

Intellectual Property Rights In Bankruptcy

Ragan Powers and
Hugh McCullough

August 10, 2011



Davis Wright
Tremaine LLP

DEFINING SUCCESS TOGETHER

Abraham Lincoln: Bankruptcy Lawyer

Next came the Patent laws Before then, any man might instantly use what another had invented The patent system changed this; secured to the inventor, for a limited time, the exclusive use of his invention; and thereby added the fuel of *interest* to the *fire* of genius, in the discovery and production of new and useful things.

Abraham Lincoln, February 11, 1859

Recent Case Study – Borders Books

- Operated 400+ bookstores
- Master License Agreement with Seattle’s Best Coffee
 - SBC Café in most stores
 - Licensed “SBC System” to Borders; Borders operated the cafes
 - Trademarks/trade dress (royalty payments)
 - Copyrights
 - Trade secrets
 - Supply agreement (pre-petition and post-petition supply)
- Borders moved to “reject” MLA in Chapter 11
- Issues for SBC
 - Pre- and post-petition supply obligations
 - Royalty payments
 - Use of “SBC System” post-rejection
 - Rejection damages claim

Estate Property and the Automatic Stay

- **Property of the Estate (§541)**
 - Includes all legal and equitable interests of debtor – includes license agreements
 - What constitutes “property” determined under state law. *Butner v. United States*, 440 U.S. 48 (1979)
 - Does not in itself change existing property rights
- **Automatic Stay (§362)**
 - Stay of action to exercise control over property of the debtor
 - Applies to actions that could have been commenced pre-bankruptcy
 - Debtor is supposed to comply with law post-petition
 - Prevents non-debtor party from terminating IP license

Executory Contracts (§365)

- Debtor can elect whether to “assume” or “reject”
- Can delay decision to end of case; must perform in the interim
- Assumption – requires debtor to:
 - Cure monetary defaults
 - Compensate counterparty for any pecuniary losses
 - Provide adequate assurance of future performance
- Assignment to third parties:
 - §365(e) generally invalidates anti-assignment clauses
 - Assumption and assignment requirements same – assignee must demonstrate adequate assurance of future performance

Executory Contracts (§365)

- Debtor may not assume or assign if:
 - “[A]pplicable law excuses a party, other than the debtor . . . from accepting performance or rendering performance to the trustee or to an assignee of such contract or lease . . .” (§365(c)(1)(A) and (e)(2))
 - Has been applied to assignment of: personal service contracts; patent licenses; non-exclusive copyright licenses; exclusive copyright licenses (split); trademark licenses; franchise agreements (split)
 - May prevent mere assumption in some cases
 - Actual vs. hypothetical test: First Circuit follows actual test, Ninth Circuit follows hypothetical test

Executory Contracts (§365)

- Rejection constitutes default as of petition date
- Consequences:
 - Non-debtor party has pre-petition unsecured claim for breach
 - Licensee debtor not entitled to use IP post-rejection
 - Non-contractual remedies available – e.g., Lanham Act
 - Contract provisions post-rejection may not be enforceable
 - Special protections for non-debtor licensees – §365(n)
 - Non-debtor licensee may use “intellectual property” through term of license (including extensions); can enforce exclusivity; must pay royalties
 - Debtor licensor does not have to provide additional performance
 - “Intellectual property” includes trade secrets, patents, and copyrights, but not trademarks

IP Licenses – Practical Considerations

- Debtor not automatically deprived of use of IP
- Debtor supposed to honor license terms pending assumption/rejection
- Counterparty can't terminate without court approval
- Res judicata effect of orders – beware of sale orders and plans of reorganization
- Assumption/rejection issues can be significant

Presenters



Ragan L. Powers

- Ragan Powers represents investors, secured and unsecured lenders, debtors and lessors in restructuring and bankruptcy. He handles out-of-court workouts and restructurings, consensual and litigated Chapter 11 cases, distressed business transactions and related litigation. Ragan has helped clients with a range of issues including underperforming equity investments, large secured transactions, management of troubled loan portfolios and distressed financing arrangements.
- 206.757.8123 phone | raganpowers@dwt.com



Hugh R. McCullough

- Hugh McCullough advises clients in complex commercial and bankruptcy litigation, in-court and out-of-court restructurings, and secured financing transactions. He has represented debtors and creditors in various Chapter 7, 11, and 15 bankruptcy proceedings as well as state-court receiverships.
- 206.757.8189 phone | hughmccullough@dwt.com



Davis Wright
Tremaine LLP

DEFINING SUCCESS TOGETHER