IP deals meet bankruptcy: what every IP professional needs to know

Some of the best prospects for value creation, and the most significant risks, lie in creative use of the IP portfolios of financially distressed businesses

By **Nader A Mousavi and Andrew G Dietderich**

IP-rich companies with liquidity problems present extraordinary risks and opportunities for deal making. Over the next decade, we see few areas of transactional practice where more value can be created or where the traps have sharper teeth. Yet the necessary know-how to implement distressed IP transactions and navigate IP risks in bankruptcy remains too segregated. The intricacies of bankruptcy can cause even the most attentive IP experts to glaze over. And the same goes for bankruptcy experts pressed with IP detail. In practice, issues are often characterised as 'IP' issues or 'bankruptcy' issues, but at the intersection of intellectual property and bankruptcy, which discipline should drive solutions? Although the professional community has no lack of experts in IP transactions or bankruptcy transactions, communication between these very different areas of specialist learning needs to be more robust.

This article hopes to start a better dialogue. We begin from the standpoint of a distressed company with significant intellectual property, particularly patent rights, and identify three general types of IP strategy: liquidation, reorganisation and enforcement in bankruptcy. We then turn to the types of transaction that the three scenarios engender and the special risks and opportunities involved. Near the end we examine the secondary effects of distressed IP transactions on the rights of licensors and licensees, which we regard as essential to understanding the true value of the different transactional alternatives.

Policy clash – bankruptcy treatment of intellectual property

The US Bankruptcy Code and IP law are both rooted in federal statutory regimes, each with a constitutional basis and fundamentally different public policy goals.

Bankruptcy is effectively a shield designed to protect a bankrupt entity. US bankruptcy law's overriding public policy is to preserve the going-concern value of businesses seeking bankruptcy protection wherever possible. This includes the ability to breach contracts selectively and, subject to certain constraints, the ability to sell assets free and clear of encumbrances and ownership disputes.

The uncertainty created by the debtor-friendly bankruptcy system can, at times, be at odds with IP law's policy to incentivise and protect innovation and prevent consumer confusion. Intellectual property – which is at its essence a right to exclude or tax – may be capable of neither against a company under the shield of bankruptcy. Moreover, IP rights or claims may be compromised or even lost without diligent action to preserve and enforce them against a bankrupt counterparty.

Backed into a corner – risks of a bankrupt counterparty

When a business files for Chapter 11 bankruptcy protection in the United States, it becomes a debtor. Generally, the debtor and its management remain in possession and control of the business after filing Chapter 11. The goal of most large Chapter 11 bankruptcies is for the debtor to reorganise or sell its assets as a going concern. However, some insolvent debtors may cease operation and liquidate. Liquidations can be accomplished by the debtor under Chapter 11 or by an appointed trustee under Chapter 7, which governs trustee supervised liquidations.

The debtor or trustee is a fiduciary, responsible for maximising stakeholder recovery. Consistent with this fiduciary duty and under court supervision, the debtor will vigorously pursue those actions likely to increase creditor recoveries. As a result, bankruptcy can effect a change in the interests of debtors, and those interests can drive the resulting IP monetisation strategies. These strategies typically play out in one of three restructuring models: liquidation, reorganisation or enforcement-in-bankruptcy.

Models for IP transactions in bankruptcy

These models are aptly represented by three of the most notable IP-intensive bankruptcies: Nortel, Kodak and Qimonda. They range from the sale of residual patents after the sale of business lines (*Nortel*), to use of patents to fund reorganisation (*Kodak*), to aggressive use of international insolvency regimes to drive value through licensing (*Qimonda*). Chapter 11 requires none of these outcomes – they were each the result of strategic choices by the debtors.

Sale of residual patents after the sale of business lines

Nortel was a liquidation. The goal of its global insolvency cases was to dispose of its businesses and intellectual property for the maximum amount of cash and then distribute the cash to creditors.

The IP strategy was first to protect the businesses slated for sale, by offering buyers intellectual property that was necessary to maximise the value of the divested business lines. Only after these businesses were sold did Nortel auction its residual patents, which were not naturally or necessarily a part of any of the operating businesses that were sold.

After Nortel's sale of business lines, it could sell all remaining rights to its patents without the need to retain licences for operating businesses or additional future dispositions. Rather, the remaining patents were licensed, to the extent relevant, to the previously divested business lines. This provides a clear picture of encumbrances to the patent buyers, while avoiding the challenges of a reorganisation, as in the case of *Kodak* (discussed below), associated with anticipating the demands of buyers and investors in the reorganised businesses.

Patent monetisation to fund reorganisation

Kodak's Chapter 11 case was a reorganisation, not a liquidation. The main purpose of the company's filing was to manage legacy liabilities, improve liquidity and restructure around its most profitable business lines. Kodak eventually shut or sold its consumer businesses, and now focuses on high-tech printing, packaging, industrial and software products for commercial customers.

Kodak's patent strategy followed suit.

Digital imaging – which was the heart of the patent portfolio Kodak put up for sale – had generated over $3 billion in licensing revenue. The patents were a defensive necessity for the reorganised business, potentially covering aspects of Kodak's retained businesses – such as capturing images for scanning or printing – and had provided Kodak with strategic value in the form of patent balance with other market players. Since Kodak's reorganisation involved the continuation of three of its major business lines (commercial printing, digital imaging and consumer-focused personalised imaging), it was imperative for Kodak to obtain liquidity from its patent sale while ensuring continuity and strategic patent balance for these reorganised businesses.

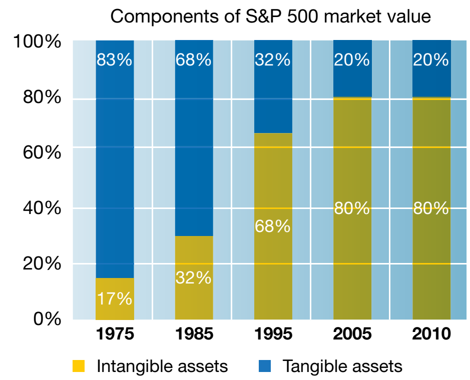
The answer for Kodak was selling the patents as early in its reorganisation as possible, subject to a broad non-exclusive licence-back and other licensing arrangements that covered each of its businesses. Since Kodak was uncertain at the time which of the continuing businesses it would eventually retain, the licence-back had to be sub-licensable to accommodate future sales to as-yet unidentified third parties.

When the dust settled, Kodak received cash consideration of $527 million in a patent monetisation involving:

- licensing transactions with a consortium of 12 leading technology companies; and
- a sale of the residual digital imaging portfolio to Intellectual Ventures (IV), subject to the 12 licences, as well as a broad licence-back to Kodak.

The transaction made sense to all parties. The 12 licensees were protected from the threat of enforcement action by Kodak's estate or creditors (see *Qimonda* below), which was a particularly poignant prospect in light of the perceived uncertainty about Kodak's reorganisation prospects at the time of the transaction. IV received the residual offensive interest in the digital imaging patents at a price that reflected the relatively heavy encumbrances, including the prior licences that generated $3 billion in licensing revenue for Kodak, the rights

Figure 1. **Intangible assets form an increasingly large portion of the value of large companies**



granted to the 12 consortium licensees, the licence-back to Kodak and Kodak's ability to sub-licence that licence-back to third parties in connection with subsequent strategic dispositions of Kodak business lines. Although the sale price did not meet initial expectations, Kodak received enough money to finance its case, as well as strategic flexibility necessary for its reorganisation.

This question of strategic flexibility can be critical for IP sellers or licensors facing a complex restructuring. It is rare for a patent portfolio to be purely non-strategic. Disentangling business lines from even superficially unrelated intellectual property is an imperfect art. When a restructuring involves the disposition of businesses, buyers can be expected to have concerns about post-closing enforcement actions from the debtor or buyers of retained patents, as well as concerns about the loss of patent parity with business competitors. The balancing act is to ensure that the debtor can meet demands by investors and buyers of reorganising businesses, without undermining the value of patents for sale. This is a central strategic challenge of selling a major patent portfolio as a source of liquidity for a complex reorganisation.

Aggressive use of insolvency to drive value through licensing

Qimonda offers an example of a third alternative: retain the patents and enforce them as a financial asset. Qimonda's insolvency administrator sought to use global insolvency laws to cancel existing patent licences and re-license its patents for additional value.

Qimonda was one of the world's largest memory chip producers and had over 10,000 patents, including 4,000 US patents. While it was an operating company, Qimonda entered into numerous patent cross-licences with its competitors. Qimonda's insolvency administrator took the position that, under Section 103 of the German Insolvency Code, pre-insolvency licences were no longer enforceable. This led to a heavily litigated, but ultimately unsuccessful attempt to use the US Bankruptcy Code to nullify pre-petition licences of Qimonda's US patents in order to re-license them. *Qimonda* was decided on its facts after a four-day trial, with the court balancing the interest of the licensees against the interest of the debtor. The decision leaves open the possibility that different facts could produce a different result.

Qimonda illustrates the risk that a relationship with a debtor that was once a long-term strategic partner or competitor operating in a patent cross-licence détente may abruptly change course. A former strategic partner or peaceful competitor may take aggressive positions designed to extract value from its licensees. This risk is particularly acute where a debtor is not, or ceases to be, an operating business and therefore may discount or disregard defensive and commercial considerations that might otherwise constrain aggressive monetisation.

What would happen if a debtor under Chapter 11 decided to enforce a major patent portfolio aggressively while in bankruptcy?

We do not yet know, but Chapter 11 and the Bankruptcy Code can be powerful tools in any patent enforcement strategy. Chapter 11 offers substantial litigation advantage as well as potential rights to avoid certain existing licences. The Bankruptcy Code generally precludes lawsuits against the debtor outside of bankruptcy courts, permitting a debtor to notice targets of infringement with less risk of counter-claims of infringement against the debtor or declaratory judgment actions being brought in jurisdictions of the target's choosing. The debtor may even be permitted to proceed with infringement claims, while counter-claims of infringement against the debtor are stayed. Although untested, it is also possible that the Bankruptcy Code would preclude post-grant review, *inter partes* review and other procedures under the American Invents Act designed to facilitate patent challenges.

Additionally, the avoidance powers of a debtor under the Bankruptcy Code allow the debtor to avoid licences where the debtor received less than reasonably equivalent value for the licence at a time when the debtor was insolvent, or where the grant of the licence was merely promised and not perfected. A Chapter 11 debtor would also have the ability to assume or reject individual licences, as discussed below, with the IP entitlement of a rejected licence limited to the specific protections provided by Section 365(n) of the Bankruptcy Code (discussed below).

No Chapter 11 debtor with a major patent portfolio has pursued all of these tactics aggressively, choosing instead to sell

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the residual interest in financial patents to others. However, this day may come.

Special considerations for patent sales in bankruptcy

The easiest approach to non-strategic intellectual property in bankruptcy is to sell it. Of course, this assumes that there is market demand to buy that intellectual property. The dynamics of bankruptcy patent sales differ substantially from those of non-bankruptcy sales. These differences are evident in the sales process, as well as key transaction documents, including confidentiality agreements, bid documents and asset purchase agreements. Both buyers and sellers of intellectual property in bankruptcy or financial distress should understand these dynamics and work either to mitigate risks or to exploit the opportunities that they create.

Special considerations for patent acquisitions in bankruptcy are set out below.

Auction process

Bankruptcy's predisposition towards an open and transparent sales process usually mandates some form of auction. While auction procedures vary considerably, other bidders (as well as creditors) in a bankruptcy auction will often obtain greater visibility into bids than in non-bankruptcy auctions. Private sales – where terms are negotiated on a confidential basis between two parties – are rare for material assets where it is difficult to determine a market price with any level of certainty.

Stalking-horse bid protection

Many bankruptcy auctions begin with an opening (or stalking-horse) bid. This is a fully negotiated and executed purchase contract that expressly allows the debtor to solicit higher and better offers at an auction. The stalking horse gives the debtor a floor price and is compensated by negotiated bid protections. These generally include a fee in the event that the stalking horse is outbid (the break fee), expense reimbursement and input into the structure of the auction (eg, bid increments or timing). The scope of bid protections is highly negotiated.

Because a debtor cannot engage in transactions outside the ordinary course of business without court approval, stalking-horse bid protections are unenforceable against the debtor until approved by the court. However, the purchase agreement is generally enforceable against the stalking-horse purchaser. This creates a difficult dynamic for a potential stalking-horse bidder. A potential stalking horse should weigh the advantages of being the stalking horse (ie, control over process and transaction structure, superior access to due diligence and first mover advantage) versus the risks of not getting the benefit of its bargain.

Transaction certainty

Unlike a non-bankruptcy sale, bankruptcy IP sales are generally conducted pursuant to a public timetable that has been agreed to by creditors and ordered by the court. There is therefore a high likelihood that a transaction will occur, as many debtors are forced sellers which do not have the option not to transact. This can provide buyers with significant leverage over a debtor where competitive tension in the auction is low, but also spur intense focus, commitment and bidding among would-be buyers where competition is fierce.

Creditor dynamics

Unlike a non-bankruptcy sale, where the corporate seller is the sole and ultimate decision maker, a bankruptcy sale process is

Figure 2. **Market participants indicated that average loan credit risk has increased in a 2013 survey**

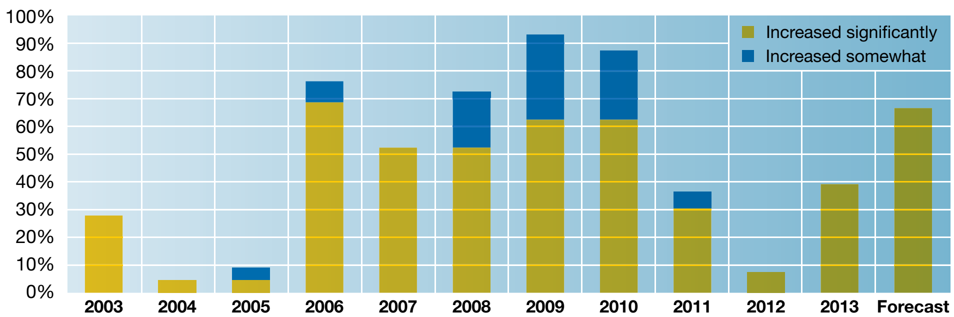


Figure 3. **Public company Chapter 11 filings are falling since the 2008 economic crisis**

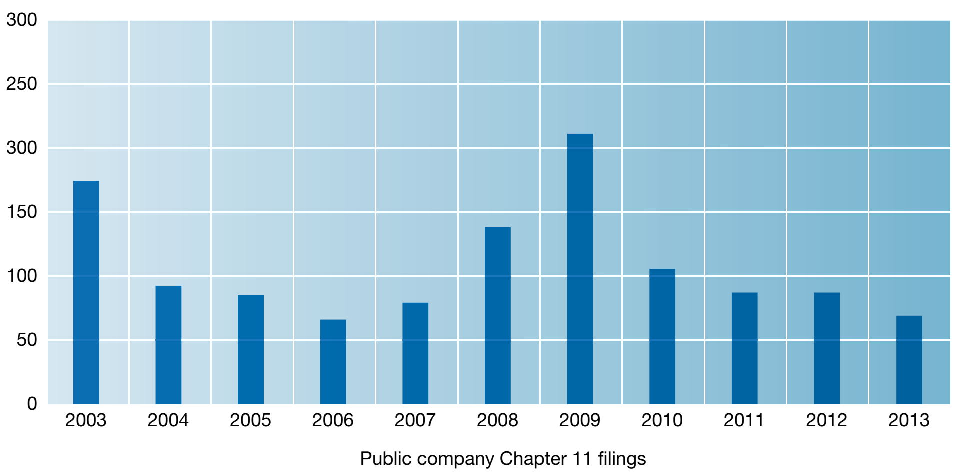
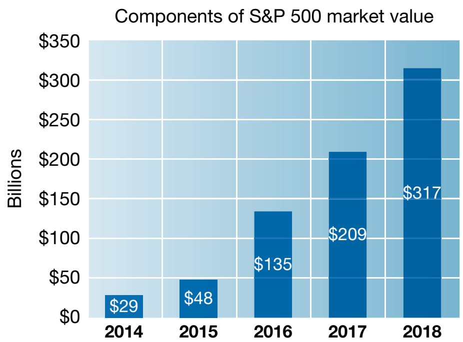


Figure 4. **Companies will need to refinance substantial amounts of debt in the near future**



Special considerations for patent sales in bankruptcy

- Auction process
- Stalking-horse bid protections
- Transaction certainty
- Creditor dynamics
- Clean and certain title
- Heightened confidentiality concerns

open and subject to review and control of the seller, creditors and the bankruptcy court.

Creditor dynamics are one of the central tensions in any bankruptcy. It is imperative to understand these dynamics before engaging with a debtor in any serious IP monetisation transaction, as creditors may look to the outcome of a patent sale for a substantial portion of their recovery. Secured creditors may hold approval rights, effectively making them a third rail of the negotiation. Unsecured creditors will often have a committee representing their interests which can wield significant influence in the approval of a major IP deal. Creditors must, in effect, be convinced that the IP monetisation deal or strategy proposed maximises value for them over all reasonably available alternatives. This challenge is exacerbated by the various, and sometimes conflicting, interests of different classes of creditor. More senior creditors will favour transactions that pay them in full as soon as possible, while more junior creditors may object to sales that do not result in value that flows to their class. Buyers and sellers in bankruptcy need to understand these diverse motivations and manage all classes of creditor appropriately.

Clean and certain title

Bankruptcy patent sales can create substantial value for a debtor by granting buyers a level of title certainty not available under state law. Unlike a non-bankruptcy sale, where a seller can effectively grant only whatever right, title and interest it actually owns, a debtor can sell assets free and clear of liens, claims and encumbrances (including title infirmities and disputes as to ownership). Subject to satisfaction of certain conditions, a bankruptcy court order generally grants the buyer clean title to the patents transferred, subject only to known and scheduled licences or other encumbrances.

The typical process begins when the debtor files a motion seeking a court order authorising the sale of assets free and clear of all interests in property. All parties with known interests in the property should receive notice. If a non-debtor counterparty receives notice and its interest in property is not a permitted encumbrance, it may lose whatever interest in property it had before the sale. If a non-debtor counterparty receives such a notice, it needs to ensure that its licence rights are expressly recognised.

For example, Kodak and Apple were involved in a long-running patent dispute in which Apple claimed ownership and co-inventorship rights in certain patents. Kodak disputed these rights, but rather than litigate the issues to conclusion, Kodak sought to sell the patents free and clear of Apple's purported rights. Even though the bankruptcy court concluded there was a *bona fide* dispute as to Apple's interest in certain of the patents, the court authorised a sale free and clear of Apple's purported interests, subject to adequate protection of those interests (eg, a lien on the proceeds).

This feature of bankruptcy sales presents both opportunities and risks. Debtors and buyers in a bankruptcy auction have an opportunity to reap certainty and value by cleansing IP assets of unknown or even disputed encumbrances to those assets. Licensees or others with an interest in the same IP assets face having their rights or claims compromised or even lost forever. In this context, licensees and others must participate actively in the bankruptcy process to ensure that their rights are preserved.

Confidentiality

The varied constituencies of a bankruptcy sale and uncertainty about who will own the patent portfolio in the future raise unique confidentiality concerns. A potential buyer will be asked to sign a confidentiality agreement, but the debtor will generally ask to share bid information with secured creditors, a committee representing unsecured creditors and other parties in interest. While all of these parties are typically subject to confidentiality undertakings, avoiding leaks and managing conflicts of interest among such a broad array of recipients can be a serious challenge.

Potential buyers may also be subject to current or potential patent litigation. Thus, a buyer takes the risk that communicating a level of interest in a patent portfolio will also communicate implied admission of the need for a licence. Both debtors and potential bidders need to weigh the value of a transparent process appropriately with the chilling effect of oversharing bidder information.

Rights of a debtor to terminate effectively outbound licences granted to third parties under debtor intellectual property

Whether inside or outside of bankruptcy, one of the most significant variables in the value of intellectual property is the degree to which it is encumbered by existing licences, releases, options, covenants not to sue or similar rights granted to third parties. Nortel's patents were generally regarded as minimally encumbered, which drove value, and Kodak's patents were generally regarded as significantly encumbered, which constrained value. Outside of bankruptcy, encumbrances are scrutinised, but options for reshaping them unilaterally are typically very limited or non-existent. In bankruptcy, the rules of the game are quite different. Debtors have multiple tools at their disposal to terminate or limit effectively prior outbound licences and other rights granted to third parties under debtor intellectual property.

Each of these tools represents a risk to non-debtor licensees. However, informed IP deal-makers can dull the sharpest edges of these tools, and may be able to structure around risks entirely.

There are three essential debtor tools. First, debtors may seek to sell their intellectual property free and clear of a non-debtor counterparty's licence or other interests in the intellectual property (as discussed above in the context of patent sales). Second, debtors can reject licences granted to a non-debtor counterparty under debtor intellectual property. In both cases, a non-debtor counterparty's best defence is a good offence. Third, a debtor may seek to avoid a non-debtor counterparty's licence as a constructive fraudulent conveyance.

Rejection of a non-debtor counterparty's licence under debtor intellectual property

A debtor can generally reject a contract for which both the debtor and counterparty have material unperformed obligations. Rejection operates as a court-sanctioned breach of the contract. While it does not render the contract void, it generally excuses further performance by the debtor.

Rejection will give rise to a damages claim. However, the damages claim will generally not be the commercial equivalent of performance. Rejection damages claims are general unsecured claims that are paid far in the future in an amount that is usually materially less than face value.

The general rule for rejection is obviously problematic in the IP context because it would, if followed strictly, deprive a non-debtor licensee of bargained-for and possibly even fully paid rights to use of US debtor intellectual property. Congress enacted a special provision – Section 365(n) of the Bankruptcy Code – to allow counterparties to elect to retain contracted rights to use debtor intellectual property after rejection. The Section 365(n) rules are complex, but the takeaway is that, in the context of a US bankruptcy where both parties have material unperformed obligations, non-debtor licensees can elect to retain rights to use certain intellectual property if they make all royalty payments without offset.

However, the Section 365(n) protections do not solve all problems for a rejected IP licensee. Though recent cases have extended these protections, the statutory definition of 'intellectual property' in the Bankruptcy Code does not include trademarks and is not clear as to whether it includes non-US intellectual property. For highly material licences covering trademarks or non-US IP rights, or where a licensee has significant leverage, a licensee may consider a structure under which a bankruptcy remote entity or well-capitalised joint venture would own and license the intellectual property, thereby insulating it from the risk of bankruptcy or rejection. Alternatively, in certain exceptional circumstances, it may be possible to negotiate a security interest or joint ownership interest in critical IP rights.

In addition, whether Section 365(n) entitles a licensee to intellectual property developed after the debtor files bankruptcy is unsettled, even when the rejected licence gave rights to use improvements (for technology licences) or has an open capture period (for patent licences). Furthermore, it does not entitle the counterparty to service and support by the bankrupt debtor.

The treatment of covenants not to sue is also unsettled. The issue is whether a covenant not to sue should be treated as an IP licence for which Section 365(n) applies. The one federal court of appeal judgment to address the question concluded that Section 365(n) protects covenants not to sue. Because the law is unsettled, preference should be given to licences over covenants not to sue where bankruptcy considerations are relevant.

Lastly, Section 365(n) may not protect rights granted under an option to license, unless that option is exercised before the bankruptcy filing. The safest course of action is to exercise valuable options before a bankruptcy filing.

In sum, Section 365(n) mitigates non-debtor licensee risk from rejection of licences in the United States, but does not eliminate it. Each of these residual risks to a non-debtor licensee or rights holder equally represents a potential leverage or value point for a debtor, particularly one willing to maximise value at the expense of a non-debtor counterparty. Nonetheless, even if limited, Section 365(n) is preferable over many non-US jurisdictions, which do not have equivalent protections. Therefore, licensees in material IP transactions must consider carefully the implications if the licensor, as a non-US party, were to seek bankruptcy protection in a non-US jurisdiction.

Bankruptcy risks in IP transactions

- Sale "free and clear" of licences and ownership disputes
- Assignment to third parties, notwithstanding anti-assignment clauses
- Licence rejection and debtor non-performance

Table 1. **Section 365(n) exceptions**

Section 365(n) may not protect rights of non-debtor licensees in:	Possible mitigation steps
Trademarks	Bankruptcy remote entity as licensor. Security interests in trademarks. Joint ownership of trademarks. Negotiation for value with debtor. Select jurisdictions that are favourable towards trademark licensees.
Non-US IP rights	Same.
IP rights arising after bankruptcy filing	Bankruptcy remote entity as licensor. Negotiation for value with debtor.
Covenants not to sue	Favour releases for past damages and affirmative licence grants for prospective activity. Legal challenge to treat covenants as licences for purposes of Section 365(n).
Options to obtain a licence	Exercise before bankruptcy filing of grantor of option.

Licensee bankruptcy as leverage for the non-debtor licensor?

Licensee bankruptcy may provide a non-debtor licensor with an opportunity to renegotiate, particularly by the diligent (and perhaps disruptive) exercise of all rights available. Dissatisfied non-debtor counterparties may use legal ambiguity on the question of assumption to force renegotiation.

Attempts to avoid a licence

The Bankruptcy Code allows the debtor to avoid licences where it received less than reasonably equivalent value for the licence at a time when it was insolvent, on the basis that they are constructively fraudulent transfers. Avoiding a licence as a fraudulent transfer involves either unwinding the transaction or fashioning an equitable remedy that provides reasonably equivalent value to the debtor.

As it can be difficult to ascribe value to intellectual property with any degree of certainty, any licence taken during the time that the debtor was insolvent is at risk of later attack as a constructively fraudulent transfer. To the extent there are questions as to the solvency of the licensor, ensure there was a fair process that led to a fair price paid.

Risks and opportunities for IP owners that have granted licences to bankrupt debtors

Bankruptcy breeds uncertainty. The prospects of the distressed debtor are in doubt. Downsizing, divestitures and changes of control are typical. In this environment, a non-debtor who has licensed its valuable IP rights to a bankrupt debtor may be concerned not only about the ability or willingness of the debtor to perform (eg, pay), but also about the risk that licensed intellectual property may be exploited (eg, transferred) contrary to its terms, with little recourse. On the other hand, non-debtor licensors may have leverage over the ability of bankrupt licensees to assume, and therefore maintain, ongoing licence rights in bankruptcy.

Reorganised debtor attempts to assume a licence

When a debtor emerges from bankruptcy, it has the option to assume contracts that are important for its continuing business operations. Even though a reorganised debtor is the same legal entity, there is legal ambiguity as to whether it can assume non-exclusive licence agreements when applicable non-bankruptcy law would prohibit the assignment of such agreements. A non-debtor licensor may be able to obtain concessions in exchange for consent to assumption.

The ambiguity on assumption flows from a circuit split on the ability of reorganised debtors to assume certain licences. The Third, Fourth, Ninth and 11th Circuits follow a so-called 'hypothetical' test that suggests a debtor could not assume a licence if it could not also assign it. In these circuits, anti-assignment clauses can provide significant leverage to the non-debtor licensor effectively to veto ongoing exploitation of their IP rights. However, the First Circuit and Southern District of New York follow a different test that would generally allow assumption, even if the licence could not be assigned. In these circuits, the debtors can be assured of their rights upon assumption, and the focus in a restructuring is often whether the assignment and change of control provisions allow the strategic flexibility the debtor needs to implement its plans.

Bankruptcy may provide a non-debtor licensor with an opportunity to renegotiate, particularly by the diligent (and perhaps disruptive) exercise of all rights available. Dissatisfied non-debtor counterparties may use legal ambiguity on the question of assumption to renegotiate burdensome terms in exchange for consent to assume.

Debtor attempts to transfer an inbound licence to a third party

Depending on the jurisdiction of the debtor's bankruptcy, a debtor may be able to transfer certain IP licences provided the transferee provides adequate assurance of future performance.

A debtor cannot assign executory contracts where applicable law excuses a third party from accepting or rendering performance. Because federal law generally holds that, unless otherwise agreed, non-exclusive IP licensees are personal and not freely assignable, non-exclusive licences are generally not assignable in bankruptcy.

However, the Bankruptcy Code invalidates contractual anti-assignment clauses which put non-debtor licensors at risk of assignment without consent where applicable law would permit the assignment.

The non-consensual assignability of exclusive IP licences under federal law is subject to substantial ambiguity. Cases have allowed non-consensual assignment of exclusive copyright licences and fast-food franchise agreements that include trademark licences. However, there are non-bankruptcy law defences to assignment that could change the result depending on the facts.

Regardless, if the IP licence does not have clear anti-assignment provisions, a bankruptcy court may set aside the general prohibition on non-assignability altogether. In that context, a debtor may seek to assign or otherwise transfer the IP licence to third parties in connection with divestitures or other transactions with approval of the bankruptcy court. As a licensor, consider mitigating these risks by drafting licences that have robust anti-assignment clauses, shorter terms requiring renewal and/or adequate termination clauses including for change of control of the counterparty.

Debtor rejection of licences
The debtor may reject an inbound licence under non-debtor intellectual property which operates as a court-sanctioned

Action plan

When entering into an IP licensing agreement, parties can take a number of steps to mitigate the risks if the other party enters bankruptcy:

- Draft licences that contemplate insolvency – this may include possession or escrow of key enabling technology (eg, source code escrows).
- For trademarks and foreign intellectual property, licences should mitigate insolvency risk by taking a security interest in the intellectual property or contracting through bankruptcy remote vehicles.
- Consider working collaboratively with other parties in similar situations.
- Scrutinise any notices from debtors, including notices that are not specifically directed at you (eg, boilerplate bankruptcy notices confirming a plan of reorganisation may operate to reject contracts).
- Know and exercise your rights – as there may be fewer than 30 days from the rejection to the date when you need to exercise rights, it is important to anticipate near-term issues.

breach. After a debtor rejects a licence, the non-debtor licensor should not expect to obtain future payment or performance from a debtor after rejection, but should not be compelled to perform on the licence.

Rejection will generally leave a non-debtor licensor with a general unsecured claim for damages. It is important to file a proof of claim promptly and accurately in accordance with the rules established in the debtor's case. Failure to do this may result in no recovery.

Extraordinary risks and opportunities

Bankruptcy can be daunting and its rules non-intuitive and complex, but it is more important than ever for IP professionals to understand them. As large technology and other IP-intensive companies mature and face financial distress and markets are disrupted by globalisation, new technologies and new entrants, intellectual property may be among the most valuable assets remaining.

IP-rich companies facing financial difficulty will, in turn, present extraordinary risks and opportunities for IP and bankruptcy deal makers alike. It will take close collaboration between these bankruptcy and IP professionals, and a deep appreciation for the essentials of both areas, in order to respond effectively to this call. *iam*

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The opinions expressed in this article are solely those of the authors.

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