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Bankruptcy Court Determines Special Provisions Protecting IP Licenses of Bankrupt Debtors Apply to Foreign Corporation

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Section 365(n) of the US Bankruptcy Code provides special protection to licensees of intellectual property, essentially permitting them to continue to enjoy the licensed rights notwithstanding rejection in the licensor's bankruptcy.[1] Whether these provisions would apply to the US licenses of a foreign company with an ancillary US bankruptcy supporting a foreign insolvency proceeding has recently been the subject of extensive litigation in the Eastern District of Virginia. In the latest decision, the bankruptcy court finds that the provisions of 365(n) do apply to US licenses granted by a foreign corporation.[2]

Section 365(n) was enacted by the Intellectual Property License in Bankruptcy Act in response to a Fourth Circuit ruling that following rejection of a patent license in a licensor's bankruptcy, the licensee had no right to continued enjoyment of the patent.[3] Congress effectively overruled that decision by enacting Section 365(n), finding that protection of IP licenses was essential to promote US innovation in technology. Completely independently, US law has long provided for ancillary bankruptcy proceedings to assist administration of foreign insolvency proceedings. Those provisions were recently codified in Chapter 15 of the US Bankruptcy Code, and provide that certain basic provisions of US bankruptcy law automatically apply in a Chapter 15 case, while others may be incorporated

by the US court as appropriate. While Chapter 15 generally envisions comity with the foreign proceeding and application of the foreign substantive insolvency law, a limitation is that the US court may do nothing "manifestly contrary" to US public policy.

The interplay of these provisions came to a head in the pending Chapter 15 case of Qimonda, AG.[4] Prior to falling on hard times, Qimonda – a German entity – was a major manufacturer of electronic Dynamic Random Access Memory (DRAM) products. Because these products often involve a myriad of potential patents held by multiple parties, the industry relies on extensive cross-licensing agreements between the participants. Following the economic failure of Qimonda, an insolvency administrator appointed by the German court ceased operations of the company. He filed a petition in Virginia commencing an ancillary Chapter 15 case to aid in administration of extensive US assets and liabilities. Initially, an order was entered incorporating various "boiler plate" provisions of the US law, but also specifically including all of Section 365. The administrator sought a revision to remove Section 365, arguing that it would improperly interfere with his ability under German law to elect to not perform license agreements and thereby – he asserted – terminate licensees' rights. The administrator was apparently concerned that the cross-licenses to Qimonda were of no value, as it had ceased operations, and offered to grant new licenses on "market terms." Finding that application of Section 365(n) would indeed unfairly hinder the administrator, the bankruptcy court granted the revision to its initial order, thus eliminating application of Section 365(n).[5] Various licensees appealed, arguing that as to licenses of US intellectual property section 365(n) must apply. The district court remanded for determination whether failure to apply Section 365(n) would interfere with a fundamental US public policy. In doing so, the court noted that not every rule under US law need have an identical outcome under foreign law to respect fundamental public policy, and emphasized the presumption of applying foreign substantive law in Chapter 15.[6]

On remand, the original bankruptcy judge recused himself because of a newly perceived conflict. The bankruptcy court then held an extensive evidentiary hearing, with expert testimony and briefing by all parties. The court ultimately ruled that fundamental US policy required that Section 365(n) apply to Qimonda's US licenses. The court specifically stated that "certainly the issue is close." However, it found that on balance US policy required that the non-debtor parties be protected by Section 365(n). The court noted the anomaly that Congress did not expressly incorporate Section 365(n) into all Chapter 15 cases, but found on the specific facts before it that "failure to apply Section 365(n) under the circumstances of this case and this industry would 'severely impinge' an important statutory protection accorded licensees of US patents and thereby undermine a fundamental US public policy promoting technological innovation," suggesting that on other specific facts the provision might not apply. In addition, the court noted that relief to the licensees – who generally market

products on a global basis – is limited to the US and concluded “It goes without saying that nothing in the court’s ruling affects the foreign administrator’s right, to the extent permitted under German insolvency law, to terminate licenses to non-US patents.” It seems inevitable that the bankruptcy court’s ruling will not be the final word on application of section 365(n) in chapter 15; the latest ruling has been appealed.

[1] The protections of Section 365(n) are not complete. For a full discussion, see Evan M. Jones, et al., *Intellectual Project Licenses and Bankruptcy*, The Americas Restructuring and Insolvency Guide 2008/2009, 159 (2008).
[2] *In re Qimonda AG*, Case No. 09-14766-SSM, 2011 WL 5149831 (Bankr. E.D. Va. Oct. 28, 2011).
[3] *Lubrizol Enters. Inc. v. Richmond Metal Finishers (In re Lubrizol),* 756 F.2d 1043 (4th Cir. 1985).
[4] O’Melveny & Myers, LLP did not participate in the subject litigation. However, clients of OMM are interested in the outcome of the litigation. This alert offers no views on the correctness of the decision.
[5] *In re Qimonda AG*, 425 B.R. 256 (Bankr. E.D. Va. 2010).
[6] In *re Qimonda AG*, 433 B.R. 547 (E.D. Va. 2010).