). In *Waterman*, the Court explained that the patentee may assign either the whole patent, which is comprised of the exclusive right to make, use and vend the invention throughout the United States; or, an undivided part or portion of that exclusive right; or, the exclusive right under the patent within and throughout a particular area of the United States. *Id.* at 255. The Court noted that any assignment or transfer which fell short of one of these is merely a license. *Id.* at 255.

[2] The transfer of copyright ownership is defined by statute as "[a]n assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright or of any of the exclusive rights comprised in a copyright, whether or not it is limited in time or place of effect, but not including a nonexclusive license." Copyright Act of 1976, 17 U.S.C. § 101 (1988).

[3] "Software" is the industry term for computer programs. M. LEAFFER, UNDERSTANDING COPYRIGHT LAW, § 3.5[A] (1989). Computer programs are defined in the Copyright Act as "a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result." 17 U.S.C. § 101 (1988). Congress clarified copyright protection of computer programs in a 1980 amendment of the Copyright Act. *Id.* at § 117. This protection has been conferred by the courts on programs existing in a variety of forms. *See, e.g.*, Tandy Corp. v. Personal Micro Computers, Inc., 524 F. Supp. 171 (N.D. Cal. 1981) (programs embodied in ROM computer chips copyrightable); Apple Computer, Inc. v. Franklin Computer Corp., 714 F.2d 1240 (3d Cir. 1983) (operating systems copyrightable); Apple Computer, Inc. v. Formula Int'l, Inc., 562 F. Supp. 775 (C.D. Cal. 1983) (programs embodied in object code, which is unintelligible to humans, are copyrightable). *See also* 17 U.S.C. § 117 (1980). Computer software patents are generally more difficult to obtain because of the principal that natural phenomena, intellectual concepts and mental processes themselves, rather than their application to a specific end, are not patentable. Gottschalk v. Benson, 409 U.S. 63, 67 (1972). Systems incorporating computer software, however, can be patentable as a whole. *See* Diamond v. Diehr, 450 U.S. 175, 192 (1981).

for royalties.[4] Like many technology licensing contracts, this agreement contains licensor improvement[5] clauses granting the automaker rights in future technology developments by Independent.[6] These clauses, which are the subject of this comment, are not to be confused with contracts which create affirmative obligations on the part of the licensor relating to software updates, training, and continued research. The automaker incorporates the steering system in a new vehicle design, makes a substantial investment in specialized manufacturing equipment, and begins production. Unfortunately, the royalties Independent receives from this project fail to offset the large losses it has suffered lately in other endeavors. Thus, Independent is forced to seek relief under Chapter 11[7] of the Bankruptcy Code (the Code).[8] Independent, however, continues to develop its steering technology after the bankruptcy petition and discovers several major improvements in the system. Acting as debtor in possession for the benefit of the reorganization, Independent "rejects" the technology license as an executory contract under section 365(a) of the Code.[9]

Congress recently enacted the Intellectual Property Licenses in Bankruptcy Act[10] [IPLBA] in 1988 in order to prevent a tech-

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[4] *See* R. ELLIS, PATENT ASSIGNMENTS AND LICENSES § 3, at 7 (1936) ("As a rule an assignment is a sale of all rights under the patent for a fixed, definite sum, while a license is a sale of the right to operate under the patent for a royalty based on the extent to which the invention is used.").

[5] *See* BLACK'S LAW DICTIONARY 757 (6th ed. 1990) (*citing* Steiner Sales Co. v. Schwartz Sales Co., 98 F.2d 999, 1010 (10th Cir. 1938) ("In the law of patents, [an improvement is] an addition to, or modification of, a previous invention or discovery, intended or claimed to increase its utility or value.")).

[6] Technology exchange clauses in patent licenses can involve antitrust issues, especially if the clause is exclusive. This topic, however, is beyond the scope of this comment. *See, e.g.*, United States v. General Electric Co., 82 F. Supp. 753 (D.N.J. 1949). General Electric, as the owner of the patents in the tungsten filament light bulb, required its licensees to grant back exclusive licenses for all patented developments made by the licensees relating to incandescent lamps. *Id.* at 856-57. The court considered the anti-competitive effect this provision might have by taking away the licensee's incentive for research. *Id.* at 857. On this issue, however, the court found the government's proofs to be insufficient. *Id.* at 858.

[7] 11 U.S.C. §§ 1101-74 (1988) (provides for reorganization of a debtor under a court-supervised plan).

[8] *Id.* at §§ 101-1330 (1988).

[9] *Id.* at § 365(a) (1988). In general, section 365(a) allows the trustee to "[a]ssume or reject any executory contract or unexpired lease of the debtor." *Id.*

[10] 11 U.S.C. § 365(n) (1988). This section provides in full:

> (1) If 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—
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> (A) to treat such contract as terminated by such rejection if

nology licensor/debtor from unilaterally terminating intellectual

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

(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.

(2) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, under such contract—

(A) the trustee shall allow the licensee to exercise such rights;

(B) the licensee shall make all royalty payments due under such contract and for the duration of such contract described in paragraph (1)(B) of this subsection for which the licensee extends such contract; and

(C) the licensee shall be deemed to waive—

(i) any right to setoff it may have with respect to such contract under this title or applicable nonbankruptcy law; and

(ii) any claim allowable under section 503(b) of this title arising from the performance of such contract.

(3) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, then 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, provide to the licensee any intellectual property (including such embodiment) 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.

(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 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), includproperty interests of the licensee.[11] The IPLBA allows the hypothetical automaker to retain its rights in the technology as they existed at the time of the bankruptcy petition.[12] Under the IPLBA, the automaker in the instant hypothetical would be permitted to continue its use of the steering technology for the duration of the contract,[13] despite rejection by Independent. If Independent had granted the automaker exclusive rights in the technology, the exclusivity would be enforced as well.[14] Accordingly, the automaker would be required to continue its royalty payments[15] and would waive any right to setoff it might otherwise have had based on Independent's nonperformance of ancillary clauses.[16]

Notwithstanding these IPLBA provisions, the status of the automaker's interest in improvements developed after Independent filed for bankruptcy (post-petition) is unclear. The purpose of this comment is to address the disposition of this important interest.[17] Initially, an examination of the purpose and context of licensor improvement clauses in current technology licensing practice will be conducted.[18] Secondly, this comment will outline Congress' recent treatment of general intellectual property licenses under the IPLBA.[19] Lastly, this comment will critically analyze the authority that the courts will likely rely on to determine the fate of licensor improvement clauses in bankruptcy,[20] including cases where courts have applied section 365 to analogous situations.[21] This comment concludes with an argument that licensees should be permitted to retain the rights created by

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ing any right to obtain such intellectual property (or such embodiment) from another entity.

[11] *See* S. REP. No. 505, 100th Cong., 2d Sess. 1, *reprinted in* 1988 U.S. CODE CONG. & ADMIN. NEWS 3200, 3200 [hereinafter S. REP. No. 505] ("The purpose of the bill is . . . to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to Section 365 in the event of the licensor's bankruptcy.").

[12] 11 U.S.C. § 365(n)(1)(B) (1988) (*see supra* note 10 for text).

[13] *Id.* at § 365(n)(1)(B)(i).

[14] *Id.* at § 365(n)(1)(B).

[15] *Id.* at § 365(n)(2)(B).

[16] *Id.* at § 365(n)(2)(C)(i).

[17] It is important to appreciate that when the licensor continues a substantial research and development program, the licensor improvement clause may be more important than the original grant. H. MAYERS & B. BRUNSVOLD, DRAFTING PATENT LICENSE AGREEMENTS § 8.00 (2d ed. 1984).

[18] *See infra* notes 23-28 and accompanying text.

[19] *See infra* notes 39-68 and accompanying text.

[20] *See infra* notes 69-120 and accompanying text.

[21] *See infra* notes 121-172 and accompanying text.

improvement clauses in the face of rejection by a bankrupt licensor.[22]

II. Licensor Improvement Clauses

In today's environment of rapidly developing technology, patent and copyright licensing agreements frequently contain clauses which facilitate the sharing between licensor and licensee of future developments in the licensed subject matter.[23] These clauses often take the form of licensor improvement agreements — agreements which concern new technology developments resulting from continued research efforts by the licensor in the subject matter of the original technology license.[24] A clause granting rights to future improvements is considered essential by many licensees in fields where technology is likely to continue advancing and future improvements could render the current licensed claims obsolete.[25] Moreover, such a clause may be beneficial to the licensor in enhancing its relationship with its licensee.[26]

In the case of the hypothetical automaker, the licensor improvement clause may serve several important objectives. First, the clause can assist the automaker in remaining competitive with other automakers that are licensing the same steering system technology by assuring comparable access to improved technology later developed by the licensor. Second, because manufacturers such as automakers often enter into licensing agreements early in the development process, it is critical that the licensee preserve its interest in the anticipated developments of the technology or later versions of the software by including a licensor improvement clause in the agreement. Such a clause serves to facilitate business planning and to "stake out claims" in undevel-

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22 *See infra* notes 173-179 and accompanying text.

23 *See* R. Goldscheider & G. Maier, 1989 Licensing Law Handbook § 2.08, at 48 (1989) (generally, it is beneficial for the licensor and licensee to agree on complimentary research and development programs with each party concentrating on its own area of expertise).

24 *See, e.g.*, Aspinwall Mfg. Co. v. Gill, 32 F. 697, 699 (3d Cir. 1887) (license valid which assigned a patent "[t]ogether with all improvements I may hereafter make").

25 *See* A.B. Dick Co. v. Fuller, 198 F. 404, 406 (S.D.N.Y. 1912) (licensor improvement provisions typically the result of the licensee's concern that the licensor may soon produce a related invention which, while technically not an infringement, will render the licensee's contract worthless if licensed to a competitor).

26 R. Goldscheider & G. Maier, 1989 Licensing Law Handbook § 2.08, at 48 (a steady flow of additions to the licensed technology produced by the licensor's research program can enhance the licensing relationship such that it extends well beyond the statutory life of the intellectual property monopoly).

oped technology. Lastly, if the parties contemplate that additional consideration is to be paid by the automaker for future improvements, the automaker has a strong interest in establishing the rates during the initial negotiation of the license agreement. The automaker, by waiting until after a licensor has developed an improvement before commencing negotiations for a license to utilize it, will have committed substantial resources to the engineering, manufacturing and marketing of the new steering system, weakening its bargaining position in royalty rate negotiations. In the case of a nonexclusive license, this problem could be compounded by the appearance of these improvements on competitors' vehicles.

While a technology licensing relationship can be very beneficial for a licensee, reliance on such a license exposes a licensee to the financial risk of the licensor's bankruptcy. The monopolistic nature of intellectual property protection[27] forces the technology licensee to do business with the owner of the sought-after technology, regardless of the financial stability of that owner. This situation is aggravated by the fact that many sources of new technology are young enterprises without established financial histories.[28] Despite this uncertainty, the licensor must often put considerable capital at risk in preparing the technology for the market. If the availability of future improvements to the technology is an important consideration, the licensee will be concerned about their treatment in the case of the licensor's bankruptcy.

III. SECTION 365(n)- THE INTELLECTUAL PROPERTY LICENSES IN BANKRUPTCY ACT

Rejection of Executory Contracts

The right of a debtor in bankruptcy to assume or reject an executory[29] contract has long been recognized in case law,[30] and

[27] In general, the granting of patent and copyright monopolies in the United States is a concession made to authors and inventors in order to "promote the Progress of Science and the useful Arts." U.S. CONST. art. I, § 8. This utilitarian policy, however, does not underlie many foreign intellectual property laws. For example, copyright monopoly in most civil law countries is based in a "natural rights" theory under which artists and authors have inherent rights in the works they create. P. GOLDSTEIN, COPYRIGHT § 1.1, at 8 (1989).

[28] *See* R. GOLDSCHEIDER, TECHNOLOGY MANAGEMENT § 1.01 (1990) ("[T]he history of invention is that the maverick, working alone, more frequently gets the exciting insight that presages important new technology . . . .").

[29] *See infra* text accompanying notes 38-41 (defining "executory contract").

[30] *See* Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U.

was first codified in the United States in 1938 as section 70b of the Chandler Act.[31] The basic terminology and concept of this provision were left intact in the current 1978 statute as section 365 of the Bankruptcy Code, entitled *Executory contracts and unexpired leases*.[32]

Allowing a debtor to reject executory contracts reflects the notion that a debtor should not be required to perform those contracts which, in the debtor's best business judgement, would not benefit the estate as a whole.[33] Under section 365(g), the debtor's rejection of an executory contract "constitutes a breach of such contract."[34] As a result, rejection effectively reduces the contractual rights of the non-debtor party to an unsecured damage claim in breach against the debtor.[35] The non-debtor party to the contract thus joins other unsecured creditors in the creditor pool and will likely receive only a portion of its claim.[36]

Rejection under section 365(a) is limited to "executory contracts and unexpired leases",[37] although neither term is defined explicitly in the statute.[38] Generally, courts have applied the definition of executory contracts first proposed by Professor Countryman in 1973 as "a contract under which the obligation of both the bankrupt 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

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COLO. L. REV. 845, 856-59 (1988). The Andrew article described Copeland v. Stephens, 106 Eng. Rep. 218 (K.B. 1818), as the "fountainhead of U.S. executory contracts doctrine." In *Copeland*, the court recognized that certain leases and contracts do not pass to the debtor's assignees unless "accepted" by them. *Id.* at 222; *see supra* notes 29-41 and accompanying text. The court reasoned that assignment of such leases and contracts should take place only if it enhanced the value of the fund used to pay the creditors. *Copeland*, 106 Eng. Rep. at 222.

31 Chandler Act, ch. 575, § 70(b), 52 Stat. 840, 880-81 (1938) (*repealed by* Pub. L. No. 95-598, tit. IV, § 401(a), 92 Stat. 2682 (1978)).

32 *See* Andrew, *supra* note 30, at 862 n.77.

33 D. BAIRD & T. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY 244-45 (2d ed. 1990) [hereinafter BAIRD & JACKSON].

34 11 U.S.C. § 365(g) (1988).

35 BAIRD & JACKSON, *supra* note 33, at 244-45.

36 *Id.* This result is the same as if the debtor had breached the contract before bankruptcy. *Id. See* 11 U.S.C. § 502(g) (1988) which provides:

> "A claim arising from the rejection, under Section 365 of this title or under a plan under Chapter 9, 11, 12 or 13 of this title of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed . . . the same as if such claim had arisen before the date of filing.

37 11 U.S.C. § 365(a) (1988).

38 H.R. REP. No. 595, 95th Cong., 2d Sess. 347, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6303 [hereinafter H.R. REP. No. 595].

other."[39] The legislative history of section 365(a) indicates that Congress intended a meaning for "executory contract" similar to the Countryman definition by utilizing the term in the 1978 statute.[40] Notwithstanding these attempts at clarifying the executory nature of a contract, the use of this classification as the criterion for permitting rejection has come under increasing criticism by commentators.[41] The problem is especially evident in cases where the contract involves vested rights of the non-debtor party.

Vested Rights

The right of the trustee under section 365 to reject executory contracts can present difficulties when the non-debtor party has pre-petition vested rights under non-bankruptcy law in the

[39] Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973) (footnote omitted). Professor Countryman's articles are considered by some to have taken "a great muddle of confused and often wrong decisions and [to have] made them coherent by developing his famous 'material breach' test for determining if a contract satisfied the courts' requirement of executoriness." Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 230 (1989) [hereinafter Westbrook] (footnote omitted). The Countryman definition has been applied frequently in case decisions regarding executory contracts in bankruptcy. *See* Westbrook, *supra* note 39, at 236 n.48.

[40] H.R. REP. No. 595 at 6303 ("Though there is no precise definition of what contracts are executory, it generally includes contracts on which performance remains due to some extent on both sides.").

[41] *See, e.g.*, Andrew, *supra* note 30, at 884-95. The Andrew article argued that identifying a contract as executory does not reflect bankruptcy policy or affect the result of rejection. *Id.* at 889. (citing *In re* KMMCO, Inc., 40 Bankr. 976 (E.D. Mich. S.D. 1984) (employment contract which included death benefits for a deceased employee's wife held non-executory after considering debtor/employer's argument that wife had an unperformed obligation not to die, remarry, or cohabitate with a man)). Andrew argued that the employee's wife in *KMMCO* would have had an unsecured claim whether or not the contract was found to be executory. Andrew, *supra* note 30, at 887 (citing *In re* Transamerican Natural Gas Corp., 79 Bankr. 663 (Bankr. S.D. Tex. 1987) (liquidated damages portion of a contract to supply electric power could be rejected by the buyer/debtor because it was part of the executory contract)). Andrew observed that the allowance of rejection of the clause in *Transamerican* depended on whether the overall contract was executory. Andrew, *supra* note 30, at 889.

See also Westbrook, *supra* note 39, at 239-42 & 315-23. Professor Westbrook argued that the requirement of executoriness can lead to incorrect results where the nondebtor party has property interests created by state law which the court voids as a result of rejection. *Id.* at 239. Professor Westbrook demonstrated this result in several recurring factual situations, including the rejection of covenants not to compete. (*See, e.g.*, Burger King Corp. v. Rovine Corp. (*In re* Rovine Corp.), 6 Bankr. 661 (Bankr. W.D. Tenn. 1980) (upon rejection of an executory franchise agreement, a covenant not to compete included therein may not be enforced); *In re* Constant Care Community Health Center, Inc., 99 Bankr. 697 (Bankr. D. Mo. 1989) (debtor's rejection of employment contract precludes enforcement of covenant not to compete).

subject matter of the contract.[42] Under such circumstances, a court must decide whether the vested rights portion of the contract can be separated from the remainder of the contract and be considered non-executory.[43] Courts are not in agreement on how rejection affects the vested interests of the non-debtor party. For example, in *Leasing Service Corp. v. First Tennessee National Bank Association*,[44] the Sixth Circuit held that a perfected security interest in an equipment lease was fully vested, and as such constituted a non-executory portion of the lease agreement.[45] Accordingly, the court concluded that the trustee could not reject the security interest, which in turn precluded the non-debtor party's interest from being reduced to an unsecured money damages claim.[46] In contrast, the Fourth Circuit in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*[47] determined that the rights of a licensee to use a patented process were part of an executory

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42 *See, e.g., infra* notes 44-46 and accompanying text (executory contracts with security interests); *infra* notes 147-164 and accompanying text (executory contract with an option to purchase real property).

43 Baird & Jackson, *supra* note 33, at 256. Based on the theory that "an executory contract must be rejected in its entirety or not at all," courts have allowed debtors to reject obligations to nondebtor parties as part of a larger executory contract. *See Rovine*, 6 Bankr. at 666 (citation omitted); *see, e.g.*, Silk Plants, Etc. Franchise Sys., Inc., Register (*In re* Register), 95 Bankr. 73 (Bankr. M.D. Tenn. 1989) (covenant not to compete unenforceable after debtor rejected franchise agreement in which it was contained); *In re* Transamerican Natural Gas Corp., 79 Bankr. 667 (liquidated damages clause unenforceable upon rejection of sales contract). Professors Baird and Jackson have questioned whether there is a legitimate policy reason for reviewing the rejection of an obligation based on its inclusion in an executory contract. *See* Baird & Jackson, *supra* note 33, at 256-58.

44 826 F.2d 434 (6th Cir. 1987).

45 *Id.* at 437. The Court found the security interest to be fully vested and non-executory because the lessor's performance, by agreeing to lease the crane, had been completely performed. *Id.*

46 *Id.* A third-party creditor argued unsuccessfully that the rejection of the lease extended to the security interest as well. *Id.* The court instead allowed "disaggregation" of the leasing contract, holding the security portion to be non-executory. *Id. See* Baird & Jackson, *supra* note 33, at 256. *See also In re* Midwest Polychem, Ltd., 61 Bankr. 559 (Bankr. N.D. Ill. 1986) (while finding a manufacturing agreement to be executory, the court refused to allow rejection of a covenant not to compete which was included in the agreement because of the non-debtor's strong interests in the covenant); *In re* Carrere, 64 Bankr. 156 (Bankr. C.D. Cal. 1986) (debtor-in-possession cannot reject a personal services contract because the interest in the contract itself does not become a part of the bankruptcy estate); *In re* Huff, 81 Bankr. 531 (Bankr. D. Minn. 1988) (debtor's motion to reject a contract allowing excavating company to mine his land was denied, due to recognition of the vested property interests of the excavator).

47 756 F.2d 1043 (4th Cir. 1985), *cert. denied*, 475 U.S. 1057 (1986). *See infra* notes 121-146 and accompanying text.

contract that was rejected by the debtor/licensor.[48] The court disagreed with the district court's characterization of the license agreement as a completed sale of property and instead analogized it to a lease,[49] which is explicitly subject to rejection under section 365.[50] Consequently, the court held that the licensor, through rejection, could divest the licensee of its rights in the patented process, leaving the licensee to pursue an unsecured money damages claim.[51] The *Leasing Services* and *Lubrizol* cases illustrate the divergent approaches taken by courts faced with the rejection of a contract that includes vested rights.

Congress, on several occasions, has specifically addressed issues involving vested rights coupled with executory contracts in other areas. For example, section 365(h)[52] provides relief for a lessee of real property in the case of rejection of the lease agreement by the debtor. In this situation, under non-bankruptcy law, the non-debtor/lessee would have specific performance and self-help remedies available to him.[53] Likewise, under section 365(h), Congress provided protection for a lessee in the event of the lessor's rejection by allowing the lessee to continue to occupy the

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48 *Id.* at 1048.

49 *Id.* at 1046 n. [*]. The court made this determination because of the limited nature of the conveyed interest.

50 11 U.S.C. § 365 (a), (g) (1988).

51 *Lubrizol*, 756 F.2d at 1048. *See also In re* Register, 95 Bankr. 73 (Bankr. M.D. Tenn), *aff'd*, 100 Bankr. 360 (1989) (court refused to sever a covenant not to compete from an executory franchise and allowed the franchisee/debtor to reject the entire agreement); Matter of Gifford, 688 F.2d 447 (7th Cir. 1982) (a non-possessory, non-purchase money lien on personal property does not create a sufficient property interest to invoke the fifth amendment due process or takings clauses when a debtor avoids the lien); *In re* P.I.N.E., Inc., 52 Bankr. 463 (Bankr. W.D. Mich. 1985) (an otherwise binding option contract to purchase real property was allowed to be rejected by the owners of the property under an executory contract analysis).

52 11 U.S.C. § 365(h) (1988).

53 A lessee has several options available in pursuing a remedy against a landlord who is in breach of the implied warranty of habitability. 2 R. POWELL, THE LAW OF REAL PROPERTY ¶ 233[2][e] (1991). The lessee may deduct his damages from the rental payments, using the landlord's breach as a defense in the event of a possessory action. *See, e.g.*, Marini v. Ireland, 56 N.J. 130, 140-41, 265 A.2d 526, 531 (1970) (tenant deducted cost of repairing cracked toilet from rent and successfully defended dispossession suit); Javins v. First Nat'l Realty Corp., 428 F.2d 1071, 1082 (D.C. Cir., 1970) (espousing a contractual, rather than possessory, relationship between landlord and tenant). Alternatively, the lessor could bring an affirmative action for damages. *See, e.g.*, Conille v. Secretary of Housing and Urban Dev., 840 F.2d 105 (1st Cir. 1988) (where apartment has deteriorated below "decent, safe and sanitary" conditions, tenant in HUD housing can bring action against federal government for restitution of rent). In both instances, the lessee is permitted to remain in possession. 2 R. POWELL, *supra* note 53, at ¶ 233[2][e].

dwelling and pay rent after rejection of the lease.[54] The 1984 amendments to the Act provide similar relief for a purchaser of real property in a land installment sales contract under section 365(i).[55] Moreover, the 1984 amendments included section 1113[56] which protects the beneficiaries of a collective bargaining agreement in the event that their employer files for protection under the Code.[57] Section 1113 heightens the standard of review for rejection of a collective bargaining agreement from the business judgment rule, typically applied in section 365 cases,[58] to a

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[54] 11 U.S.C. § 365(h). This section provides that the non-debtor lessee may, in the event of rejection of the lease by the trustee, take the following action:

> [T]he lessee or time share interest purchaser may remain in possession of the leasehold or timeshare interest under any lease or timeshare plan the term of which has commenced for the balance of such term and for any renewal or extension of such term that is enforceable by such lessee or timeshare interest purchaser under applicable non-bankruptcy law.

11 U.S.C. § 365(h)(1) (1988).

Moreover, this section provides for a form of self-help in the event of damages to the lessor as a result of the bankruptcy:

> [S]uch lessee or timeshare interest purchaser *may offset against the rent* reserved under such lease or moneys due for such timeshare interest for the balance of the term after the date of the rejection of such lease or timeshare interest, and any such renewal or extension thereof, any damages occurring after such date caused by the non-performance of any obligation of the debtor under such lease or timeshare plan after such date . . . .

11 U.S.C. § 365(h)(2) (1988) (emphasis added).

[55] *Id.* at § 365(i). Section 365(i) allows a purchaser, who has entered into a contract for the sale of real property with the debtor, and who is in possession of the property, to remain in possession after rejection of the contract, to continue making payments, and to offset damages caused by the rejection.

[56] *Id.* at § 1113(c)(3). Congress mandated a "balancing of the equities" standard in § 1113, codifying the rejection criterion for collective bargaining agreements previously articulated in NLRB v. Bildisco & Bildisco, 465 U.S. 513, 526 (1984). This standard, together with procedural requirements set forth in § 1113, have been interpreted by the courts as a nine-point test for approval of rejection. *See In re* American Provision Co., 44 Bankr. 907, 909 (Bankr. D. Minn. 1984) (the Court, in denying rejection of two collective bargaining agreements due to bad faith negotiation of the debtor, articulated a nine-point test). *See also In re* Big Sky Transp. Co., 104 Bankr. 333 (Bankr. D. Mont. 1989) (motion to reject collective bargaining agreements granted under *American Provision* nine-point test); *In re* Carey Transp., Inc., 50 Bankr. 203 (Bankr. S.D.N.Y. 1985) (rejection motion granted under nine-point test). *See generally* Vian, *The Rejection of Collective Bargaining Agreements Since the 1984 Amendments: The Case Law Under New Bankruptcy Section 1113*, 91 COM. L.J. 252 (1986).

[57] Vian, *supra* note 56, at 252.

[58] Although the executory contract doctrine is based on the principle that a trustee can renounce or abandon burdensome property, courts have not required a finding that executory contracts are burdensome before granting a motion to reject. 2 COLLIER ON BANKRUPTCY ¶ 365.03, at 365-16 (15th ed. 1988). Instead, a

balancing of the equities approach.[59] Moreover, this section requires the debtor in possession to follow a structured negotiation procedure to prevent inequitable avoidance of collective bargaining agreements by employers.[60]

Protecting Non-Debtors' Intellectual Property Rights

The most recent provision of the Code protecting vested rights of the non-debtor party addresses the rights of a licensee in an intellectual property license. Congress enacted the Intellectual Property Licenses in Bankruptcy Act [IPLBA][61] in 1988 to "make clear that the rights of an intellectual property licensee to

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majority of the courts defer to the business judgment of the trustee or debtor in possession. *Id. See* Group of Institutional Investors v. Chicago, Mil., St. P. & Pac. R.R., 318 U.S. 523, 550 (1943) (although there was no showing that the lease was burdensome, the court permitted rejection of a lease under which the debtor operated railroad lines because whether the rejection would make the reorganization plan more attractive to the majority of creditors was a question of business judgment). *See also In re* Tilco, Inc., 558 F.2d 1369 (10th Cir. 1977); *In re* Minges, 602 F.2d 38 (2d Cir. 1979).

59 11 U.S.C. § 1113(c)(3) ("The court shall approve an application for rejection of a collective bargaining agreement only if the court finds that . . . the balance of the equities clearly favors rejection of such agreement.")

60 *Id.* at § 1113(d). Once the application for rejection has been filed, the court must schedule a hearing within 14 days. *Id.* Notice of the hearing must be provided to all of the parties involved; the court has the discretion with certain limits to extend the date of the hearing. *Id.*

61 *Id.* at § 365(n) (1988) (*See supra* note 10 for text). *See generally* Brown, Hansen & Salerno, *Technology Licenses Under Section 365(n) of the Bankruptcy Code: The Protections Afforded the Technology User*, 95 COM. L.J. No.2, at 170 (1990) (comparison of courts' treatment of rejected technology licenses before and after the enactment of § 365(n), concluding that although the new section takes away some of the courts' flexibility, it accomplishes its goal of increasing predictability in American technology licensing); DuVal, *How Do Intellectual Property Licensees Spell Relief? "IPLBA"*, FAULKNER & GRAY'S BANKR. L. REV., Summer 1990, at 5 (practical analysis of how the IPLBA will operate in typical licensor bankruptcy situations); Moskowitz, *Intellectual Property Licenses in Bankruptcy: New "Veto Power" for Licensees Under Section 365(n)*, 44 BUS. LAW. 771 (1989) (analysis of the historical development of the IPLBA, suggesting that although IPLBA provides more certainty in technology licensing, it may have gone too far in favoring the licensee); Warden & Costello, *New Bankruptcy Code § 365(h): Limited Comfort for the Technology Licensee*, 1989 NORTON BANKRUPTCY LAW ADVISOR No. 3, at 1 (noting the interests of the licensee that are not protected under § 365(n), and suggesting the utilization of certain drafting techniques in order to minimize the licensee's risk); Note, *The Rejection of Executory Contracts Under the Intellectual Property Bankruptcy Protection Act of 1988*, 37 CLEV. ST. L. REV. 621 (1989) (analysis of the importance of licensing in technology-related industry, and the success of § 365(n) in addressing problems in the practice); Note, *The Intellectual Property Bankruptcy Protection Act: The Legislative Response to Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 16 RUTGERS COMPUTER & TECH. L.J. 603 (1990) (the IPLBA succeeds in removing the burden placed on American technology licensing by *Lubrizol*, without severely burdening the licensor/debtor's right to reject).

use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to section 365 in the event of the licensor's bankruptcy."[62] The bill was passed in response to the *Lubrizol* case, in which the licensor, in rejecting a license as an executory contract, was relieved not only of its affirmative duties under the license, but also of its passive obligation to continue to make the intellectual property available to the non-debtor party.[63] The legislative history of the IPLBA indicates that Congress specifically rejected the *Lubrizol* holding[64] and its potential effect on intellectual property licensing.[65] Congress' position was that the effect of the *Lubrizol* decision was to "impose[] a burden on American technological development that was never intended."[66] To remove this burden, Congress designed the new provision in order to allow the intellectual property licensee, upon rejection of the license by the licensor, to "retain its rights"[67] in the intellectual property, while continuing to pay royalties.[68] This provision allows the hypothetical automaker, faced with the rejection of the steering system technology license, to continue to utilize its substantial capital investment in manufacturing equipment and to continue marketing vehicles equipped with the new steering system.

While the IPLBA now provides for the licensee's retention of rights in pre-petition technology, no similar provision exists to protect the rights of the automaker in the improvements developed by Independent after filing a petition for bankruptcy. Consequently, a serious problem for licensees may develop if courts find that the IPLBA does not apply to post-petition technology.

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62 S. REP. No. 505 at 3200.

63 S. REP. No. 505, 2d Sess. at 3201-03. The Senate Report theorizes that potential intellectual property licensees, unwilling to risk being stripped of their licenses, will insist on an assignment instead of a license. Moreover, the report maintains that because licensees typically have only narrow uses for inventions that may have a broad range of applications, assignment in lieu of licensing may limit the potential for many inventions. *Id.* S. REP. No. 505, 2d Sess. 3-4, at 3202-03.

64 *See infra* notes 121-46 and accompanying text.

65 *See* S. REP. No. 505, 2d Sess. 2-3, at 3201-02 (citing the *Lubrizol* decision in describing the development of case law which threatened the United States intellectual property licensing system by exposing innocent licensees to being stripped of "rights central to the operation of their ongoing business"); H.R. REP. No. 1012, 100th Cong., 2d Sess., at 4 (citing the *Lubrizol* decision as creating a risk that potential technology licensees will instead attempt to purchase the technology outright, resulting in high cost to the user and restriction of the technology to a single entity).

66 S. REP. No. 505, 2d Sess. 1, at 3200.

67 11 U.S.C. § 365(n)(1)(B) (1988) (*see supra* note 10 for complete text).

68 *Id.* at § 365(n)(2)(B).

Licensees, such as the automaker, would be left with rights in technology which may be worthless without the improvements developed by the licensor. In persuading the courts to find otherwise, the licensee may therefore have to rely on analogous sections of the Bankruptcy Code as well as other bodies of law, such as, intellectual property, to refute the licensor's almost inevitable rejection of improvement clauses. Currently, there is no consensus of opinion on the issue of whether licensor improvement clauses are excluded from the reach of the IPLBA. It is thus important to examine the treatment of these clauses under the IPLBA as well as under intellectual property law.

IV. The Fate of Improvements Made Post-Petition

To date, a court has not had occasion to apply (or refuse to apply) the IPLBA where rejection of a licensor improvement clause would affect intellectual property created post-petition.[69] This section will examine the language, history and background of the IPLBA as well as its relationship to intellectual property law in determining the approach likely to be taken by the courts if presented with this problem. Although there is case law in analogous areas to construct an argument that, notwithstanding the IPLBA, a debtor could reject an improvement clause and retain complete rights to the technology developed after filing a bankruptcy petition, reliance on such case law may be misplaced. The consequences of this outcome should not be understated; the debtor/licensor could then contract with new licensees and negotiate new licenses in the improved technology to the detriment of the original licensee.

The Statutory Language of the IPLBA

Upon rejection of a license by an intellectual property licensor in bankruptcy, the IPLBA permits the licensee "to retain its rights . . . *as such rights existed immediately before the case commenced.*"[70]

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[69] *See* DuVal, *How Do Intellectual Property Licensees Spell Relief? "IPLBA"*, in FAULKNER & GRAY'S BANKR. L. REV., Summer 1990, at 5, 8 & n.13 (indicating that the disposition of these rights is still an "open issue," and suggesting a possible analogy to § 541(a)(6) which incorporates post-petition property into the bankruptcy estate). Section 541(a)(6) defines property of the estate as "[p]roceeds, product, offspring, rents or profit of or from property of the estate, except such as are earnings from services performed by an individual debtor after commencement of the case." 11 U.S.C. § 541(a)(6).

[70] 11 U.S.C. § 365(n)(1)(B) (emphasis added) (*see supra* note 10 for complete text).

The new section strikes a careful balance between the interests of the licensee in continued exploitation of the intellectual property and the interests of the debtor in avoiding contractual duties which would burden the bankrupt estate.[71]

An analysis of the statutory language and history manifests a policy to balance these two interests. First, the IPLBA expressly permits the licensee to retain its rights to licensed intellectual property that existed before the bankruptcy petition was filed."[72] This feature of the IPLBA assures the licensee that it will have continued access to the technology without burdening the estate with affirmative duties under the contract. Second, Congress has indicated that the IPLBA does not allow post-rejection enforcement of terms requiring continued research, training or updating.[73] The legislators sought to avoid enforcing duties requiring affirmative performance on the part of the trustee, reasoning that the trustee would not be in a position to perform these duties.[74] Congress thus expressly differentiated between the "passive obligation"[75] of the debtor in allowing the licensee access to existing technology, and the "affirmative performance"[76] of the debtor in meeting its ancillary obligations under the license. The IPLBA enforces the former while relieving the debtor of the latter.

The right of the hypothetical automaker to Independent's post-petition intellectual property improvements falls between

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71 S. REP. No. 505, 2d Sess. 10, at 3207. The licensee can expect to retain its rights in the property while the debtor can preserve the royalty payments, often necessary to a successful reorganization, free of administrative or offset claims. The IPLBA maintains the licensee's general claim to damages however. *Id. See also* Brown, Hansen & Salerno, *Technology Licenses Under Section 365(n) of the Bankruptcy Code: The Protections Afforded the Technology User*, 95 COM. L.J. No.2 170, 185 (1990) (section 365(n) attempts to balance the equities involved in — technology licensing agreement where the debtor is the licensor).

72 11 U.S.C. § 365(n)(1)(B) (*see supra* note 10 for complete text).

73 *See* S. REP. No. 505, 2d Sess. 7, at 3205 ("The bill recognizes that continued affirmative performance of an intellectual property license may be impractical; for instance, a trustee will generally be unable to perform covenants calling for continued research to improve licensed intellectual property."); H.R. REP. No. 1012, 100th Cong., 2d Sess. 8 [hereinafter H. REP. No. 1012] ("[t]he licensee is relieved of any burdens to take additional affirmative actions under the contract such as a duty to provide training or updates to the licensee.").

74 S. REP. No. 505, 2d Sess. 7, at 3205.

75 S. REP. No. 505, 2d Sess. 2, at 3201. *Cf.* S. REP. No. 505, 2d Sess. 8, at 3205 ("performance of covenants requiring no action by the trustee impose no burden on the estate and result in equity to the nonbreaching party and certainty to the economy as a whole.").

76 *Id.* Ancillary obligations might include, for example, performance under covenants calling for new versions of software. *Id.* These kind of obligations require resources and therefore are virtually impractical for a debtor to perform. *Id.*

these two situations. While the improvements *themselves* did not exist at the time of the debtor's bankruptcy petition, the *right* to that technology "[e]xisted immediately before the case commenced,"[77] — a right which is a valuable interest in the future development of the technology. In order for a licensee to retain this right, no "affirmative performance" was required on the part of the debtor-in-possession. The improvements resulted not from obligations arising under a covenant in the license agreement, but from the debtor's ongoing research program which was unaffected by the filing.

Section 365(n)(1)(B) of the IPLBA defines both the scope of and extent to which these contractual rights in intellectual property can be retained by the licensee.[78] This subsection allows the licensee to "retain its rights [to such intellectual property] (including a right to enforce any exclusivity provision of such contract, but *excluding any other right* under applicable non-bankruptcy law *to specific performance* of such contract). . . ."[79] By enforcing an exclusivity provision, the licensee can prevent the debtor from licensing the technology to other parties.[80] The parenthetical indicates that this is the only right, outside of rights to the technology itself, where specific performance is available under the IPLBA. This singular reference to specific performance refers to the enforcement of covenants which require continued affirmative performance on the part of the debtor.[81] Enforcing a licensor improvement clause granting rights to improvements developed post-petition in an *ongoing* research program (one not mandated by contract) does not, however, impose continued affirmative performance on the debtor. Accordingly, the enforcement of these rights does not appear to contravene the policy goals of the IPLBA and therefore could be considered within the scope of those rights retained by the licensee as provided for by the IPLBA.

In summary, the statutory language of the IPLBA does not expressly preclude its application to licensor improvement clauses. When viewed in light of its objective of removing the

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77 11 U.S.C. § 365(n)(1)(B) (*see supra* note 10 for complete text).

78 *Id.*

79 *Id.* (emphasis added) (footnote omitted).

80 6 E. Lipscomb III, Lipscomb's Walker on Patents § 20:3, at 13 (3d ed. 1987) ("An exclusive license has the promise of the owner that others will be excluded from practicing the patent within the field of use for which the license has been given" (footnote omitted)).

81 *See supra* note 73.

burden of unilateral rejection on the licensee[82] while avoiding imposition of affirmative duties on the debtor,[83] the IPLBA can be constructed to allow a licensee to retain its rights in post-petition technology created under a licensor improvement clause.

The Legislative History of the IPLBA

The legislative history of the IPLBA provides little guidance regarding resolution of this issue; careful analysis of the Senate report produces the type of ambiguity likely to result in divergent court opinions. The Report states that the purpose of the IPLBA is to remove a burden on the development of American technology by preventing the unilateral termination of intellectual property rights through rejection by the licensor under section 365.[84] Although this policy would seem to favor inclusion of licensor improvement clauses within the scope of the IPLBA, other language in the Report can be read to indicate that Congress intended to exclude them.

In defining the scope of the amendment, the Report distinguishes subsection 365(n) from subsection 365(h), a parallel subsection which protects lessees of real property in the event of rejection by the lessor.[85] This protection is available to the lessee only if the term of the lease had commenced before filing.[86] The Report notes that, in contrast to subsection 365(h), subsection 365(n) is deliberately worded to apply to prospective intellectual property licenses that are contingent on some future event.[87] The Report noted that such contingent licenses may include licenses for pharmaceutical technology awaiting FDA approval,

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82 *See* S. REP. No. 505, 2d Sess. 2, at 3200 ("[t]he adoption of this bill will immediately remove that burden [of unilateral rejection] and its attendant threat to the development of American Technology . . . .").

83 S. REP. No. 505, 2d Sess. 2, at 3201.

84 S. REP. No. 505, 2d Sess. 1, at 3200.

85 S. REP. No. 505, 2d Sess. 8, at 3206.

86 Section 365(h)(1) states in pertinent part:

> If the trustee rejects an unexpired lease of real property . . . the lessee may remain in possession of the leasehold . . . under any lease . . . *the term of which has commenced* for the balance of such term and for any renewal or extension of such term that is enforceable by the lessee . . . under applicable nonbankruptcy law.

11 U.S.C. § 365(h)(1) (1988) (emphasis added).

87 S. REP. No. 505, 2d Sess. 8, at 3206 (in order to include licenses which have not commenced as of the bankruptcy petition filing date, Congress deliberately omitted the phrase "the term of which has commenced" in describing the contracts to which § 365(n) applies. This phrase was used in the parallel subsection (h) treating unexpired leases of real property).

as well as technology licenses commencing upon the issuance of a patent.[88] In this respect, a licensor improvement clause, which creates a license contingent upon the development of improvements in the existing technology, can be read to fall within these parameters.

Congress, however, qualified the inclusion of contingent licenses in section 365(n):

> The benefits of the bill are intended to extend to such [contingent] license agreements, *consistent with the limitation that the licensee's rights are only in the underlying intellectual property as it existed at the time of filing.*
>
> For the term of the rejected license and any period for which such license could have been extended, the licensee under the rejected license . . . is entitled to use the underlying intellectual property *in the state that it existed on the day of the bankruptcy filing as provided in the license* . . . .[89]

The limitation of paragraph (n)(1) to technology which existed at the time of filing of the bankruptcy petition may be the result of one of two policies adopted by Congress in order to protect the interests of the debtor in section 365.

First, the limitation may have been intended to allow a debtor-in-possession to continue improving its technology without the burden of licensing terms that were negotiated pre-petition. This manifests the classic "fresh start" policy, which allows the individual or reorganizing corporation to obtain a discharge from most pre-existing debts, and thus favors the debtor in the debtor's attempt to once again become a financially viable entity.[90] If Congress was motivated by this policy in limiting the licensee's retention to prepetition technology, a licensee may have difficulty arguing that they have no rights in post petition technology, including those created by licensor improvement clauses. To date, no commentator has suggested that Congress considered this policy when it enacted the IPLBA, nor was it mentioned in the Senate Report.

Rather, the limitation of a licensee's rights to pre-petition technology appears to focus on licenses which require the debtor to affirmatively continue development of the licensed technology

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88 *Id.*

89 S. REP. No. 505, 2d Sess. 8-9, at 3206 (emphasis added).

90 *See* Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) ("[The Bankruptcy Act] gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns *at the time of bankruptcy*, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preëxisting debt.") (citations omitted).

through continued research.[91] There is much substantive evidence in the Senate Report that Congress was opposed to any requirement of affirmative performance on the part of the debtor,[92] and indeed this notion is an important objective of the entire executory contracts section of the Code.[93] If the Senate Report limitation of section 365(n) to pre-petition technology was in fact prompted by this second policy, the limitation does not reach rights created by licensor improvement clauses, which require no affirmative performance.[94]

Post-petition development of technology is again addressed in the Report's discussion of the duties of the trustee after the licensee elects to retain its rights — paragraphs (n)(3) and (n)(4) of the IPLBA:

> [U]pon rejection by the debtor licensor combined with the licensee's election to retain rights in intellectual property ((n)(3)), the trustee, upon written request by the licensee, as provided in the parties' agreements, shall turn over to the licensee intellectual property held by the trustee and shall not interfere with the licensee's contractual rights to use the intellectual property or to obtain it from a third party. *The intellectual property referred to is only that which is in existence at the time of the petition filing and not anything which first comes into being post-petition.*[95]

This language once again appears to exclude post-petition technology from the ambit of section 365, this time in the context of the mechanics of the licensee's access to the technology after rejection by the licensor. Once again, however, if the purpose of the exclusion is to avoid the requirement of affirmative performance on the part of the debtor, rights created by licensor improvement clauses which create no duty of affirmative performance should not be excluded.

In summary, the Report on the IPLBA identifies the purpose of the IPLBA as preventing the debtor from unilaterally cutting off a licensee's rights in intellectual property in the event of the licensor's bankruptcy. The Report indicates that this policy does not extend as far as to include licenses requiring the creation of intellectual

91 *See* Brown, Hansen & Salerno, *supra* note 71, at 195.

92 S. REP. No. 505, 2d Sess. 7, at 3205 (trustees typically cannot perform covenants to continue research).

93 BAIRD & JACKSON, *supra* note 33, at 244-45.

94 Congress recognized that performance of covenants granting rights in existing intellectual property requires no affirmative performance on the part of the debtor. S. REP. No. 505, 2d Sess. 8, at 3205.

95 S. REP. No. 505, 2d Sess. 10, at 3208.

property after the licensor has filed for bankruptcy. The policy does, however, embrace licenses contingent on future events. Of the two possible reasons why Congress may have intended to exclude post-petition intellectual property — discharge of a licensor's obligations under a "fresh start policy," or the licensor's avoidance of affirmative performance obligations — the latter appears to have much more support in the legislative history and statutory language.

Treatment as Vested Rights

Despite the fact that the IPLBA is intended to remove the burden[96] imposed on the licensee in the critical area of technology licensing,[97] it is concededly a stopgap measure.[98] Congress dealt with the problem of debtors' rejection of contracts containing non-debtors' vested rights by supplementing section 365 with provisions, such as the IPLBA, which deal with those specific circumstances deemed by Congress to require special treatment.[99] Congress, however, has not addressed the rejection of other classes of contracts, such as covenants not to compete and trademarks, which involve non-debtors' vested rights. Consequently, courts have several options in determining the results of rejection.

Some courts have determined that rights vested in the non-debtor are no longer executory, and thus cannot be rejected. In *In re Minges*,[100] a case decided under the 1898 Bankruptcy Act which included no specific provisions for executory contracts, the court held that a lease for real property is partly a conveyance,

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96 S. REP. No. 505, 2d Sess. 1-2, at 3200 (the burden referred to is that imposed by allowing the licensor to unilaterally cut off the licensee's interests).

97 The licensing system is an invaluable legal device in the development American technology. It provides flexibility to the inventor by making costly development available to him, and to the investor by providing a mechanism to distribute risk by making the invention available to multiple speculators. Brown, Hansen & Salerno, *supra* note 71, at 171-72.

98 In summarizing the background of the IPLBA, the House Committee on the Judiciary agreed that "in the long run, section 365 and the treatment of executory contracts and unexpired leases in the bankruptcy laws should be revisited as a whole and fashioned so as to apply consistently in all situations." H.R. REP. No. 1012, 100th Cong., 2d Sess., at 3. *See* Westbrook, *supra* note 39, at 308-09 (suggesting that "executoriness" should not be the criterion by which rejection is permitted, and that in its place, a functional approach should be used, looking to non-bankruptcy law to determine the consequences of breach by the debtor).

99 *See* Moskowitz, *Intellectual Property Licenses in Bankruptcy: New "Veto Power" for Licensees Under Section 365(n)*, 44 BUS. LAW. 771, 788 n.87 (1989) (questioning the effectiveness of this "piecemeal legislation").

100 602 F.2d 38 (2d Cir. 1979).

and could not be unilaterally terminated by the debtor.[101] Other courts, however, have regarded express Congressional protection of certain rights as precluding the protection of others.[102] In *Lubrizol*, a case decided prior to passage of the IPLBA, the court noted that although Congress had afforded special treatment to collective bargaining agreements and leases for real property, no comparable provisions were available for technology licenses. The court, therefore, subjected the license one of the "general hazards created by section 365."[103]

A court reviewing the rejection of a licensor improvement clause must engage in a similar statutory analysis. The court may find that express Congressional protection of rights in pre-petition technology precludes protection of rights in technology created post-petition. Conversely, the court may find that protection of pre-petition technology rights indicates a legislative policy that should be extended to post-petition technology in the case of an improvement clause.

Interplay with Intellectual Property Law

Licensor improvement clauses often deal with two classifications of intellectual property:[104] improvements in patented inventions,[105] and derivative works based on copyrighted subject matter[106]. These forms of intellectual property invoke several

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101 *Id.* at 41 (citations omitted).

102 This maxim of statutory interpretation is known as *expressio unius est exclusio alterius*, "the expression of one thing is the exclusion of another." BLACK'S LAW DICTIONARY 581 (6th ed. 1990).

103 Lubrizol Enterprises v. Richmond Metal Finishers, 756 F.2d 1043, 1048 (4th Cir. 1985).

104 Clauses granting less restricted rights in the future technological developments of the licensor have been held to be against public policy. *See* Westinghouse Air-Brake Co. v. Chicago Brake & Mfg. Co., 85 F. 786 (C.C.N.D. Ill. 1898). The *Westinghouse* court observed that:

> I need not say that I concur . . . in the general statement that "a naked assignment or agreement to assign, in gross, a man's future labors as author or inventor, — in other words, a mortgage upon a man's brain, — does not address itself favorably to our consideration." The contravention of public policy involved in such an agreement needs no support in the argument that in such instances the public is deprived of the industrial and literary gains of the person mortgaged.

Id. at 793-94 (quoting Aspinwall Mfg. Co. v. Gill, 32 F. 697, 700 (3d Cir. 1887)).

105 The Patent Act declares as patentable "[a]ny new and useful process, machine, manufacture, or composition of matter, *or any new and useful improvement thereof*." 35 U.S.C. § 101 (1988) (emphasis added).

106 The Copyright Act of 1976 defines a derivative work as "[a] work based upon one or more preexisting works, such as a translation, . . . abridgement, condensa-

doctrines of patent and copyright law which can affect property interests.

The use of an improvement patent often infringes the underlying patent under the Rule of Addition or the Doctrine of Equivalents.[107] Under the Rule of Addition, the infringing patent contains all the elements of the infringed patent, and merely adds another element.[108] For example, suppose that Independent granted the automaker an exclusive license in a basic hydraulic power steering patent. If Independent later developed an improvement which merely added a feature to the hydraulic system, such as an adjustable parking effort, the manufacturing of a system utilizing this improvement would infringe on the underlying patent. Thus under the Rule of Addition, the automaker could use its exclusive rights in the hydraulic steering system to prevent Independent from licensing its improved hydraulic system to a second licensee.

Under the Doctrine of Equivalents, the infringing patent substitutes a component which "[p]erforms substantially the same function in substantially the same way to obtain the same result."[109] For example, suppose the exclusive license granted by Independent to the automaker was for a basic hydraulic steering system using hydraulic fluid "A". Independent is later granted a second patent for a similar system using hydraulic fluid "B". Under the Doctrine of Equivalents, the automaker could enjoin Independent from licensing its new system to a second licensee.

To avoid copyright infringement when using a derivative work based on a work which is not in the public domain, the user must obtain the permission of the copyright owner of the preexisting work.[110] If the automaker had an exclusive license from Independent to use copyrighted steering controller software in its vehicles, Independent could not license revisions of that software, which would be considered derivative works, to a second licensee.

Because the subject matter of the underlying license can dominate that of the improvement, the user of an improvement

tion, or any other form in which a work may be recast, transformed, or adapted." 17 U.S.C. § 101 (1988).

[107] E. LIPCOMB III, *supra* note 80, at § 22:29.

[108] R. HILDRETH, PATENT LAW: A PRACTITIONER'S GUIDE 121-22 (1988).

[109] Graver Tank & Mfg. Co. v. Linde Air Prod. Co., 339 U.S. 605, 608 (1950) (quoting Sanitary Refrigerator Co. v. Winters, 280 U.S. 30, 42 (1929)).

[110] M. LEAFFER, UNDERSTANDING COPYRIGHT LAW § 2.8 (1989).

must obtain permission from the holder of rights in the dominant license.[111] This is especially true in a new area of technology where the claims of the original patent are broad. These exclusive rights are created under non-bankruptcy law, and are therefore generally enforced in bankruptcy.[112]

The IPLBA can work in concert with these intellectual property principles in preserving the licensee's rights to post-petition improvements developed by the debtor. Under section 365(n)(1)(B), a licensee with exclusive rights in the intellectual property can retain those rights, "[i]ncluding a right to enforce any exclusivity provision."[113] Thus, even without the benefit of a licensor improvement clause, a licensee who has retained its rights under section 365(n)(1)(B) to enforce an exclusivity provision may have the right, under patent or copyright law, to preclude the debtor from using or licensing the debtor's own post-petition improvements or derivative works.[114] While this right does not itself allow the licensee to use the improvement, it would be an effective tool for the non-debtor to use in negotiating licenses for the use of the improvement.[115] This result restricts the effect of section 365(n)(1)(B) in limiting the rights retained by the licensee to "[t]he underlying intellectual property as it existed at the time of the filing."[116]

It is interesting to note that the rights of an exclusive licen-

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111 *In re* Kaplan, 789 F.2d 1574 (D.C. Cir. 1986) (a broad patent can dominate a narrow patent which makes a more specific claim because the narrow patent cannot be used without infringing the broad).

112 Westbrook, *supra* note 39, at 257-63. Professor Westbrook noted that this generally accepted rule has never been explicitly stated in the Code and must be derived by negative implication. *Id.* Under § 541, the property that is in the debtor's estate is defined by non-bankruptcy law; therefore, non-bankruptcy law must also define those interests outside the estate. *Id.* at 259.

113 11 U.S.C § 365(n)(1)(B) (1988) (footnote omitted) (*see supra* note 10 for complete text).

114 A licensee with an exclusive license in a patent can prevent the licensor as well as anyone else from infringing the patent. E. LIPSCOMB III, *supra* note 80 § 203, at 13.

115 There are several situations where failed negotiations between holders of separate interests in the same intellectual property can result in the disuse of that property. *See, e.g.*, United States v. Line Material Co., 333 U.S. 287 (1948) (where two manufacturers, one owning the dominant patent and the other owning the improvement patent on the same device, were deadlocked and therefore unable to manufacture the device, the Court held the agreement they eventually reached illegal under the Sherman Act); Stewart v. Abend, 110 S. Ct. 1750 (1990) (owners of a copyright in a detective story successfully enjoined public display of Alfred Hitchcock's movie *Rear Window*, a derivative work, when the owners of the movie refused to negotiate a license.)

116 S. REP. No. 505, 2d Sess. 8, at 3206.

see to prevent others from using post-petition improvements depend on the licensee's ability to retain its exclusivity rights. As a result, the licensee's rights in the post-petition improvements are attributable not only to intellectual property law, but also to the provisions of the IPLBA which allow it to retain its exclusivity.[117] For example, if the hypothetical automaker was granted an exclusive license in Independent's basic hydraulic steering technology, it would have rights based in intellectual property law to prevent others from using certain improvements developed by Independent.[118] If the automaker were not permitted to retain its exclusivity rights after Independent's rejection of the license (as in *Lubrizol*), the automaker would also lose its rights in Independent's improvements. Conversely, under the IPLBA, the automaker would be permitted to retain its rights in the intellectual property, including exclusivity rights; intellectual property law would then operate to secure the automaker's interests in the improvements.

In summary, intellectual property law can operate in conjunction with section 365(n)(1)(B)'s exclusivity provision to enable the licensee to prevent the use of improvements developed by the licensor post-petition.[119] This result would be a strong bargaining tool for the licensee in negotiating rights to these improvements. These intellectual property law principles, however, are likely to become relevant only in cases where the license is for the broad claims typically made in a new technological field.[120]

V. Analogous Case Law

Because the IPLBA is recent legislation which has not been interpreted by the courts to allocate rights under licensor improvement clauses, it is helpful to examine cases involving analogous sections of the Code in attempting to predict the courts' disposal of licensor improvement clauses in bankruptcy. This section of the comment will examine cases where intellectual property as well as other interests were the subject of executory contracts in bankruptcy. While the application of these holdings to licensor improvement clauses is not direct, the reasoning used in the cases suggests several paths a court may choose to take.

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117 11 U.S.C. § 365(n)(1)(B) (1988) (see *supra* note 10 for complete text).

118 These rights can be based on the Rule of Addition or the Doctrine of Equivalents in patent law, or the right to create a derivative work in copyright law. *See supra* notes 107-110 and accompanying text.

119 *See supra* text accompanying notes 113-116.

120 *See supra* text accompanying notes 111-112.

Lubrizol Enterprises v. Richmond Metal Finishers, Inc.[121]

Although overruled by the IPLBA in its application to general intellectual property licenses,[122] the reasoning in *Lubrizol* remains available to courts in evaluating the rejection of other contracts.[123] Richmond Metal Finishers, Inc. [Richmond], the owner of a metal coating process technology, entered into a licensing agreement granting Lubrizol Enterprises [Lubrizol] the right to use the process in return for royalties and the cancellation of preexisting debt.[124] Richmond was required to provide Lubrizol with notice and defense of any patent infringement suit, and to indemnify Lubrizol for any warranty claims on the technology.[125] The license was non-exclusive, allowing Richmond to license subsequent third parties.[126] Richmond, however, was required to notify Lubrizol of subsequent licenses, and to offer Lubrizol royalty rates comparable to those in the subsequent licenses.[127] In addition to paying royalties, Lubrizol was required to submit monthly accounting statements and to keep the technology confidential.[128]

Before Lubrizol began using the metal coating technology, Richmond petitioned for bankruptcy under chapter 11. As debtor in possession, Richmond rejected the licensing agreement.[129] The court permitted rejection of the complete contract, including Richmond's obligation to allow Lubrizol to use the process.[130] In permitting the rejection, the court engaged in a two-step inquiry: first, whether the contract was executory; and second, whether the rejection benefitted the bankrupt estate.[131]

Applying the Countryman definition of executory contracts,[132] the court held that the licensing agreement was execu-

121 756 F.2d 1043 (4th Cir. 1985), *cert. denied*, 475 U.S. 1057-58 (1986).

122 *See supra* notes 61-68 and accompanying text.

123 Westbrook, *supra* note 39, at 309.

124 Lubrizol Enterprises vs. Richmond Metal Finishers, 756 F.2d 1043, 1045 (4th Cir. 1985).

125 *Id.*

126 *Id. See supra* note 80 (description of exclusive licensing).

127 *Id.* This license term is not unusual in technology licensing and is sometimes known as a "most-favored licensee" clause. *See* LaPaglia, *Key License Clauses*, in TECHNOLOGY LICENSING 1989, at 189, 205-06.

128 *Lubrizol*, 756 F.2d at 1046.

129 *Id.* at 1045.

130 *Id.*

131 *Id.*

132 In order for a contract to be executory, there must be remaining obligations on both sides, the non-performance of which would constitute material breach. *Id. See supra* note 39 and accompanying text.

tory because unperformed obligations existed on both sides of the contract.[133] The court first found that Richmond's contingent obligation to defend and indemnify suits was executory.[134] While noting that Lubrizol's mere promise to pay royalties would have been insufficient to create an executory contract, the court nevertheless determined that Lubrizol's duty to keep financial records and to submit quarterly sales statements were sufficient to establish that its obligations were executory.[135]

Given this relatively low threshold espoused by the *Lubrizol* court to determine whether unperformed obligations exist, a court applying this analysis would have little difficulty finding most improvement clauses to be executory. Performance could be construed as due on the part of the licensor because the licensor has the contingent duty to license the improvements.[136] Similarly, the fact that the licensee may have minimal accounting and record-keeping duties would be sufficient under *Lubrizol* to invoke executory contracts analysis.[137]

In order to meet the second prong of the *Lubrizol* criteria, rejection of the contract must be advantageous to the debtor.[138] In evaluating this criterion, the *Lubrizol* court applied a business judgment rule, and deferred to the decision of the trustee.[139] Most rejections of licensor improvement clauses would meet this criterion because they would relieve the debtor of its passive obligation to allow the licensee to use further developments in the technology,[140] and thus permit the licensor to negotiate the lucrative licenses or to use the improved technology itself. Rejection would thus be arguably beneficial in nearly all cases, and meet the business judgment rule.[141]

While *Lubrizol* was decided before the passage of the IPLBA, the *Lubrizol* court could have applied other provisions by analogy,

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133 Lubrizol Enterprises v. Richmond Metal Finishers, 756 F.2d 1043, 1045-46 (4th Cir. 1985).

134 *Id.* at 1045.

135 *Id.* at 1046. Professor Andrew found it "remarkable" that "Lubrizol lost its right to the technology because it had the duty to 'deliver written quarterly sales reports and keep books of account subject to inspection.' " Andrew, *supra* note 30, at 917-918 (quoting *Lubrizol*, 756 F.2d at 1046).

136 *See supra* text accompanying note 134.

137 *See supra* note 135 and accompanying text.

138 Lubrizol Enterprises v. Richmond Metal Finishers, 756 F.2d 1043, 1045-46 (4th Cir. 1985).

139 *Id.* at 1046-47 (citing National Labor Relations Board v. Bildisco and Bildisco, 465 U.S. 513 (1984) (*see supra* note 56).

140 S. Rep. No. 505, 2d Sess. 2, at 3201.

141 S. Rep. No. 505, 2d Sess. 2-3, at 3201.

such as section 365(h), which allows a lessee of real property to remain in possession after rejection of the lease.[142] Today, a court holding that the IPLBA is not directly applicable to licensor improvement clauses may similarly decline to apply the IPLBA by analogy. Under the *two-part Lubrizol* analysis, the court may to (1) find the contract executory, and (2) applying a business judgment rule, confirm rejection of the licensor's obligations under the improvement clause.

The *Lubrizol* holding has been severely criticized both on grounds of intellectual property licensing policy[143] and on grounds of bankruptcy/executory contract theory.[144] Several commentators have argued that provisions like the IPLBA offering non-debtors relief from rejection[145] merely recognize a preexisting vested right created under non-bankruptcy law.[146] If a vested right were so recognized, a court may find that the licen-

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142 *See supra* note 54. The *Lubrizol* court could have used the analogous characteristics of a real property lease and a technology license, such as the uniqueness of the property itself and the reliance of the lessee or licensee on its interest, to apply § 365(h) by analogy to a technology license. Instead, the *Lubrizol* court chose to use Congress' passage of § 365(h) to indicate Congress' intent *not* to except technology licenses from § 365 rejection. *See supra* note 102 and accompanying text.

143 The Senate report, in discussing the background of the IPLBA, noted the impact of *Lubrizol* on the technology licensing system in the United States:

> Several recent court decisions, including *Lubrizol* . . . , have interpreted Section 365 of the Bankruptcy Code (the "Code") as providing a basis for permitting a licensor of intellectual property to strip its licensee of any continuing right to use the licensed intellectual property under the auspices of rejecting the license as an executory contract. . . . These cases, however, have relieved the debtor not simply of its ongoing affirmative performance obligations under the executory license agreement, but also of its passive obligation to permit the licensee to use the intellectual property as provided in the license.

S. REP. No. 505, 2d Sess. 2, at 3201.

144 *See* Westbrook, *supra* note 39, at 307. Professor Westbrook noted that even after the IPLBA, the *Lubrizol* approach is still available to courts to apply in other contract situations.

> The [*Lubrizol v.*] *Richmond* analysis is so dangerous because it provides no requirement of insolvency, limitation of time (within one year, for example), or any other limit, except the mirage limit of executoriness. It also leads to the obvious anomaly that the Other Party loses if it has extracted promises of future performance from the debtor, but might win if it has driven a worse bargain, with the debtor promising no future performance.

Id. (footnote omitted).

145 *See supra* notes 53-57 and accompanying text.

146 *See, e.g.*, Andrew, *supra* note 30, at 919-922 (rejection of the contract and its associated obligations should be considered separately from the disposition of the underlying asset that is the subject of the contract); Westbrook, *supra* note 39, at 308-09 (application of functional analysis would involve use of patent-contract law and conclude that the licensor would not have rescission available to him in the

see's right to future improvements could not be rejected because under non-bankruptcy law the right to future improvements that existed at the time of petition is vested in the licensee.

In re A.J. Lane & Co.[147]

In *A.J. Lane*, a bankruptcy court held that an option to buy back real estate, where the option was held by the vendor, could be rejected as part of an executory contract by the debtor in possession.[148] The debtor had purchased commercially zoned land from a development company.[149] Because the development company owned several other parcels in the vicinity, it had an interest in the timely development of this land.[150] The contract for sale therefore included an option for the development company to repurchase the land in the event that A.J. Lane had not completed a specified construction schedule within four years.[151] Suffering financial woes due to a depressed real estate market, A.J. Lane filed for Chapter 11 relief less than one and a half years after purchasing the land.[152] In its reorganization plan, the debtor proposed selling the parcel together with an adjoining parcel it owned.[153] The proposed buyer, however, would not take the land subject to the development company's option.[154] The debtor therefore rejected the option under section 365.[155]

In allowing the rejection, the court stressed that the development company was not in possession and that the option was

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case of its own breach, and therefore could not regain possession of the intellectual property).

147 107 Bankr. 435 (Bankr. D. Mass. 1989).

148 *Id.* at 437. *See also In re* Hardie, 100 Bankr. 284 (Bankr. E.D. N.C. 1989) (finding a land purchase option to be executory, even though a specific performance remedy would be available in breach); Carlisle Homes, Inc. v. Azzari (*In re* Carlisle Homes, Inc.), 103 Bankr. 524 (Bankr. D.N.J. 1988) (partially exercised option where most lots had not yet been purchased found to be executory). *But see* Brown v. Snellen (*In re* Giesing), 96 Bankr. 229 (Bankr. W.D. Mo. 1989) (option term was separated from executory lease contract and found to be a separate, nonexecutory contract with debtors having fully performed under the option contract by paying the option fee); Hudson Holding Assoc., v. Rifino (*In re* Hudson Holding Assoc.), 82 Bankr. 246 (Bankr. S.D.N.Y. 1988) (although court permitted rejection by lessor/debtor of lease contract, tenant was entitled to specific performance of an "option to purchase" clause).

149 *Id.* at 435.

150 *Id.*

151 *Id.*

152 *Id.* at 435-36.

153 *Id.* at 436.

154 *Id.*

155 *Id.* at 435.

therefore not a property interest.[156] The court maintained that the option was "only a contract right"; the court was persuaded neither by the development company's argument that the normal remedy for breach was specific performance, nor by the fact that the interest was recorded on the deed.[157]

The court in *A.J. Lane* espoused the "rule of statutory construction that if Congress intends to change an established judicial doctrine, it should make that intent specific."[158] Noting that Congress specifically addressed real estate leases in section 365(h) and intellectual property in section 365(n), the court concluded that Congress did not intend to protect options to purchase real estate from rejection under section 365.[159]

The *A.J. Lane* court would presumably regard a licensor improvement clause in a technology licensing agreement in the same way: it was non-possessory at the time of filing in that the improvement did not exist, and there is no specific provision of section 365 protecting such a contract from rejection.

This reasoning, however, is by no means universal and several district courts have reached contrary conclusions.[160] For example, in *Brown v. Snellen*,[161] the Court of Appeals for the Eighth Circuit expressly held that an option to buy land was non-executory, and refused to allow the debtor, who in this case held the option, to reject under section 365.[162] The court noted that after paying the option fee, the option holder no longer had any obligations under the contract.[163] Similarly, a court could view the obligations of a licensee in a licensor improvement clause to be completed upon payment of consideration for the license. The licensor improvement clause would therefore be found to be nonexecutory under the Countryman definition,[164] and a debtor/licensor would not be permitted to reject it.

156 *Id.* at 438-39.
157 *Id.* at 438.
158 *Id.* This is an application of the maxim "*expressio unius est exclusio alterius*", which was similarly invoked in *Lubrizol*. *See supra* note 98.
159 *In re* A.J. Lane & Co., 107 Bankr. 435, 438 (Bankr. D. Mass. 1989).
160 *See supra* note 141.
161 96 Bankr. 229 (Bankr. W.D. Mo. 1989).
162 *Id.* at 232.
163 *Id.*
164 *See supra* note 39 and accompanying text.

Infosystems Technology, Inc. v. Logical Software, Inc.[165]

The court in *Infosystems* took a novel approach in evaluating rejection in a case involving an intellectual property license. While courts, when reviewing rejection,[166] typically use a business judgment rule, the *Infosystems* court balanced the equities to determine whether the benefit that rejection would yield to the pool of general creditors was greater than the damage done to the non-debtor party to the rejected contract.[167]

The debtor in *Infosystems* rejected a distribution agreement giving Infosystems marketing rights in software.[168] Infosystems appealed the decision of the bankruptcy court allowing the rejection.[169] The district court remanded the case, noting that the bankruptcy court should consider the business impact on Infosystems, the licensee, as well as the likelihood that the debtor will successfully reorganize.[170] Thus, the approach taken in *Infosystems* allows a court to consider the interests of the non-debtor party in evaluating a proposed rejection. In the case of a licensor improvement clause, a court following this approach could consider the importance of the improvements in the technology to the non-debtor party. Where the license was entered in anticipation of major improvements to the technology,[171] it is possible that the licensee's interest in continued enforcement of the license will outweigh the licensor's interest in avoiding encumbrances on improvements to its technology. Allowing the bankruptcy court to use its discretion in permitting rejection may in many cases produce more equitable results than in *Lubrizol.*[172]

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165 [1986-1987 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 71,899 (D. Mass. June 25, 1987).

166 *Lubrizol Enterprises v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1047 (4th Cir. 1985), *cert. denied*, 475 U.S. 1057 (1986).

167 *Infosystems*, [1986-1987 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 71,899 at 91,602. *See also In re* Petur U.S.A. Instrument Co., Inc., 35 Bankr. 561 (Bankr. W.D. Wash. 1983) (motion to reject executory distribution contract denied where non-debtor/distributor depends on contract for all its income); Robertson v. Pierce (*In re* Chi-Feng Huang), 23 Bankr. 798 (Bankr. 9th Cir. 1982) (court remanded to determine whether rejection of a contract to sell apartment buildings would benefit the debtor/owner's creditors or merely harm the nondebtor party to the contract). *Contra In re* Logical Software, Inc., 66 Bankr. 683 (Bankr. D. Mass. 1986) (allowing rejection of software licensing agreement although licensee depended on license for 100% of business).

168 *Infosystems*, [1986-1987 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 71,899 at 91,601.

169 *Id.*

170 *Id.* at 91,602.

171 *See supra* note 17.

172 It has been argued, however, that any inquiry into the non-debtor's situation

VI. Summary and Conclusion

Congress' purpose in enacting the IPLBA was to enhance American licensing law by making the outcome of a licensor's bankruptcy both fair and predictable.[173] The bill was aimed at a perceived threat to licensing practice presented by the willingness of the courts to allow a debtor/licensor to unilaterally reject an intellectual property license under § 365(a).[174] At the same time, Congress indicated that it would not go so far as to require the debtor/licensor to meet obligations in a license agreement requiring affirmative performance.[175] Section 365(n) thus limits the rights that can be retained by the licensee to rights in the intellectual property that existed at the time the licensor filed for bankruptcy.[176]

Licensor improvement clauses require no affirmative performance on the part of the licensor, but instead simply create rights in the licensee in certain developments resulting from the licensor's ongoing research.[177] The clauses therefore come within the scope of the IPLBA as defined by its language and history. Text in the statute limiting its scope to intellectual property "as it existed at the time of filing" is aimed at preventing the requirement of additional affirmative performance on the part of the debtor,[178] and should therefore not be applied to strip licensees of rights created by licensor improvement clauses.

Cutting off a licensee's rights in improvements developed by the licensor will impair the expectations of the licensee. The licensor improvement clause is often included in the contract in anticipation of further developments by the licensor in an invention that had little value in its primitive form but great potential as a mature technology. Or the clause may have been intended to assure the non-exclusive licensee that the licensor would not license the improvements to competitors while leaving the licensee with the unimproved technology. The intent of Congress in enacting the IPLBA was to preserve expectations such as these and thereby strengthen the efficient American system of technology licensing.

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is a preference of that party over the other unsecured creditors solely on the basis that its contract was executory. Andrew, *supra* note 30, at 898-899.

173 *See supra* notes 61-68 and accompanying text.

174 *Id.*

175 *See supra* notes 70-83 and accompanying text.

176 *Id.*

177 *See supra* notes 23-28 and accompanying text.

178 *See supra* notes 84-95 and accompanying text.

In making its decision to license Independent's technology, the hypothetical automaker would be discouraged by the fact that the fate of its rights in licensor improvements would depend on the licensor's decision to assume or reject in the event of its Chapter 11 reorganization. This is the result that Congress sought to avoid by enacting the IPLBA. In applying the IPLBA to licensor improvement clauses and allowing the licensee to retain its rights in post-petition improvements, courts would be applying the act in a manner consistent with congressional intent.

Robert T. Canavan