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Technology Transfers: What If the Other Party Files Bankruptcy.

Ann Livingston

Leif M. Clark

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TECHNOLOGY TRANSFERS: WHAT IF THE OTHER PARTY FILES BANKRUPTCY?

ANN LIVINGSTON*
HONORABLE LEIF M. CLARK**

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* J.D., St. Mary's School of Law, 1979, B.S.E.E., The University of Texas at San Antonio (in progress); patent attorney, Baker, Mills & Glast, P.C., San Antonio, Texas.
** J.D., University of Houston School of Law, 1980; U.S. Bankruptcy Judge for the Western District of Texas, San Antonio, Texas.

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I. Introduction

"Technology transfers" is a contemporary description of agreements involving intellectual property that wed development and marketing. Bankruptcy is the last thing either wants to anticipate in this marriage while prospective parties to such agreements are negotiating. So, rather like family lawyers who must gently counsel their clients about such things as pre-nuptial agreements, lawyers who assist with technology transfer agreements are remiss if they do not consider a possible bankruptcy.

Unless there are hidden agendas in this happy alliance, it can probably be assumed that neither party anticipates its own impoverishment. Rather, from each party's point of view, it is the other party who just might digress. Thus, at least for purposes of this paper, a party's own pre-bankruptcy planning is not considered as a moving force. Rather, this paper deals with the question posed to the other party, whether implicitly or explicitly: "What happens to me if you go bankrupt?"

A "technology transfer" could be any one of a number of widely varying transactions. The "technology" subject matter could be intellectual property, such as a patent, trade secret or copyright, or a combination of these. Trademark agreements, while not involving technology, raise similar concerns and will also be discussed. The "transfer" could be a standard assignment or a license, as well as a more intricate deal such as a development agreement that contemplates future licensing.

Section II of this paper sets out various bankruptcy law basics, and sections III and IV apply them to technology transfers. Section III is

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written from the point of view of a transferee, such as an assignee or licensee, whose transferor might file, or has filed, bankruptcy. Conversely, section IV is written from the point of view of a transferor whose transferee might file, or has filed, bankruptcy. Both sections III and IV discuss the risks of bankruptcy and give advice on what to do when preparing to enter an agreement or what to do if representing a non-debtor after the other party's bankruptcy has already occurred.

II. Bankruptcy Laws Affecting Technology Transfers

Persons working with contracts involving technology may be well-versed in contract law and intellectual property law but perhaps not in bankruptcy law. If this is the case, there are several bankruptcy basics, not necessarily unique to technology transfers, that provide a framework for the "What if you go bankrupt?" question. This section discusses those basics, as well as a few other laws that may affect a technology transfer agreement in a bankruptcy context and that should be known to both parties.

A. *Types of Bankruptcy Proceedings*

If either party to a technology transfer files bankruptcy, the subsequent proceedings will generally be governed by either chapter 7 or chapter 11 of the Bankruptcy Code. Under chapter 7, a trustee[1] collects, classifies and liquidates the property of the estate.[2] Under chapter 11, the trustee, who is usually the debtor in possession, devises a plan for continuing the debtor's business and paying its creditors.

From the viewpoint of negotiating and drafting technology transfer agreements, each party can deal with the specter of either type of bankruptcy without having to distinguish between them. In other words, although chapter 11 proceedings have certain aspects that chapter 7 proceedings do not have, if chapter 11 problems are properly anticipated, a chapter 7 proceeding should not present new difficulties.

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1. For purposes of this paper, the term "trustee" will be used to describe a trustee in a chapter 7 proceeding or a trustee or debtor in possession in a chapter 11 proceeding. Under the Bankruptcy Code, statutory references to "trustee" include a debtor in possession. 11 U.S.C. § 1107 (1982).

2. 11 U.S.C. § 704 (1982 & Supp. V 1987).

B. *The Automatic Stay*

Section 362 of the Bankruptcy Code provides that the filing of a petition in bankruptcy operates as an automatic stay of actions against the debtor.[3] The automatic stay prevents such action even if they are otherwise authorized by contract or by law.[4] If the automatic stay is violated, the violating party could suffer harsh reproof. The trustee could assert damages and could seek to deny the violating party relief to which it might otherwise have been entitled.[5]

Many technology transfer agreements routinely include "fast action" terms, such as a term providing for injunctive relief upon certain breaches of contractual duties. These terms may favor either the transferor, such as when a transferee breaches a confidentiality duty, or the transferee, such as when a transferor breaches a duty to support the technology. In either case, each party should realize that, in the context of bankruptcy, immediate relief for such breaches may not be available.

On the other hand, the automatic stay does not protect the debtor from post-petition torts.[6] Thus, an injunction may be available if, after the filing of the petition, the trustee commits or is about to commit a tort.[7] An example of such a situation is when a debtor licensee's license is terminated, but the trustee continues to exploit the technology.

C. *The Bankruptcy Estate*

Section 541 of the Bankruptcy Code provides that the filing of a bankruptcy petition creates a bankruptcy estate, which has a legal existence separate from that of the debtor who filed the case.[8] The

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3. 11 U.S.C. § 362 (1982 & Supp. V 1987).

4. *See* Computer Communications, Inc. v. Codex Corp. (*In re* Computer Communications, Inc.), 824 F.2d 725, 728-29 (9th Cir. 1987).

5. *Id.* at 731; *see also* Beverley Plaza Assocs. v. Saul (*In re* Kroh Bros. Dev. Co.), 91 Bankr. 525, 537 (Bankr. W.D. Mo. 1988); *In re* Adana Mortgage Bankers, Inc., 12 Bankr. 1012, 1023 (Bankr. N.D. Ga. 1981).

6. 11 U.S.C. § 362(a) (1982 & Supp. V 1987); *see also* Brutoco Eng'g & Constr. Co. v. Dennis Ponte, Inc. (*In re* Dennis Ponte, Inc.), 61 Bankr. 296, 298 (Bankr. 9th Cir. 1986)(negligence action against estate for post-petition conduct).

7. *See* 11 U.S.C. § 362(a)(1) (1982)(stay applies to suits involving prepetition claims). A trustee's post-petition breach of a prepetition contract is also unprotected by the automatic stay. *See In re* Beck, 5 Bankr. 169, 171 (Bankr. D. Haw. 1980)(automatic stay did not affect prepetition license agreement).

8. 11 U.S.C. § 541(a) (1982 & Supp. V 1987).

"property of the estate" under the Code is a term of art defined as all the debtor's legal and equitable interests in property as of the date the petition is filed.[9] This definition includes the debtor's contract rights.[10]

In the context of technology transfers, the debtor's interests in patents, copyrights and trademarks, and in applications for such rights, become part of the bankruptcy estate.[11] Technology transfer agreements generally result in ownership in one party or the other, with assignments operating to transfer ownership and licenses not having that effect.[12] Thus, if an assignee or licensor files bankruptcy, the bankruptcy estate will include the assigned or licensed technology, as well as any contract rights that may exist in connection with a technology transfer agreement.

The nature of the bankruptcy estate's interest in property affects the trustee's powers to deal with it. In the context of technology transfers, the trustee could be dealing either with the estate's ownership in the technology itself or with the estate's contract rights under an executory license or assignment. As discussed below, this distinction between property ownership and contract interests determines whether the trustee can sell, use or lease property under section 363 of the Bankruptcy Code, or whether the trustee must follow the guidelines for executory contracts under section 365.

1. Section 363: The Bankruptcy Trustee's Power to Use, Sell, or Lease Property of the Estate

If an asset is the property of the bankruptcy estate, section 363 of the Bankruptcy Code permits the trustee to sell, lease or use it in the

9. *Id.*; *see also* United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983).

10. Quarles House Apartments v. Plunkett (*In re* Plunkett), 23 Bankr. 392, 394 (Bankr. E.D. Wis. 1982).

11. The legislative history of section 541 states that property of the estate includes "rights such as copyrights, trademarks, patents, and processes, contingent interests and future interests, whether or not transferable by the debtor." H.R. REP. NO. 595, 95th Cong., 1st Sess. 175-76 (1977), *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5963, 6136 (footnotes omitted); *see also* Nasson College v. New England Ass'n of Schools & Colleges, Inc. (*In re* Nasson College), 80 Bankr. 600, 604 (Bankr. D. Me. 1988); *In Re* Townsend, 72 Bankr. 960, 964 (Bankr. W.D. Mo. 1987)(quoting legislative history of section 541).

12. *See* Fenix Cattle Co. v. Silver (*In re* Select-A-Seat Corp.), 625 F.2d 290, 292 (9th Cir. 1980)(non-debtor licensee's interest in license did not affect treatment of license as executory contract).

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ordinary course of business.[13] When a non-debtor has an interest in the same property, section 363(e) permits the trustee to sell, lease, or use the property after notice and hearing, on a showing that the non-debtor's interest is "adequately protected."[14]

The question whether the trustee may sell the property free and clear of the non-debtor's interest is governed by section 363(f). Relevant factors are if non-bankruptcy law permits such a sale, or if the interest is in bona fide dispute, or if the non-debtor could be compelled to accept monetary satisfaction.[15]

2. Section 365: Executory Contracts

Section 365 of the Bankruptcy Code provides that contracts that are executory when bankruptcy is filed are subject to the trustee's option to reject or assume them.[16] Generally, the policy of section 365 is to permit the trustee to review the debtor's contracts, terminate or reject those that do not benefit the estate, and assume those that do, provided certain requirements are met.

Assumption and rejection do not automatically take place early in a bankruptcy. In a chapter 11 bankruptcy, the trustee may make its decision to assume or reject at any time before confirmation of the plan.[17] However, the court, at the request of the non-debtor, may order the trustee to decide within a specified time.[18] In a chapter 7 bankruptcy, "if the trustee does not assume or reject within 60 days after the order for relief, the contract is deemed rejected."[19] Especially in a technology-oriented company, a shake-out period during which the estate consolidates its operations can usually be expected. During this period, the trustee may postpone decisions that will determine the outcome of the reorganization. In a chapter 11 case, the decision to assume or reject an important license can be expected to

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13. 11 U.S.C. § 363 (1982 & Supp. V 1987).

14. *Id.* § 363(e); *see also* 11 U.S.C. § 361 (1982 & Supp. V 1987)(defining adequate protection); 11 U.S.C. § 363(h) (1982 & Supp. V 1987)(trustee to sell entire interest owned in cotenancy under certain circumstances).

15. 11 U.S.C. § 363(f) (1982 & Supp. V 1987); *see also In re* Beker Indus. Corp., 63 Bankr. 474, 475 (Bankr. S.D.N.Y. 1986)(applies section 363(f)).

16. 11 U.S.C. § 365 (1982 & Supp. V 1987).

17. *Id.*

18. *Id.*

19. *Id.* § 365(d)(1)-(2); *see also* Skeen v. Denver Coca-Cola Bottling Co. (*In re* Feyline Presents, Inc.), 81 Bankr. 623, 625-26 (Bankr. D. Colo. 1988).

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be delayed for as long as possible, perhaps as late as confirmation of the plan.

During the period after a bankruptcy filing and before the trustee's decision to reject or assume an executory contract, the trustee can enforce the contract against the non-debtor.[20] On the other hand, the non-debtor cannot enforce the contract against the trustee.[21] The non-debtor may not unilaterally breach the contract by terminating it. It also appears that even a non-debtor's contractual right to terminate on notice might not be permitted, if notice is given after the debtor's bankruptcy filing.[22]

a. What Contracts are Executory?

The definition of executory contracts has been the subject of much dispute because executory contracts are not defined in the Bankruptcy Code, and the trustee's option to assume or reject is so often undesired by non-debtors. The most frequently used definition is "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that failure of either to complete performance would constitute a material breach excusing the performance of the other."[23] Some courts consider this definition to be too formal and tend toward a more pragmatic approach.[24] In the context of technology transfers, most agreements will include continuing rights and duties by both parties and will be considered execu-

20. *See Feyline*, 81 Bankr. at 626.

21. NLRB v. Bildisco, 465 U.S. 513, 532, (1984); *see also Feyline*, 81 Bankr. at 626; Bordewieck, *The Post Petition, Pre-Rejection, Pre-Assumption Status of an Executory Contract*, 59 AMER. BANKR. L.J. 197, 200 (1985).

22. *See Feyline*, 81 Bankr. at 627 (non-debtor terminated contract after debtor filed bankruptcy). This opinion is not clear whether the non-debtor had a contractual right to terminate but indicates that any post-petition termination is prohibited. *Id.*

23. Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973); *see also* Counties Contracting & Constr. Co. v. Constitution Life Ins. Co., 855 F.2d 1054, 1060 (3d Cir. 1988)(quoting Countryman).

24. *See, e.g.*, Arrow Air v. Port Auth. of New York & New Jersey (*In re* Arrow Air, Inc.), 60 Bankr. 117, 122 (Bankr. S.D. Fla. 1986)(contract executory even though material obligations outstanding on part of only one party to contract); *In re* Norquist, 43 Bankr. 224, 229 (Bankr. E.D. Wash. 1984)(contracts requiring substantial performance by either party to contract may be executory in bankruptcy context); *In re* Booth, 19 Bankr. 53, 56 (Bankr. D. Utah 1982)(executory contracts measured by nature of parties and goals of reorganization, not by mutuality of commitments). *See generally* Weintraub & Resnick, *What is an Executory Contract? A Challenge to the Countryman Test*, 15 U.C.C. L.J. 273 (1983)(discussing executory contracts).

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tory.[25] At one extreme, assignments that simply convey a patent, trademark or copyright from one party to another without continuing duties are probably nonexecutory.[26] Apart from such assignments, most grants of rights in connection with technology will be licenses which are likely to be executory.[27] The determination of whether a license is executory is made by reviewing the duties set out in the license and the status of performance of those duties at the time the trustee elects to assume or reject.[28] There is a good argument that the contract is no longer executory when the duties left to be performed by one party, either the debtor or the non-debtor, are completed or are very minimal.[29]

b. Effect of Assumption or Rejection

The trustee will want out of the contract if the trustee concludes that the obligations of an executory contract, relative to its value, are burdensome to the estate. The contract itself may give the trustee a right of termination without cause or notice. The trustee may exercise this right instead of rejection. If not, section 365 permits the trustee to reject the contract, an act that may operate as a breach by the trustee.

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25. *See* Countryman, *Executory Contracts in Bankruptcy: Part II*, 58 MINN. L. REV. 479, 502 (1974); *see also* Morris & Arnold, *Protection of Interests in Licensed or Assigned Technology*, 69 J. PAT. OFF. SOC'Y 525, 540-44 (1987).

26. A basic tenet of patent law is that a patent is a right to exclude others from making, using or selling embodiments of the patented invention. An assignment transfers this right to another. *See, e.g.*, CMS Indus., Inc. v. L. P. S. Int'l, Ltd., 643 F.2d 289, 294 (5th Cir. 1981); Bell Intercontinental Corp. v. United States, 381 F.2d 1004, 1019 (Ct. Cl. 1967); Von Brimer v. Whirlpool Corp., 362 F. Supp. 1182, 1192-93 (N.D. Cal. 1973).

27. *See, e.g.*, Pacific Express Inc. v. Teknekron Infoswitch (*In re* Pacific Express, Inc.), 780 F.2d 1482, 1486 (9th Cir. 1986)(executory software license); Lubrizol Enters. v. Richmond Metal Finishers, Inc. (*In re* Richmond Metal Finishers, Inc.), 756 F.2d 1043, 1046 (4th Cir. 1985)(executory technology license), *cert. denied*, 475 U.S. 1057 (1986); Fenix Cattle Co. v. Silver (*In re* Select-A-Seat Corp.), 625 F.2d 290, 292 (9th Cir. 1980)(executory software license); *In re* Chipwich, Inc., 54 Bankr. 427, 430 (Bankr. S.D.N.Y. 1985)(executory trademark license); *In re* Petur U.S.A. Instrument Co., 35 Bankr. 561, 563 (Bankr. W.D. Wash. 1983)(executory patent license). One commentator has concluded that, because a license is a grant of a right to infringe without being sued, it is always executory. *See* Tamietti, *Technology Licenses Under the Bankruptcy Code: A Licensee's Mine Field*, 62 AMER. BANKR. L.J. 295, 302 (1988).

28. *See, e.g.*, *Select-A-Seat Corp.*, 625 F.2d at 292; *In re* Chipwich, Inc., 54 Bankr. at 430; *In re* Petur U.S.A. Instrument, Co., 35 Bankr. at 563.

29. The Fifth Circuit has held that a contract requiring performance by one side only may be an executory contract. Rivercity v. Herpel (*In re* Jackson Brewing Co.), 567 F.2d 618, 623 (5th Cir. 1978).

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If the trustee's rejection constitutes a breach of contract, or the debtor has otherwise breached the contract, the non-debtor party has a claim for damages.[30] In the case of a licensor's or assignor's bankruptcy, this claim gives the non-debtor a right of set-off against any royalties owed to the estate.[31]

If the trustee assumes the contract, the contract should continue as if no bankruptcy had occurred.[32] If the debtor breaches the contract, however, the trustee may only assume it after meeting the following requirements: curing the default or providing adequate assurance of a cure, compensating the non-debtor party for pecuniary loss from the default, and providing adequate assurance of future performance.[33] The trustee may assign an assumed contract to a third party, regardless of contractual restrictions, unless applicable non-bankruptcy law excuses the non-debtor from accepting performance from a third party.[34]

The attitude of a non-debtor faced with a trustee's option to reject or assume a technology license depends on whether the non-debtor is licensor or licensee. As discussed in sections III and IV below, when one party to a license becomes a debtor in bankruptcy, the non-debtor will typically not want the trustee to have an option. A licensee whose licensor files bankruptcy will prefer the license to continue without rejection by the trustee. A licensor whose licensee files bankruptcy will prefer the license to terminate without the trustee having an option to assume or assign it.

c. The Business Judgment Rule

The trustee must show a sound business reason to obtain court approval for assuming or rejecting a contract.[35] The issue is couched primarily in terms of benefit to the estate, rather than harm to the non-debtor.[36]

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30. *Id.*

31. *See* Ambulance Corp. of Am. v. Schweiker (*In re* Ambulance Corp. of Am.), 27 Bankr. 910, 912 (Bankr. E.D. Pa. 1983).

32. 11 U.S.C. § 365(b) (1982 & Supp. V 1987).

33. *Id.*

34. *Id.* § 365(c),(f); *see also In re* Pioneer Ford Sales, Inc., 729 F.2d 27, 29 (1st Cir. 1984).

35. *In re* Norquist, 43 Bankr. 224, 231 (Bankr. E.D. Wash. 1984); *see also* Robertson v. Pierce (*In re* Chi-Feng Huang), 23 Bankr. 798, 800 (Bankr. 9th Cir. 1982)(application of business judgment rule).

36. *See Chi-Feng*, 23 Bankr. at 801; *see also* Borman's, Inc. v. Allied Supermarkets, Inc.,

Rejections of executory technology transfer agreements by a trustee of a licensor in bankruptcy have raised concern about the business judgment rule because the harm to the non-debtor licensee due to a rejected license can be devastating.[37] Nevertheless, the business judgment rule prevails.[38] Only in rare cases will a court refuse to approve the trustee's decision to assume or reject, usually on a showing of disproportionate impact on the non-debtor, or that the trustee's decision was in bad faith or in gross abuse of business discretion.[39] The harsh effects of the business judgment rule have been ameliorated by recent legislation, however, as discussed in section III below.

D. *Property of the Bankruptcy Estate Subject to a Security Interest*

1. What Property is the Collateral?

A non-debtor generally hopes for two advantages in having a security interest: the ability to foreclose on the collateral and an enhanced likelihood to prevent financial loss. In connection with technology transfer agreements, the prospect of actually realizing these advantages determines the subject matter of the security interest. In other words, whether the interest should be in the technology itself or in more conventional things such as inventories and accounts receivable. The purpose of having a security interest in the technology itself is obtaining possession of the technology in the event of bankruptcy of the other party. This is the likely goal of an assignor who has assigned technology and wants it back or of a licensee who wants to continue to exploit the technology.

A security interest in other assets of the debtor furthers the goal of raising the non-debtor's status from that of an unsecured creditor to a secured creditor, thereby enhancing recovery of a damage claim. This could be a motivation of an assignor or licensor who might lose royal-

706 F.2d 187, 189 (6th Cir. 1983), *cert. denied*, 464 U.S. 908 (1983); Control Data Corp. v. Zelman (*In re* Minges), 602 F.2d 38, 43 (2d Cir. 1979).

37. *See* Lubrizol Enters. v. Richmond Metal Finishers (*In re* Richmond Metal Finishers), 756 F.2d 1043, 1046-47 (4th Cir. 1985)(rejection of technology license approved), *cert. denied*, 475 U.S. 1057 (1986).

38. *Lubrizol*, 756 F.2d at 1048. Some courts have expressed a willingness to "balance the equities" to decide whether a trustee may reject a technology license. *See* Infosystems Tech., Inc. v. Logical Software, Inc., Bankr. L. Rep. (CCH) ¶ 71, 639 (1987)(court may consider whether rejection will benefit unsecured creditors).

39. *See In re* Southern California Sound Sys., Inc., 69 Bankr. 893, 899, 900 (Bankr. S.D. Cal. 1987)(rejection of software license not approved); *see also In re* Petur U.S.A. Instrument Co., 35 Bankr. 561, 563 (Bankr. W.D. Wash. 1983)(rejection of patent license not approved).

ties. This could also be a motivation of a licensee who, although continuing to have use of the technology, is damaged by loss of contract rights if a license is rejected.

2. Effect of a Security Interest

The actual advantage of having a security interest in property of the bankruptcy estate is a function of the value of the collateral under the Bankruptcy Code.[40] The value of the collateral has a great effect on the course the secured party will follow through the pendency of the bankruptcy case.

In order to foreclose on collateral in the possession of a debtor, the non-debtor must first obtain relief from stay.[41] Although the requirements for such relief are somewhat different depending on whether the proceeding is under chapter 7 or 11, a frequent issue common to both proceedings is whether the bankruptcy estate has equity in the collateral. The non-debtor must show that the estate has no equity, such as the value of the collateral does not exceed the amount of all liens against it.[42]

In a chapter 7 proceeding, the non-debtor will generally need to show either of two things: there is no equity in the collateral, or the trustee will not be able to sell the collateral in a reasonable period of time.[43]

A chapter 11 proceeding provides two alternative grounds for relief from stay: the "for cause" ground under section 362(d)(1), and the "no equity" ground under section 362(a)(2). Under the "for cause" ground, the cause is usually a lack of adequate protection of the non-debtor's interest in the collateral.[44] The "no equity" ground has two elements: the bankruptcy estate can have no equity in the collateral and no reasonable prospect of a timely reorganization requiring the retention of the collateral in question.[45]

In the absence of a relief from stay, the trustee can sell collateral

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40. 11 U.S.C. § 506(a) (1982).

41. 11 U.S.C. § 362(d) (1982 & Supp. V 1987).

42. Bankers Life Ins. Co. of Nebraska v. Alyucan Interstate Corp. (*In re* Alyucan), 12 Bankr. 803, 810 (Bankr. D. Utah 1981); 11 U.S.C. § 362(d)(2).

43. 11 U.S.C. § 362(d)(2).

44. *Id.* § 362(d)(1).

45. United Sav. Ass'n v. Timbers of Inwood Forest Assoc., __ U.S. __, __, 108 S. Ct. 626, 631-32, 98 L. Ed. 2d 740, 750 (1988); *see also* 11 U.S.C. § 362(d)(2).

subject to the security interest.[46] In a chapter 11 proceeding, the secured claim can be treated in the plan of reorganization, which may effectively "write down" the debt to the value of the collateral.[47]

The great significance of the collateral's value can have unexpected results for the secured party in the context of technology transfers. New technology may be hard to value. This tends to make the outcome of relief from stay difficult to predict and increases the risk of a large "write down" in a plan. Even if relief from stay is granted, foreclosure sales of intellectual property have special problems, such as the difficulty of conducting a commercially reasonable sale or complying with state laws governing foreclosure of intangible property.[48]

The problems associated with security interests in technology could mean that a security interest in the technology itself may disappoint a non-debtor who relies on the security interest to reclaim the technology or gain access to the technology. An assignor may be better off financially with a security interest in other assets that are more easily valued and sold, or a licensee may have other means for access to the technology. In sum, a security interest in the technology is best thought of as desirable, but somewhat unruly, and therefore best supplemented with other protection.

E. *Creation and Perfection of a Security Interest in Technology*

A security interest must withstand scrutiny in the bankruptcy court. If the security interest was improperly created or perfected, the trustee may seek to set it aside, thus leaving the nonbankrupt party with a potentially worthless unsecured claim.[49]

Security interests in connection with technology transfers can take a number of forms depending on the subject matter of the transaction.[50] The Uniform Commercial Code's definitions encompass vari-

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46. 11 U.S.C. § 363(f) (1982 & Supp. V 1987).

47. *See* Bankers Life Ins. Co. of Nebraska v. Alyucan (*In Re* Alyucan), 12 Bankr. 803, 808 (Bankr. D. Utah 1981)(increase in value of collateral may be immaterial); *see also* 11 U.S.C. § 1129(b)(2)(A) (1982 & Supp. V 1987).

48. *See* Bahrick, *Security Interests in Intellectual Property*, 15 A.I.P.L.A. Q.J. 30, 48 (1987)(advising practitioners to check law of jurisdiction in question because of absence of federal laws governing foreclosure of security interests).

49. *See* 11 U.S.C. §§ 544, 547 (1982 & Supp. V 1987).

50. Many helpful articles have been written on this subject, giving practical advice for creating and perfecting security interests in intellectual property. *See generally*, Bahrick, *Security Interests in Intellectual Property*, 15 A.I.P.L.A. Q.J. 30 (1987); Engel & Radcliffe, *Intellectual Property Financing for High-Technology Companies*, 19 U.C.C. L.J. 3 (1986); Feldman,

ous types of security interests that may be created in connection with technology transfers. Patents, copyrights and trademarks are general intangibles.[51] On the other hand, physical embodiments of patents and copyrights are goods.[52] This distinction is important in determining how to create and perfect the security interest.[53]

If the security is to be a patent, copyright or trademark, the proper manner of creating it is generally governed by the Uniform Commercial Code of the state in which the debtor does business or, if goods are involved, the location of the goods.[54] Certain federal laws, however, may require a federal filing as a means of perfection or at least encourage a federal filing as discussed below.[55]

A security interest in a patent may be structured as a conditional assignment, and it therefore falls within the rule that assignments must be recorded in the U.S. Patent and Trademark Office.[56] Whether a conventional security interest constitutes an "assignment, grant or conveyance" within the meaning of the Patent Office's mandatory recordation requirement is unclear. This raises the possibility that the federal filing system preempts the state UCC-1 filing system for perfection of such interests. Although the rule seems to be that state rather than federal filing is required,[57] the cautious party

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Bankruptcy of Software Licenses: Some Proposed Drafting Solutions, 5 COMPUTER LAW. 13 (May 1987); Freed, *Security Interests in the Computer Age: Practical Advice for the Secured Lender*, 101 BANKING L.J. 404 (1984); Handler & Lin, *How to Perfect Security Interests in Patents, Trademarks, and Copyrights*, 11 U.C.C. L.J. 346 (1979); Morris & Arnold, *Protection of Interests in Licensed or Assigned Intellectual Property*, 69 J. PAT. OFF. SOC'Y. 525, 544-50 (1987).

51. U.C.C. § 9-106 (1977); *see also* United States v. Antenna Sys., Inc., 251 F. Supp. 1013, 1016 (D.N.H. 1966)(trade secrets); *In re* C.C. & Co., 86 Bankr. 485, 487 (E.D. Va. 1988)(trademarks).

52. U.C.C. § 9-105(1)(h) (1977).

53. *See* Bahrick, *Security Interests in Intellectual Property*, 15 A.I.P.L.A. Q.J. 30, 30-34 (1987)(discussing intellectual property as collateral for secured transactions).

54. U.C.C. § 1-105 (1977); *see also* Bahrick, *Security Interests in Intellectual Property*, 15 A.I.P.L.A. Q.J. 30 (1987).

55. *See* Bahrick, *Security Interests in Intellectual Property*, 15 A.I.P.L.A. Q.J. 30, 37-38 (1987); *see also* Engel & Radcliffe, *Intellectual Property Financing for High-Technology Companies*, 19 U.C.C. L.J. 3, 7 (1986); Feldman, *Bankruptcy of Software Licenses: Some Proposed Drafting Solutions*, 5 COMPUTER LAW. 13 (May 1987); Morris & Arnold, *Protection of Interests in Licensed or Assigned Intellectual Property*, 69 J. PAT. OFF. SOC'Y 525, 544-50 (1987).

56. 35 U.S.C. § 261 (1982); *see also* CMS Indus., Inc. v. L. P. S. Int'l, 643 F.2d 289, 295 (5th Cir. 1981). Other interests may also be recorded. 37 C.F.R. § 1.331 (1986).

57. *See* City Bank & Trust Co. v. Otto Fabric, Inc., 83 Bankr. 780, 782, 784 (D. Kan. 1988); *see also In re* Transportation Design & Tech., Inc., 48 Bankr. 635, 639 (Bankr. S.D. Cal. 1985).

will record any security interest in both locations. Additionally, a security interest can also be taken in trade secrets; however, it can only be perfected with a state filing as there is no federal registration system for such things.

The Copyright Act governs security interests in copyrights.[58] Security interests in copyrights are probably best perfected with a filing in the Copyright Office as well as a state UCC-1 filing. There is some confusion over which filing is truly effective, though most commentators agree that the federal filing is sufficient.[59] If the copyright is not registered, however, a state UCC-1 filing may be necessary[60].

Trademark security interests raise a question about whether or not the rule of trademark law prohibiting sales in gross is violated. Apparently, the issue is more: what must occur after default in order for the secured party to realize the security?[61] To help ensure a valid foreclosure, a secured party who takes a security interest in a trademark should also have security in other assets that will enable it to accompany a foreclosure of the trademark with the debtor's goodwill.[62]

Trademark security interests also raise the question of whether the federal recordation system preempts state filing.[63] The rule seems to be that state, rather than federal, filing is required.[64] The cautious party will use the federal recordation, in addition to the traditional state UCC-1 filing, lest the perfection be found invalid for federally registered trademarks. If the trademark has not been federally regis-

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58. 17 U.S.C. § 301(a) (1982).

59. *See, e.g.*, Bahrick, *Security Interests in Intellectual Property*, 15 A.I.P.L.A. Q.J. 30, 38-39 (1987); Bransom, *Intellectual Property as Collateral—Patents, Trade Secrets, Trademarks and Copyrights*, 36 BUS. LAW. 1567, 1581 (1981): Hemnes & Montgomery, *The Bankruptcy Code, The Copyright Act, and Transactions in Computer Software*, 7 COMPUTER L.J. 327, 368-71 (1987).

60. *See* Bahrick, *Security Interests in Intellectual Property*, 15 A.I.P.L.A. Q.J. 30, 47 (1987).

61. *See, e.g.*, Patterson Laboratories, Inc. v. Roman Cleanser Co. (*In re* Roman Cleanser Co.), 802 F.2d 207, 211 (6th Cir. 1986)(security interest did not violate assignment in gross rule); *see also* Haymaker Sports, Inc. v. Turian, 581 F.2d 257, 261 (C.C.P.A. 1978)(after default only legal title passed to secured party who could not convey valid interest to third party); Lil' Red Barn, Inc. v. Red Barn Sys. Inc., 322 F. Supp. 98, 107 (N.D. Ind. 1970)(merely granting security interest is not abandonment of trademark).

62. *See* Bahrick, *Security Interests in Intellectual Property*, 15 A.I.P.L.A. Q.J. 30, 35-36 (1987).

63. *See* 15 U.S.C. § 1060 (1982)(federal trademark recordation statute).

64. *See In re* C.C. & Co., 86 Bankr. 485, 486 (E.D. Va. 1988).

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tered, a security interest may only be perfected with a state [65]

F. *The Trustee's Powers to Avoid Transfers*

The trustee in a bankruptcy enjoys some extraordinary powers with which to recover assets from non-debtors for the estate. Each of these deal with transfers, which include assignments and the taking of security interests, but could include other transactions.[66] The most important of these powers are discussed below.

1. Strongarm Powers

Section 544(a) of the Bankruptcy Code, known as the "strongarm" law, gives the trustee the status of a hypothetical creditor who holds a judgment obtained as of the date of the bankruptcy filing, which is fully perfected under state law against real and personal property.[67] With this hypothetical status, the trustee may set aside unperfected transfers and security interests, including unrecorded patent assignments.[68] Thus, in bankruptcy, as a practical matter, a security interest must be perfected to have any efficacy, as must an outright assignment.

2. Preferences

A trustee may set aside, i.e. "avoid," transfers of property by the debtor for or on account of an antecedent debt where the transfer has been made within ninety days of the bankruptcy filing, i.e. a "preference."[69] Possible voidable preferences are the taking of a security interest or the reversion of an assignment within the ninety day preference period in the absence of statutory exceptions.[70] Payments made by a licensee, under a license made to settle a lawsuit, could be set aside as a preference.[71]

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65. Heine-Geldern v. ESIC Capital, Inc. (*In re* Magnum Opus Elecs. Ltd.), 19 U.C.C. Rep. Serv. (Callaghan) 242, 243-44 (S.D.N.Y. 1976).

66. *See* 11 U.S.C. § 101(50) (Supp. V 1987)(defining transfers).

67. 11 U.S.C. § 544(a)(1),(2) (1982 & Supp. V 1987).

68. 11 U.S.C. § 550 (1982 & Supp. V 1987); *see also In re* Transportation Design & Tech., Inc. 48 Bankr. 635, 639 (Bankr. S.D. Cal. 1985)(trustee may set aside unrecorded patent assignments).

69. 11 U.S.C. § 547(b) (1982 & Supp. V 1987).

70. *See* Margraff v. Gruber Bottling Works, Inc. (*In re Gruber Bottling Works, Inc.*), 16 Bankr. 348, 351 (Bankr. E.D. Pa. 1982)(granting of security interest can be voidable preference).

71. *See* Hickey v. Nightingale Roofing, Inc., 83 Bankr. 180, 184-85 (D. Mass. 1988)(con-

3. Fraudulent Conveyances

Transfers must be made for "reasonably equivalent value" and must not have been made to hinder, delay or defraud any other entity to whom the debtor owes money on or after the transfer in question.[72] A license created under either of these circumstances is vulnerable to attack by the trustee as a fraudulent conveyance.[73]

III. THE TRANSFEREE'S POINT OF VIEW: BANKRUPTCY OF THE TRANSFEROR

A. *Concerns of a Potential Transferee*

Technology transfers, by their very nature, are often transfers from a technology owner who is not financially established. The potential transferor may be, for example, a start-up company or some other creative, but less than prudential, wunderkind that developed a promising patent or computer software.

In this context, the potential transferee is going to have legitimate worries. Its primary concern is that its use of the technology not be interfered with if the transferor files bankruptcy.

B. *Treatment of Licenses of Patents, Copyrights and Trade Secrets Under Section 365(n) of the Bankruptcy Code*

Technology licensees benefit from the recently enacted section 365(n) of the Bankruptcy Code which alleviates the risk of rejection of licenses by the trustee. Prior to its enactment, the trustee could reject the license if a licensor filed bankruptcy. This prevented the licensee from using the technology or requiring the licensee to negotiate a new license. The business judgment rule was small protection for the licensee.[74] In a worst case scenario, the trustee could not only

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struction litigation settlement is a voidable preference); Gold v. Kubick: *In re* Redway Cartage Co., 84 Bankr. 459, 462 (Bankr. E.D. Mich. 1988)(payments made pursuant to lease settlement are voidable preferences).

72. 11 U.S.C. § 548(a)(1) (Supp. V 1987).

73. This is so even though the trustee is the debtor-in-possession, the post-bankruptcy incarnation of the debtor, or the other party to the fraudulent scheme. This is so because the debtor-in-possession is deemed to be acting on behalf of the estate's creditors, rather than for its own benefit. *See* Lustig v. Sweden Broadcasting Co. (*In re* Four Score Broadcasting, Inc., 77 Bankr. 404, 407 (Bankr. W.D.N.Y. 1987)(debtor-in-possession has duty to preserve estate assets); *see also* Frankel v. Frankel (*In re* Frankel), 77 Bankr. 401, 404 (Bankr. W.D.N.Y. 1987)(corporate officer committed fraud while in fiduciary capacity).

74. *See supra* notes 36-40 and accompanying text.

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reject the license but also re-license the technology to a competitor of the now productless licensee. This left the licensee with only an unsecured claim for damages.[75]

Section 365(n) was enacted in response to these concerns of licensees. Recognizing the limitations of assignments as an alternative means for technology transfers, the drafters sought to reinforce the efficacy of technology licensing.[76] A discussion of the law's provisions follows.

1. Definition of "Intellectual Property" Under Section 365(n)

"Intellectual property" as defined in section 365(n) can be used in connection with any a number of listed technologies: a trade secret; an invention, process, design or plant protected under title 35; a patent application; a plant variety; a work of authorship protected under title 17; or a mask work protected under chapter 9 of title 17.[77] This definitional list is exclusive, unlike many other definitions in the Bankruptcy Code.[78]

Conspicuously absent from the list are trademarks. This presumably means that trademark licenses are not within the new law. Trademark licenses in bankruptcy are discussed below, but because of their exclusion from section 365(n), the new law is more appropriately designated in terms of rights to technology, as opposed to intellectual property.

2. Section 365(n) Applies Only to Executory Contracts

Section 365(n) applies only to contracts that are executory at the

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75. *See* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc. (*In re* Richmond Metal Finishers), 756 F.2d 1043, 1048 (4th Cir. 1985), *cert. denied*, 475 U.S. 1057 (1986).

76. Intellectual Property Licenses In Bankruptcy Act, Pub. L. No.100-506, § 1(b), 102 Stat. 2538 (1988)(codified as amended at 11 U.S.C.A. § 365(n) (West Supp. 1989)). The Senate Report pointed out that the *Lubrizol* decision allowed valuable rights to revert to the bankruptcy estate at the expense of the licensee, " . . . [leaving] licensees in a precarious position and thus [threatening] the very flexible and beneficial system of intellectual property licensing which has developed in the United States." S. REP. NO. 505, 100th Cong., 2d Sess. 3, *reprinted in* 1988 U.S. CODE CONG. & ADMIN. NEWS 3200, 3201.

77. 11 U.S.C.A. § 101(52),(53) (West Supp. 1989).

78. *Cf.* 11 U.S.C. § 101(30) (Supp. V 1987)(items that comprise "insider"); 11 U.S.C. § 101(43)(A) (Supp. V 1987)(items that comprise "security"). *But see* 11 U.S.C. § 101(18) (Supp. V 1987)(precise definition of "family farmer"); 11 U.S.C. § 101(5) (1982)(definition of "commodity broker"); 11 U.S.C. § 101(48) (Supp. V 1987)(definition of "stockbroker"). These are all terms used in specialized provisions of the code.

https://commons.stmarytx.edu/thestmaryslawjournal/vol21/iss1/7

Livingston and Clark: Technology Transfers: What If the Other Party Files Bankruptcy.

time bankruptcy is filed.[79] Thus, a licensee who wants to benefit from section 365(n) should avoid inadvertently causing a contract to become nonexecutory. The manner of payment to the licensor could be determinative in whether the contract is executory; for example, a fully paid up license may not be executory.

If a license affecting the technology is not executory, so that section 365(n) does not apply, the technology belongs outright to the trustee, who can sell the technology under section 363, even to a competitor. Accordingly, it is in the licensee's best interest not to front load payments for a license. This could make a contract nonexecutory by the time the trustee decides to reject.

3. The Licensee's Choices When the Trustee Rejects the License

The trustee may still reject a technology license under the new law, but the trustee can no longer unilaterally deprive the licensee of its rights to the technology that was the subject matter of the license as occurred in the *Lubrizol* case. Now, the licensee has a choice between damages and retention of the rights to the property when the trustee rejects.

a. Choice Number One: Treat the License as Terminated and Claim Damages Under the *Lubrizol* Version of Section 365

Under some circumstances, it may be best for the licensee to let go of the technology. The technology may not be valuable relative to the continued royalty cost. The licensee may even owe back royalties and prefer to offset that liability with damages owed to it as a result of rejection. The licensee may accordingly "treat [the] contract as terminated by such rejection."[80]

b. Choice Number Two: Pay Royalties and Retain Rights to the Intellectual Property

If the licensee needs the technology, section 365(n) gives it a course of action. The licensee may still attempt to prevent rejection under the business judgment rule, but section 365(n) is more likely to produce a favorable result.

79. 11 U.S.C. § 365(n) (Supp. V 1987).
80. 11 U.S.C.A. § 365(n)(1)(A) (West Supp. 1989).

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4. What Rights are Retained?

a. Rights to the Intellectual Property

In general, the licensee will retain the "rights . . . to such intellectual property"[81] in accordance with the grant of the license but must pay royalties to the trustee.[82] This language could arguably lead to confusion about what rights survive rejection, but the key words are "rights . . . to such intellectual property." It appears that the familiar granting terms of a license, such as the right to "make, use, and sell" an invention, are rights protected from rejection.[83]

Other covenants, though incident to the license, will not survive rejection unless they define the licensee's right to exploit the technology. Exclusivity provisions in the license can still be enforced after rejection, however, because section 365(n) expressly preserves this covenant.[84] Therefore, the trustee cannot re-market the technology to someone else in the face of an exclusivity clause.[85]

b. Supplementary Agreements

Supplementary agreements to a technology transfer may also grant rights to the technology. Frequently, there are escrow arrangements or other supplementary agreements associated with licenses, which must be viable if the rights retained under section 365(n) are to have continuing utility. The right to retain, therefore, extends not only to rights under the license itself but also to rights to the technology that arise under appropriate supplemental agreements.[86] Thus, source code escrow agreements will survive rejection to the extent they provide the licensee with contingent access to the technology.

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81. *Id.* § 365(n)(1)(B).

82. *Id.* § 365 (n)(2)(B).

83. *See id.* § 365(n)(1)(B).

84. *Id.*

85. 11 U.S.C. § 365(n)(1)(B) (West Supp. 1989). A frequent concern after the *Lubrizol* decision was that licensors would file bankruptcy, reject their licenses, then re-license the same technology at a premium to a competitor (or back to the original licensee who would pay a premium to prevent such a result).

86. 11 U.S.C.A. § 365(n)(1)(B) (West Supp. 1989). "This bill is intended to restore confidence in the system of intellectual property licensing, and courts interpreting it should be sensitive to the reasonable practices that have and will evolve among parties . . . ." S. REP. No. 505, 100th Cong., 2d Sess. 9, *reprinted in* 1988 U. S. CODE CONG. & ADMIN. NEWS 3200, 3207.

c. Property in the Possession of the Trustee

The licensee does not always physically possess the technology when the trustee rejects, and the licensee elects to retain its rights. In such situations, the trustee must deliver the intellectual property itself and any embodiments, such as prototypes, drawings, source codes and the like.[87]

5. Important Limitations of Section 365(n)

Section 365(n) seeks to balance the competing concerns for promoting reorganization and securing a reliable licensing mechanism. There are, therefore, certain limitations on the "retention of rights" option, which the licensee should be familiar with.

a. "As such rights existed immediately before the case commenced"

Section 365(n) describes the retained rights "as such rights [that] existed immediately before the case commenced."[88] Thus, once the trustee has rejected the license and the licensee has made the election to retain, the scope of the rights retained is no more than those rights in existence the moment before the bankruptcy was filed. There is no surviving right to upgrades, improvements, completed prototypes, or finished products made after the bankruptcy filing.

This limitation has particular importance to development agreements. The licensee's rights under the agreement could be curtailed by the bankruptcy filing to the extent such agreements are treated as licenses subject to this new law. If prototypes are only half finished on filing, that is all the licensee will be entitled to receive if the trustee rejects.[89] The trustee may complete the technology development after the filing, but the licensee will have no right to demand the finished product. If the agreement failed to contain an exclusivity clause, the completed technology will then be available for licensing by the trustee to anyone, notwithstanding the development agreement. The consequences of bankruptcy on development agreements may still be quite serious, notwithstanding the new law.

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87. 11 U.S.C.A. § 365(n)(3)(A); *see also* S. REP. NO. 505, 100th Cong., 2d Sess. 10, *reprinted in* 1988 U. S. CODE CONG. & ADMIN. NEWS 3200, 3208.

88. 11 U.S.C.A. § 365(n)(1)(B).

89. *Id.*

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b. Waiver of Setoff Rights

The election to retain the rights to use the technology after the trustee's rejection of the license is an automatic waiver of any common law setoff rights.[90] Rejection often generates damages for breach of contract. These damages would otherwise be deductible from royalty payments due the trustee. This reduces or eliminates payments to the trustee.[91] The new law frees those royalties from such offsets and recognizes that the estate may need the royalty payments for its reorganization effort.[92]

c. Waiver of Administrative Priority Claims

The same policy behind the waiver of setoff rights also motivates a waiver of administrative priority claims. During a bankruptcy case, a non-debtor party may usually recover actual and necessary costs of preserving the estate ahead of other unsecured creditors.[93] Licensees do not normally incur expenses of this type, but the new law anticipates the variety of relationships that may evolve around a simple licensing arrangement.

d. Avoidance Powers

The prohibition in section 365(n)(3) and (4) on the trustee's "interfering" with the licensee's use of the intellectual property does not prevent the trustee from pursuing any of its avoidance powers under the Bankruptcy Code.[94] Therefore, the licensee is vulnerable if it received a preference or fraudulent conveyance.

6. Other Covenants in the License

Although the granting terms of a license will survive rejection, numerous other covenants often found in licenses will not. The statute excludes the right to seek specific performance of any of the trustee's

90. *Id.* § 365(n)(2)(C)(i).

91. *See supra* text accompanying notes 30-31.

92. S. REP. NO. 505, 100th Cong., 2d Sess. 10, *reprinted in* 1988 U. S. CODE CONG. & ADMIN. NEWS 3200, 3207. "This represents a careful compromise between the needs of the debtor and the licensee." *Id.*

93. 11 U.S.C. § 503(b)(1)(A) (1982 & Supp. V 1987); *see also In re* Patch Graphics, 58 Bankr. 743, 745 (Bankr. W.D. Wis. 1986)(administrative expenses must be used to preserve estate).

94. S. REP. NO. 505, 100th Cong., 2d Sess. 11 *reprinted in* 1988 U. S. CODE CONG. & ADMIN. NEWS 3200, 3208; *see also* 11 U.S.C. §§ 544-549 (1982 & Supp. V 1987).

duties under the license, except those specifically allowed by section 365(n).[95] The licensee still has the right to file a claim in bankruptcy for any damages arising from the trustee's rejection of the license.[96] The licensee may want to negotiate a security interest in the licensor's inventory, receivables or contract rights to secure this possible damage claim. The security interest may also extend to the subject matter of the license.

The fact that these other covenants do not survive rejection raises questions about how, and by whom, a patent or copyright will be defended or enforced. With respect to defending infringement claims, although section 365(n) is silent on the issue, its legislative history expressly states that "[i]f the license provided the licensee a right to defend such a[n] [infringement] claim . . . that is one of the rights which this bill would protect."[97] Thus, with respect to enforcement, the rejecting trustee is excused from bringing an infringement action. The licensee, who has an incentive to see that such actions are brought, would appear to lack standing to bring such a suit, at least without the joinder of the trustee as co-plaintiff.[98]

Although trade secrets are within section 365(n), a nettlesome problem unaddressed by the statute is whether the secrecy that is so integral to the technology is a "right to the technology" or whether confidentially covenants are rejected. After a trustee rejects a trade secret license, the trustee may no longer believe it important to "keep the secret." Even if such a duty was owed under the license, the trustee's rejection excuses it from performance of that duty.[99] The

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95. *See* 11 U.S.C.A. § 365(n)(1)(B) (West Supp. 1989).

96. 11 U.S.C. § 365(g) (1982 & Supp. V 1987); S. REP. NO. 505, 100th Cong., 2d Sess. 10 *reprinted in* 1988 U. S. CODE CONG. & ADMIN. NEWS 3200, 3207.

97. S. REP. NO. 505, 100th Cong., 2d Sess. 9, *reprinted in* 1988 U.S. CODE CONG. & ADMIN. NEWS 3200, 3206.

98. *See, e.g,* Gilson v. Republic of Ireland, 606 F. Supp. 38, 42 (D.D.C. 1984)(nonexclusive patent licensee lacks standing to sue for infringement); DEP Corp. v. Interstate Cigar Co., 622 F.2d 621, 623 (2d Cir. 1980)(exclusive trademark licensee lacked standing to sue for infringement); Silverstar Enters., Inc. v. Aday, 537 F. Supp. 236, 240 (S.D.N.Y. 1982)(exclusive trademark licensee lacks standing to sue for infringement). Under patent law, an exclusive licensee has standing to sue and nonjoinder issues are resolved by general rules of procedure. *See* Water Techs. Corp. v. Calco, Ltd., 576 F. Supp. 767, 771-73 (N.D. Ill. 1983).

99. 11 U.S.C. §§ 365(g), 502(g) (1982 & Supp. V 1987). An earlier draft of the statute required the trustee, even after rejection, to maintain the confidentiality of trade secrets, but the bill was reported out of committee without this language and it is absent from the enacted legislation. 100 CONG. REC. S11654 (daily ed. Aug. 7, 1988)(remarks of Sen. DeConcini); *see also Senate Bill would Protect Technology Licensees If Licensor Goes Bankrupt*, PAT. TRADE-

cautious licensee will affirmatively seek protection for its trade secret under section 107 of the Bankruptcy Code.[100]

a. What Happens Before the Trustee Decides to Assume or Reject?

Under section 365(n), even before rejection, the trustee must turn over to the licensee the technology it possesses, including embodiments, and must not interfere with the licensee's continued use of the technology.[101] The trustee, however, is not compelled to furnish anything more than the intellectual property in its state as of the filing of the bankruptcy.[102] Thus a trustee does not have to furnish updates, improvements, or the like, nor does the trustee have to honor maintenance or "debugging" agreements.

Section 365(n) is silent about the trustee's remedy if the licensee ceases to pay royalties, either before rejection, or after rejection and a section 365(n) election. Section 365(n) imposes an affirmative duty to pay royalties only in the latter situation, but a similar duty is implicit before rejection. The best assumption is that, if the licensee fails to perform post-petition, the trustee will be excused from further performance, just as would be the case under applicable non-bankruptcy law.

b. What if the Trustee Sells the Technology?

One concern of the licensee is assignment to a third party when the trustee has assumed the license. Under general contract and property law, the license might not be considered personal to the licensor, and therefore, it is assignable. Nevertheless, the trustee's assignment of the technology to a third party with notice should not affect the licensee's legal rights. This is the result of section 363 and substantive intellectual property law, which requires an assignee to take subject to

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MARK & COPYRIGHT J. (BNA) No. 34, at 378 (Aug. 13, 1987); *Senate Judiciary Committee Approves Bill on Technology Licencing and Bankruptcy*, PAT. TRADEMARK & COPYRIGHT J. (BNA) No. 36, at 404 (Aug. 18, 1988).

100. 11 U.S.C. § 107 (1982); *see also* BANKR. R. 9018 (Supp. V 1987). Some courts may insist instead that the licensee seek this relief by way of injunction. To avoid problems with the automatic stay, such an injunction should be sought from the bankruptcy court, which enjoys jurisdiction sufficiently broad to grant such relief. Franklin Computer Corp. v. Apple Computer, Inc. (*In re* Franklin Computer Corp.), 60 Bankr. 795, 799 (Bankr. E.D. Pa. 1986).

101. 11 U.S.C.A. § 365(n)(4)(A), (B) (West Supp. 1989).

102. *Id.* § 365(n)(3), (4).

the licenses previously granted by an assignor.[103]

On the other hand, after rejection, a trustee's sale of licensed technology was apparently not anticipated by the drafters of section 365(n). Only the provisions of section 365(n)(3) give the licensee any continuing rights to exploit the technology with the license rejected.[104] If the trustee rejects the license and the licensee elects to retain its rights to the technology, what happens if the trustee then decides to sell the technology? In some situations, it might be arguable that the license is now terminated.[105] In the absence of a termination issue, the question is whether the licensee will be able to enforce its rights under section 365(n) against a third party who purchases the technology from the trustee. The express terms of the statute seem to make the licensee's right of retention enforceable only against the trustee.[106]

By analogy to section 365(h), perhaps the third party purchaser would be bound to honor the licensee's statutory rights.[107] In a case involving leases, a third party mortgagee took over the debtor's apartment complex under a confirmed plan of reorganization. The plan had rejected a lease of the laundry room, but the lessee was entitled to the protections granted non-debtor lessees by section 365(h), including the right to remain in possession of the premises. The court held that the lessee was entitled to those protections even though the mortgagee, the successor in title to the apartment complex, intended to evict.[108]

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103. *See* Standard Oil Co. v. Clark, 163 F.2d 917, 930 (2d Cir. 1947). *See generally* E. Lipscomb, Walker on Patents § 19:22 (3d ed. 1986)(rights of assignees).

104. 11 U.S.C.A. § 365(n)(3) (West Supp. 1989).

105. *See* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc. (*In re* Richmond Metal Finishers, Inc.) 756 F.2d 1043, 1048 (4th Cir. 1986), *cert. denied*, 475 U.S. 1057 (1986)(trustee's rejection is statutory breach). *But see* Fenix Cattle Co. v. Silver (*In re* Select-A-Seat Corp.), 625 F.2d 290, 292-93 (9th Cir. 1980)(suggesting license not terminated by trustee's rejection).

106. 11 U.S.C.A. § 365(n)(3) (West Supp. 1989) reads as follows:

> (3) If the licensee elects to retain its rights, . . . then on written request of the licensee *the trustee shall* — (emphasis added)
>
> (A) . . . provide to the licensee any intellectual property (including such embodiment) *held by the trustee*; (emphasis added) and
>
> (B) not interfere with the rights of the licensee . . .

Id.

107. Section 365(h) allows non-debtor lessees whose leases have been rejected by the trustee/lessor to elect to treat the rejection as a termination or to remain in possession of the leasehold premises for the remaining term of the lease. 11 U.S.C. § 365(h) (Supp. V 1987).

108. Solon Automated Servs., Inc. v. Georgetown of Kettering, Ltd. (*In re* Georgetown

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7. Contractual Protection for the Transferee

A licensee's uncertainty about the effect of a sale of technology by a debtor licensor and about being financially compensated for the licensor's default are sufficient to justify anticipatory countermeasures. While not cure-alls, a couple of tactics suggest themselves. One is to return to the devices used before the enactment of section 365(n), such as a full assignment of the technology. Another is to retain a security interest in the technology or other property of the licensor to secure the licensor's performance. Each of these tactics is discussed below.

a. Assignments

Before the enactment of section 365(n), many commentators advised the licensee to bargain for an assignment instead of a license.[109] Assignments sacrifice flexibility and tend to discourage further innovation, but they compensate with certainty. Difficulty lies in drafting assignments that will be construed as assignments and not as licenses by a bankruptcy court. It is the structure of the transaction, rather than formalities and recitations, which results in an assignment rather than a license.[110] The grant must be unrestricted to be an assignment. Anything less than a transfer of all substantial rights is a license, not an assignment.[111] Thus, temporary uses of a patent, leases of patents, and limited term assignments all stand in danger of being treated as licenses. Additionally, the assignment, as opposed to the licensing, of technology operates as a transfer, as that term is used in the Bank-

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of Kettering, Ltd.) 22 Bankr. 312, 315-16 (Bankr. S.D. Ohio 1982). Rejection does not entirely terminate leases, but rather it places a limitation on the remedies available to the non-debtor party. Commercial Fin Ltd. v. Hawaii Dimensions, Inc. (*In re* Hawaii Dimensions, Inc.), 47 Bankr. 425, 427 (D. Haw. 1985); *cf.* Sea Harvest Corp. v. Riviera Land Co., 868 F.2d 1077, 1078-81 (9th Cir. 1989). To the extent the statute preserves certain rights of the non-debtor notwithstanding rejection, it is arguable that third parties taking from the trustee might take subject to those rights. *See In re* Independence Village, Inc., 52 Bankr. 715, 732-34 (Bankr. E.D. Mich. 1985).

109. *See* D. BENDER, 1 COMPUTER LAW: SOFTWARE PROTECTION § 4A.02[3] (1988); *see also* Duffy & Frank, *Roll of the Dice—Is One of the Parties to a Patent License Agreement Facing Chapter 7 or Chapter 11 Bankruptcy?*, 70 J. PAT. OFF. SOC'Y 728, 731-32 (Nov. 1988); Tamietti, *Technology Licenses Under the Bankruptcy Code: A Licensee's Mine Field*, 62 AMER. BANKR. L.J. 295, 303-05 (1988).

110. *See* Agrashell, Inc. v. Hammons Prods. Co., 352 F.2d 443, 446 (8th Cir. 1965).

111. *See* E. LIPSCOMB, WALKER ON PATENTS § 19:12 (3d ed. 1986)(patent assignment conveys exclusive right, or an undivided share of that exclusive right to make, use and sell in the United States).

ruptcy Code, increasing the transaction's exposure to being set aside under the trustee's avoidance powers.[112]

b. Security Interests

Another alternative is to take a security interest to secure the licensor's obligations, either in the technology itself, in the licensor's other assets, or both if possible.[113] In so doing, the licensee "hobbles" the technology, which makes it more difficult to be transferred over the licensee's objections.[114] The licensee also affords itself an additional device with which to maintain access to the technology.

Finally, when the licensee has collateral, the licensee improves the likelihood that claims for damages arising from default of the license, such as from the loss of updates, contracts for maintenance, and the like, will be paid. Rejection by the trustee will often be deemed a default of some covenants, giving vitality to the security interest.[115] If the license has been assumed by the trustee who then defaults, the same result will obtain.

All grants of security interests face certain dangers and limitations in bankruptcy, such as inability to obtain relief from stay, avoidance as a preference, revaluation at a low value, and long-term payout in a plan.[116] Nevertheless, these prospects should not deter the non-debtor from at least trying to obtain such interests as they usually confer favorable leverage.

i. Security Interest in the Technology

If the security interest is in the subject matter of the license and the contract is rejected, the licensee may be able to obtain the technology itself. Assuming the licensor is in default, and the licensee wishes to enforce the security interest to obtain possession of the technology, two events must occur.

First, the licensee, as a secured party, must persuade the bank-

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112. *See supra* text accompanying notes 67-74.

113. *See* Drabkin & Brooks, *Special Problems in Computer Industry Bankruptcies and Workouts*, in LAW LICENSING HANDBOOK § 12.15[i] (1987); *see also* D. BENDER, 1 COMPUTER LAW: SOFTWARE PROTECTION § 4A.02[3] (1988).

114. For example, a sale of technology subject to the licensee's security interest cannot be accomplished without a showing that the licensee will be adequately protected after the sale. 11 U.S.C. § 363(e)-(f) (1982 & Supp. V 1987). *See supra* text accompanying notes 13-15.

115. 11 U.S.C. § 365(g) (1982).

116. *See supra* text accompanying notes 38-60.

ruptcy court to lift the automatic stay to permit foreclosure of the security interest. As discussed above, one ground for obtaining relief from stay is "for cause."[117] For example, the trustee's financial inability to enforce or defend a patent or copyright on behalf of a licensee who lacks standing to do so may be cause for relief from stay. A licensee might also argue that the collateral is inadequately protected because of the vagaries of whether its rights are cut off after the trustee rejects the license and sells the technology to a third party.

Under the second ground for relief from stay, the "no equity" ground, the licensee must first show that the estate has no equity in the collateral.[118] This issue depends on the relative size of the claims against the debtor and the value of the technology. The value of the technology is usually a function of the royalties available from its license or the proceeds from an assignment. The license itself may be instructive as to the value of the technology if the license has already been assumed. If the trustee has not yet made an election, the trustee could argue that the contract is rejectable and worth much more than the income stream being paid by the licensee. The licensee's arguments are situation dependant but will generally be directed to showing that its claims are large and that the technology has no market for an assignment or license to another.

Under the "no equity" ground for relief from stay, in addition to showing a lack of equity in the estate, the licensee must also, as a practical matter, be prepared to show that the technology is not necessary for an effective reorganization.[119] The trustee will likely argue that loss of the technology will eliminate the royalty income stream which is an essential source of cash flow to reorganization. In the case of a nonexclusive license the trustee might also argue that the estate's own use of the technology is necessary for its continued operations. The licensee will argue that, for one reason or another, the trustee's begging for cash flow is an exercise in futility because the reorganization is not possible.

If the stay is lifted, the secured party must then convert its security interest into an ownership interest by foreclosing. This effort presents certain obstacles. A foreclosure sale under U.C.C. section 9.504 permits the licensee to be the successful bidder but exposes the licensee to

117. *See supra* note 44 and accompanying text.

118. *See supra* note 45 and accompanying text.

119. 11 U.S.C. § 362(g) (1982)(burden of proof is on trustee).

competitive bidding from its competitors.[120] The licensee could propose to retain the collateral in satisfaction of the trustee's debt under U.C.C. section 9.505. The trustee could insist on a foreclosure sale, however, if the trustee believes the technology is more valuable than the debt owed against it.

ii. Security Interest in Other Assets

If the licensor's performance is secured by other assets of the licensor, such as inventory, accounts receivable and contract rights, the licensee may get more dollars than with a security interest in the technology. With an after-acquired property clause, a security interest of little or no value at the time the agreement is made may acquire value as the licensor prospers over time. A damage claim will at least have some collateral behind it should bankruptcy intervene.

c. Development Agreements

One type of technology transfer, in which a transferee's apprehensions might not be resolved by the new law, is development agreements. These agreements typically combine a development phase with a subsequent license from the developer who retains ownership of the technology.

There are a number of approaches for protecting the licensee when there is doubt about the availability of protection under section 365(n). First, to decrease the likelihood of having an rejectable executory contract, the contract might include a clear separation of early performance terms from the license terms. The license should not be front-loaded with respect to payments. This could result in losing the benefits of having an executory contract under section 365(n).[121] Additionally, the licensee might require progress reports. To the extent that licensable rights exist when the licensor files bankruptcy, section 365(n) will permit the licensee to define and use them.

Finally, other structures for the development agreement such as including a security interest or simply requiring an assignment from the developer should not be ignored. One caveat is that a post-petition patent might not fall within an after-acquired property clause in a

120. U.C.C. § 9.504 (1977).

121. *See supra* notes 23-29 and accompanying text.

security interest in general intangibles.[122] It is important to carefully define the subject matter of the security in order to properly create and perfect it.

d. Special Considerations for Computer Software and Other Copyrighted Technology

In recent years, before the enactment of section 365(n), the software licensing industry became quite alarmed about the detrimental effect on software licensees of the bankruptcy of the licensor. Many articles were written to suggest ways to protect these licensees.[123] Apart from the contractual protections discussed elsewhere in this paper, copyright licenses for software afford some other interesting alternatives.

One alternative is the creation of a property interest in the licensee.[124] For example, the Copyright Act provides that an exclusive license is a "transfer of copyright ownership."[125] Thus, arguably, an exclusive licensee's interest should require the trustee to deal with the licensee's interest as property under section 362(a).[126] Even if the license agreement is treated as an executory contract, the licensee's interest should not terminate, regardless of assumption or rejection or assignment to a third party with notice.[127] One caveat is that as a result of a copyright licensee's interest a license could be a transfer subject to the trustee's avoidance powers.[128]

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122. *In re* Transportation Design & Tech., Inc., 48 Bankr. 635, 641 (Bankr. S.D. Cal. 1985).

123. *See e.g.*, Bacal, *Computer Software and Service Contracts: Anticipating Vendor and User Bankruptcy*, 2 J.L. & TECH. 183 (1987); Feldman, *Bankruptcy and Software Licenses: Some Proposed Drafting Solutions*, 4 COMPUTER LAW. 13 (1987); Hemnes & Montgomery, *The Bankruptcy Code, the Copyright Act and Transactions in Computer Software*, 7 COMPUTER L.J. 327 (1987);

124. *See* 1 D. BENDER, COMPUTER LAW § 4A.02[3] at 90.2-90.3 (1988); Feldman, *Bankruptcy and Software Licenses: Some Proposed Drafting Solutions*, 4 COMPUTER LAW. 13 (1987).

125. 17 U.S.C.A. §§ 101, 201(d)(2) (West 1977 & Supp. 1989).

126. *See* Rudaw/Empirical Software Prods. Ltd. v. Elgar Elecs. Corp. (*In re* Rudaw/Empirical Software Prods., Ltd.) 83 Bankr. 241, 247 (Bankr. S.D.N.Y. 1988).

127. *See* Feldman, *Bankruptcy and Software Licenses: Some Proposed Drafting Solutions*, 4 COMPUTER LAW. 13 (May 1987).

128. *See* International Horizons, Inc.v. Western Publishing Co. (*In re* International Horizons, Inc.), 15 Bankr. 798, 801. (Bankr.N.D. Ga. 1981)(debtor had sufficient property interest to order turnover). *See generally* Hemnes & Montgomery, *The Bankruptcy Code, The Copyright Act, and Transactions in Computer Software*, 7 COMPUTER L.J. 327, 360-63 (1987)(discussing effect of strong arm clause on exclusive licensee).

Another feature unique to software licenses is the use of escrow agreements. Such agreements are protected by section 365(n) and are a good complement to a security agreement.[129]

e. Trademark Licenses

Trademarks are excluded from section 365(n) because "they raise issues beyond the scope of this legislation."[130] Executory trademark licenses, therefore, continue to be governed by the more general provisions of section 365. This is not surprising considering that trademark licenses do not generally create the same risks as licenses for technology. Typically, a trademark licensor, unlike a patent or software licensor with no technology, will be approached for a license because it already has an established reputation and goodwill.

Due to the nature of trademarks, a trademark licensee's attitude about a trustee's option to assume or reject the license may be entirely different from the predilections of a license of technology such as a patent. In some trademark situations, a licensee might have no objection to a rejection of a licensee to a mark that would cause it to be tarred with perceived "ill will" flowing from the licensor's bankruptcy. Also, the licensor may have lost the financial wherewithal to maintain the quality of the good or service associated with the trademark. In other situations, the licensee may desire to continue using the trademark and want the contract to be assumed.

The trademark laws requiring control over quality by a licensor make it unlikely that a trademark license will ever be considered non-executory. Thus, trademark licenses will be rejectable or assumable depending on the business judgment rule.[131]

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129. *See* Hemnes & Montgomery, *The Bankruptcy Code, The Copyright Act, and Transactions in Computer Software*, 7 COMPUTER L.J. 327, 360-63 (1987).

130. S. REP. NO. 505, 100th Cong., 2d. Sess. 5, *reprinted in* 1988 U.S. CODE CONG. & ADMIN. NEWS 3200, 3204. Specifically, the Senate report states:

> In particular, [their] licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee. Since these matters could not be addressed without more extensive study, it was proposed to postpone congressional action . . . and to allow the development of equitable treatment of this situation by bankruptcy courts.

Id.

131. *See In re* Southern California Sound Sys., Inc., 69 Bankr. 893, 899 (Bankr. S.D. Cal. 1987)(licensor debtor trustee's rejection of trademark license not permitted). *But see In re* Chipwich, Inc., 54 Bankr. 427, 431 (Bankr. S.D.N.Y. 1985)(licensor debtor trustee's rejection of trademark license permitted).

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The licensee is best served by terms that preserve flexibility because the desirability of rejection or assumption of a trademark depends so strongly on the facts at the time the trustee's decision is made. To this end, contract terms that result in making the contract burdensome to the debtor could be asserted or waived by the non-debtor licensee depending on whether the licensee desires assumption or rejection. For example, continuing contractual duties obligating a licensor could encourage a trustee to reject if asserted by the licensee. On the other hand, such terms could be waived by a licensee who wanted to encourage an assumption.

IV. THE TRANSFEROR'S POINT OF VIEW: BANKRUPTCY OF THE TRANSFEREE

A. *Concerns of a Potential Transferor*

From the viewpoint of the party who transfers technology to another in exchange for royalties or other "running" monetary consideration, the bankruptcy of the transferee is likely to result in loss of income. If the transferee liquidates or reorganizes, it may become nonproductive for some indefinite period of time and royalties will cease. This risk is especially troublesome for an assignor or exclusive licensor whose only source of income from the technology is a defunct transferee. These transferors will want to be able to re-assign or re-license the technology to someone else.

Even if a financially troubled transferee continues to make and sell the technology, royalties could cease until the trustee elects to assume the agreement. In a chapter 11 proceeding, this could be until confirmation of the plan.[132] Furthermore, the quality of the debtor's licensed products may decline. This could cause liability for the transferor and damage the goodwill or reputation associated with the technology so that the technology loses value. When trademarks are licensed, the danger of diminished goodwill is especially acute.

For these reasons, if the transferee becomes financially troubled, an assignor would usually like to reacquire the technology. The licensor would prefer that the license simply terminate.

132. The trustee is not required to assume or reject a contract until 60 days after a chapter 7 relief order or until confirmation of a chapter 11 plan. *See* 11 U.S.C. § 365(d)(2) (1982).

B. *Termination and Reversion Clauses*

The apprehensions of potential transferors has led to the use of ipso facto clauses. These clauses provide that, if the transferee files bankruptcy, the license shall terminate or the assignment shall revert. Although the use of such clauses is widespread, section 365 of the Bankruptcy Code makes them unenforceable.[133]

Although the fact of bankruptcy will not terminate a contract, an opportunity often ignored is the inclusion of strong default and termination provisions.[134] The contract should set out the circumstances that will be considered default, provide that such default will result in termination, and set out how termination formalities will occur. If this is done, a nonpaying transferee can be terminated before its poor financial condition causes it to declare bankruptcy. Similarly, an assignment could be written so that nonpayment could result in a reversion to the assignor.

A termination pursuant to a non-debtor's notice of default that has run its full time period is clearly a valid termination.[135] Furthermore, at least one court has held that the non-debtor's giving of notice prior to bankruptcy filing avoids the automatic stay.[136] To ensure timely termination, the licensor could include a provision requiring the licensee to give prior notice of its intent to file bankruptcy.

Thus, if the transferor has termination rights, it must exercise them before filing of the bankruptcy. The automatic stay prevents the transferor from taking any action because of a default by the transferee after filing.[137] Contracts that are executory at the time of filing are subject to the trustee's power to assume or reject.[138] On the other hand, if the contract is timely terminated, post-petition sales by the trustee could be infringement not protected by the automatic stay.

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133. 11 U.S.C. § 365(e) (1982); *see also* 11 U.S.C. § 541(c)(1) (1982 & Supp. V 1987)(property of the estate).

134. *See* Shell Oil Co. v. Anne Cara Oil Co. (*In re* Anne Cara Oil Co.), 32 Bankr. 643, 645 (Bankr. D. Mass. 1983)(prepetition termination of franchise agreement); *see also* LJP, Inc. v. Royal Crown Cola Co. (*In re* LJP, Inc.), 22 Bankr. 556, 558 (Bankr. S.D. Fla. 1982)(prepetition termination of bottler's license). *See generally* Ruben, *Legislative and Judicial Confusion Concerning Executory Contracts in Bankruptcy*, 89 DICK. L. REV. 1029, 1042-45 (1985).

135. LJP, Inc. v. Royal Crown Cola Co. (*In re* LPJ, Inc.) 22 Bankr. 556, 558-59 (Bankr. S.D. Fla. 1982).

136. Shell Oil Co. v. Anne Cara Oil Co. (*In re* Anne Cara Oil Co.), 32 Bankr. 643, 648 (Bankr. D. Mass. 1982).

137. *See supra* notes 3-7 and accompanying text.

138. *See supra* notes 16-22 and accompanying text.

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The transferor with reversion rights must also be careful to avoid a preference.[139] This means that if the reversion is a "transfer of property of the debtor," for an antecedent debt, within ninety days before the bankruptcy petition was filed, the transferor may be forced to surrender the property back to the trustee as a preference.[140]

C. *Assignments*

Probably the worst position for a transferor, where the transferee has filed bankruptcy, is to be an assignor without a security interest. The technology will then be property of the estate, subject to sale to anyone, leaving the assignor with only an unsecured claim for royalties.

On the other hand, an assignor with a security interest in the assigned technology is in a quite favorable position. Upon bankruptcy of the assignee, the assignor may seek a relief from stay so that it can foreclose in accordance with appropriate foreclosure laws.[141] Obtaining relief from stay is never a certainty, but it is highly likely that monetary considerations, such as minimum royalties, could accumulate so there would be no equity in the bankruptcy estate, thus meeting the first element of the "no equity" ground.[142] The second element is probably a function of how critical the technology is to the debtor's operations. In other words, foreclosure is more likely if the technology is only one of several of the licensor's products. On the other hand, if the debtor cannot operate without the technology, relief from stay will be more difficult to get. Relief from stay is also hard to get for a trademark security interest because of the trademark laws prohibiting transfers apart from goodwill.[143] Because there could be lack of adequate protection, relief from stay under the "adequate protection" ground may be possible if the debtor assignee is financially incapable of defending or enforcing the technology.[144] In this regard, word of the assignee's insolvency could, in fact, increase the tendency

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139. Morris & Arnold, *Protection of Interests in Licensed or Assigned Intellectual Property*, 69 J. PAT. OFF. SOC'Y, 525, 531-33 (1987)(discussing risk of voidable preference); *see also In re* Commodity Merchants, Inc., 538 F.2d 1260, 1263 (7th Cir. 1976)(termination of contract is not transfer of property and thus is not voidable preference).

140. *See supra* notes 69-71 and accompanying text.

141. U.C.C. §§ 9-540, 9-505 (1977).

142. *See supra* note 45 and accompanying text.

143. *See supra* notes 61-62 and accompanying text.

144. *See supra* note 44 and accompanying text.

Livingston and Clark: Technology Transfers: What If the Other Party Files Bankruptcy.

of third parties to market products that arguably infringe a patent or to challenge the validity of a patent. The debtor may not be able to sue or defend against these possible infringers.

Even without relief from stay, the assignor, because its security interest gives it a competing property interest, can block the use, sale or lease of the technology until it is assured of protection.[145] The trustee must meet certain requirements for selling the technology to a third party, and any sale will be subject to the security interest.

A security interest in other assets of the assignee should supplement any security interest in the technology. As discussed above, the security interest in other assets may be more financially rewarding to the assignor.

D. *Executory Technology Transfers*

If the technology owner does not wish to transfer the technology by assignment, or if there are to be continuing duties and rights, the transfer agreement will probably be subject to the executory contract provision of section 365 of the Bankruptcy Code.[146]

1. Rejection

Usually, the trustee will not reject the license though it has the option to do so under section 365.[147] Rejection leaves an unsecured licensor in the position of a creditor with a claim for damages but having the right to re-license the technology to someone else. The licensor may need to take steps to ensure that confidentiality is protected.[148] The automatic stay does not protect the trustee if it continues to exploit the technology.[149]

2. Assumption

If the license is a valuable asset of the debtor and is critical to operating its business, the trustee will probably be allowed to assume it, if the trustee meets the requirements of section 365.[150] If the debtor

145. *See supra* note 14 and accompanying text.

146. *See supra* notes 23-29 and accompanying text.

147. 11 U.S.C. § 365(a) (1982 & Supp. V 1987).

148. 11 U.S.C. § 107(b) (1982).

149. *See supra* note 7.

150. *See In re* Luce Indus., Inc., 14 Bankr. 529, 531 (S.D.N.Y. 1981)(assumption of trademark license disapproved).

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licensee is in default, section 365's cure, compensation, and assurance of performance provisions give some protection to the licensor.[151]

3. Assignments to a Third Party

The licensor may successfully oppose assignment of the license to a third party even if the licensor might not be able to prevent the trustee from assuming an executory license. At least two courts in a bankruptcy context have found technology licenses to be personal and therefore not assignable without the licensor's consent.[152]

4. Assignments with Security Interest versus Exclusive Licenses

The problems associated with executory licenses may cause a transferor who is about to grant an exclusive license to consider whether it may be more advantageous to grant an assignment with a security interest and right of reversion. The problems associated with executory licenses should be weighed against the likelihood of reobtaining the technology with relief from stay and foreclosure. Furthermore, an assignment could be of an undivided interest leaving the assignor with some control over the technology.

V. Conclusion

Once the unthinkable, the remote, bankruptcy today is a prospect to contemplate whenever a technology transfer agreement is negotiated. If the parties are to enjoy a happy marriage of their interests, they will be wise to incorporate a little bankruptcy planning into their prenuptial contract. If bankruptcy does ensue, then just as in divorce, the non-debtor will find that to emerge as well-off as possible under the circumstances more can be gained by working within the constraints necessarily imposed by the bankruptcy process, than by angrily denouncing the debtor.

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151. *See supra* notes 32-33 and accompanying text.

152. *In re* Alltech Plastics, Inc., 71 Bankr. 686, 689 (W.D. Tenn. 1987)(patent license); *see also* Harris v. Emus Records Corp., 734 F.2d 1329, 1333-34 (9th Cir. 1984)(copyright license). It may be an open question whether Texas courts would find a contract with a corporation to be personal and non assignable. *See* Pearson, *Assignability of Patent Licenses—A State or Federal Question?* 69 J. PAT. OFF. SOC'Y. 315, 316-18 (1987).