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UNDER THE THEME OF: **REINFORCING A SUSTAINABLE
AND INCLUSIVE BUSINESS ENVIRONMENT**

Challenges of Protecting Intellectual Property (IP) for Fintech and Artificial Intelligence Businesses if the Licensor or Licensee of the IP is in Bankruptcy

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Agenda

- What can happen to IP rights under license agreements when companies become insolvent or bankrupt?
 - Do you lose an IP license if your licensor goes bankrupt?
 - Can you reject or terminate an IP license if your licensor or licensee goes bankrupt?
 - What happens to your rights and what remedies do you have if your license is rejected or terminated?



What is Intellectual Property (IP)?

- IP includes the following:
 - a) Patents – a government grant providing protection to a new and useful product, process, method of doing something, or a design.
Examples – cryptocurrency security system or a computer application for evaluating securities.
 - b) Copyright – a government grant protecting an original work or authorship fixes in any tangible medium of expression.
Examples – books, music, movies, architectural plans and designs, and financial software.
 - c) Trademarks and Service marks – State and Federal laws in the United States provide protection for use of distinctive names, logos, symbols, sounds and trade dress (such as, color/shape combinations) used to identify a business's goods or services and to distinguish them from similar goods or services offered by others. Trademarks and service marks represent the goodwill of the company's brand.
Examples – PayPal, Pitchbook, Uber or a distinctive shape, such as a 747 aircraft or a Coca-Cola bottle.



What is Intellectual Property (IP)? (cont.)

d) Trade Secrets – State and Federal laws in the United States protect confidential information, which provides value.

Examples – Coca-Cola formula, a blockchain improvement, or a customer list.

- What is common to all forms of IP?
 - They are intangible assets. That means the assets that are not physical in nature.
- If IP is not physical in nature, what can you do with it:
 - Sell it.
 - Grant another the right to use it either exclusively (an exclusive license) or along with others (a non-exclusive license).
- IP plays a major role in the global economy because among the major industrial companies of the world the value of intangible assets (that is, good will and innovation) is greater than hard assets (such as buildings, machinery and supplies).



What Is Bankruptcy?

- Bankruptcy law is established to (a) preserve the on-going value of failing businesses (that is debtors) and (b) maximize the investment in the failed businesses made by others (known as creditors). It is regulated in the U.S. by Bankruptcy Courts applying federal law. Bankruptcy law is not regulated state law in the U.S.

The Bankruptcy Process

- In the vast majority of businesses cases, the failing company (that is the debtor) initiates the bankruptcy process by filing a bankruptcy petition with the U.S. Bankruptcy Court. Creditors may also force the debtor into bankruptcy.



What Is Bankruptcy? (cont.)

The Bankruptcy Process (cont.)

- Filing a petition has two immediate effects:
 - First, it creates a separate legal entity, the “bankruptcy estate,” comprising the debtor's assets at the moment of filing, as well as the proceeds of such property and any additional property interests the estate may acquire later. The bankruptcy estate is managed by a bankruptcy trustee as a representative for the creditors of the failing business (that is, the debtor).
 - Second, the petition triggers an automatic stay to preserve the bankruptcy estate until all of the debtor's assets can be collected and its creditors are brought together to adjudicate their rights in the estate. The automatic stay prevents the creditors from initiating or continuing any action against the debtor or the debtor's property. The stay protects the debtor from its creditors, subject to the oversight of the bankruptcy judge.



What Is Bankruptcy? (cont.)

The Bankruptcy Process (cont.)

- * The stay can have severe ramifications for intellectual property owners. For example, they cannot pursue a breach of contract action or an IP infringement action without authorization of the bankruptcy judge presiding over the estate.
- Two ways for debtor to discharge its obligations – liquidation (Chapter 7) and reorganization (Chapter 11):
 - Chapter 7 liquidation – the court appoints a trustee to collect the seller's nonexempt property, sell it, and equitably distribute the proceeds to the creditors.
 - Chapter 11 reorganization – preserves the company as a going concern if doing so would provide more value to the creditors than liquidation. In a reorganization, the debtor retains possession of the company's assets to continue operating the business while developing a plan of reorganization.



IP Under the Bankruptcy Code

- Not all IP is created equal
- Section 101 of the Bankruptcy Laws defines “intellectual property” as the following:
 - 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
 - A mask work protected under Chapter 9 of Title 17
- Note that this definition **does not** include trademarks, trade names or service marks
 - Licensees of trademarks, trade names and service marks are at risk if licensor files bankruptcy



Treatment of IP Under the Bankruptcy Code

- What happens to an IP license agreement if the owner of the intellectual property files a bankruptcy petition
- Is a license agreement an “executory contract”
 - Contract that requires some future or ongoing performance by both parties, where the outstanding obligations for the parties are material
- Examples of material obligations for executory purposes:
 - The obligation of the intellectual property owner to refrain from suing the licensee
 - The obligation of the licensee to account for and pay royalties to the licensor
 - The duty to maintain confidentiality on the part of the licensee
 - The duty on the part of the licensor to indemnify and defend the licensee from infringement claims
- Nonexclusive license agreements - typically considered executory
- Exclusive license agreements - tantamount to sale and non-executory
- Cannot terminate an executory contract during bankruptcy



License Agreements as Executory Contracts

- Section 365 of the Bankruptcy Laws permit:
 - Rejection of the license
 - Assumption of the license
 - Assumption and assignment of the license
- Assumption requires the debtor to:
 - Cure, or provide adequate assurance that the debtor will promptly cure, defaults (subject to certain exceptions not pertinent to this discussion) under the contract
 - Compensate, or provide adequate assurance that the debtor will promptly compensate, the other party to the contract for any actual pecuniary losses resulting from prior defaults
 - Provide adequate assurance of the debtor's ability to fully perform all of its future obligations under the contract
- Assignment requires the assignee to provide adequate assurance of its ability to perform all future obligations under the contract



What Happens When a Licensor Rejects an IP License Agreement?

- Section 365(n) provides that if a debtor rejects an executory contract under which the debtor is a licensor of IP, the licensee may either:
 - Elect to treat the contract as terminated (i.e., breached), and file a proof of claim for damages flowing from the debtor's termination of the contract; or
 - Retain its rights to use the IP under the contract for the duration of the contract and for any extension periods provided for by the contract
- If non-debtor licensee elects to retain its rights to the IP
 - The licensee must continue to make all royalty payments due under the original term of the contract, and any term extensions that the licensee elects to exercise
 - The licensor must, upon written request, comply with contractual requirement to provide the IP to the licensee and must refrain from interfering with the rights of the licensee to the IP
- Recommendation for licensee
 - Be proactive
 - Do not wait for rejection to exercise Section 365(n) rights



Are Any Protections Given to Trademark Licensees?

Leading Case

- In a very important case earlier this year involving the trademark Coolcore, the U.S. Supreme Court recently held that if a bankruptcy trademark licensor rejects a trademark license agreement during bankruptcy proceedings, the trademark licensee does not lose its right to continue using the licensed trademark.



Leading Case

Background

- Tempnology, LLC manufactured and marketing exercise clothing and accessories under the brand name COOLCORE. In 2012, Tempnology granted Mission Product Holdings, Inc. a non-exclusive license to use Tempnology's COOLCORE trademarks in the United States and around the world, and an exclusive license to distribute certain COOLCORE products in the United States. The licensing agreement expired in July 2016.



Leading Case

Background (cont.)

- In September 2015, Tempnology filed for Chapter 11 bankruptcy and asked the Bankruptcy Court to “reject” its trademark licensing agreement with Mission, and the Bankruptcy Court obliged. Both parties agreed that Tempnology’s rejection relieved Tempnology of its duty to perform under the agreement and permitted Mission to bring a damages claim against Tempnology for failing to perform its obligations. But Tempnology also believed that its rejection of the agreement terminated any rights it had granted Mission to use the COOLCORE trademarks.



Leading Case

Background (cont.)

- The Bankruptcy Court agreed with Tempnology, finding the licensing agreement was rescinded upon its rejection, but the Bankruptcy Appellate Panel reversed this decision. On appeal, the First Circuit reversed the Appellate Panel and reinstated the Bankruptcy Court's original decision. The U.S. Supreme Court then agreed to hear the case on appeal.



Leading Case

The Mission Decision

- Section § 365(a) of the Bankruptcy Code allows a debtor who is asking the court for relief from obligations to “assume or reject any executory contract” after they enter bankruptcy, subject to the court's approval. An “assumed” contract obligates both parties to continue their performance. A “rejected” contract relieves the debtor of its duties to perform and allows the other party to the contract to sue the estate of the debtor for damages resulting from the debtor's nonperformance.
- Section 365(g) of the Bankruptcy Code explains that the rejection of an executory contract “constitutes a breach.” So, any debtor who rejects a contract under § 365(a) has breached that contract under § 365(g).



Leading Case

The Mission Decision (cont.)

- Mission argued that under normal contract rules a “breach” by a trademark licensor would not terminate a licensee’s rights. And it argued the result should be the same under the bankruptcy code.
- The U.S. Supreme Court agreed that the term “breach” has the same definition in bankruptcy law as in contract law and so, should not terminate Mission’s rights. The Court explained its conclusion by using a hypothetical from contract law.



Leading Case

The Mission Decision (cont.)

- The Court described a contract leasing a photocopier where the lessor would service the photocopier on a monthly basis. Upon breach of that contract by the lessor, the lessee would not be required to return the photocopier. Rather the lessee would have the option to either keep the photocopier and continue paying the lessor or return the photocopier to avoid future payment. The Court found that the same result follows in bankruptcy law – in other words, a rejection is merely a breach and the consequences of rejection are merely that of a breach, which does not include contract termination.



Leading Case

The Mission Decision (cont.)

- The Court explained that this result applies to trademark license agreements because §§ 365(a) and (g) apply to “any executory contract,” which includes trademark licensing agreements. And while a trademark license requires the licensor to monitor and exercise quality control over the licensee, potentially making a debtor's reorganization more difficult by forcing the debtor to choose between expending scarce resources on quality control or potentially losing a valuable asset, the Court noted that this is simply one of the many burdens intentionally built into the bankruptcy process.



Leading Case

The Mission Decision (cont.)

- The Court also addressed numerous exceptions in § 365 that enumerate specific categories of contracts where a counterparty may retain the contract rights even when the debtor rejects the contract. One of these exceptions – § 365(n) – even carves out copyright and patent licenses, but not trademark licenses. The Court rejected the negative inference that only these specific contracts survived rejection, and in doing so, clarified that each exception was created in response to a judicial determination that a certain contract was terminated due rejection, so the exceptions did not alter the plain meaning of § 365.



Leading Case

The Mission Decision (cont.)

- Finally, the Court grounded its decision in policy, citing the general bankruptcy rule that “the estate cannot possess anything more than the debtor itself did outside of bankruptcy.” The Court notes that a contrary holding – allowing termination upon rejection – would not only run afoul of this basic bankruptcy principle, but it would also undermine the exceptional cases where a bankruptcy trustee may legally undo pre-bankruptcy transfers, called “avoidance,” by making rejection the functional equivalent of avoidance,



Chapter 15 and Foreign Insolvency Proceedings

- Permits U.S. recognition of foreign insolvency proceeding
- What happens if the foreign jurisdiction does not protect IP license rights as per Section 365(n)
- The Fourth Circuit held that Section 365(n) should be applied in Chapter 15 cases to protect a licensee from a foreign debtor-licensor seeking to reject an IP license



Strategies

- Prior to any bankruptcy filing, review the company's existing IP license agreements to ensure that the company is protected
- If a bankruptcy is filed, consult with bankruptcy counsel If the company is a licensee under an IP license agreement, and if the licensor files
 - Review the agreement and make a determination as to whether it is executory
 - If the agreement is executory, the company must decide whether it wants to retain its rights under the agreement
 - If the company decides to retain its rights under the agreement in accordance with Section 365(n), notice should be sent to the debtor of the company's decision
 - Need to oppose any motion to reject the agreement



Strategies (cont.)

- If the company is a licensor under an IP license agreement and the debtor-licensee files
 - Determine if agreement is executory
 - Does company want to object to assumption or assumption and assignment
 - Determine test to be applied
- If negotiating an IP license agreement on behalf of a licensee
 - Ensure that the license agreement specifically provides that the subject of the license agreement is “intellectual property” and that the licensee is entitled to all of the protections afforded licensees under Section 365(n)
 - Negotiate narrowly defined royalty payments and differentiate the royalty payments from other monetary obligations under the agreement
 - Use separate agreements for separate aspects of the transaction
 - Have an SPE hold the IP
 - Negotiate for perpetual, exclusive license



Strategies (cont.)

- If negotiating an IP license agreement on behalf of a licensor
 - Goals are to
 - Increase licensor's leverage if the licensee should file for bankruptcy
 - Control the licensee's ability to assume, or assume and assign, the license agreement (e.g., through choice of law provision or by identifying the specific assignments that should be prohibited)
 - Although the enforceability of such provisions is debatable, it is best practice to include in the agreement limitations on assignability and then to litigate the enforceability of the limitations if necessary
 - Include terms to enhance the licensor's ability to terminate the agreement before a bankruptcy is filed
 - If the license agreement is terminated prior to the bankruptcy filing, the agreement cannot be revived
 - It will not be part of the bankruptcy estate and therefore cannot be assumed



Strategies (cont.)

- Declaring for bankruptcy will not allow a debtor to prematurely terminate an ongoing trademark license. As such, a decision to reject a trademark license may have little practical effect, only ridding a debtor of its obligation to provide services collateral to the trademark license itself. To retain its valuable trademark rights and avoid naked licensing, the debtor will need to continue monitoring and policing the licensee, regardless of the rejection.

