

## **TEN THINGS YOU NEED TO KNOW ABOUT INTELLECTUAL PROPERTY LICENSES IN BANKRUPTCY**

As developing, protecting and using intellectual property becomes increasingly critical to today's businesses, it is important to understand how IP licenses are treated in bankruptcy.

1. Intellectual property licenses become “property of the estate” and the non-debtor counterparty is enjoined by the “automatic stay” from taking any action to terminate the license.
2. IP licenses are typically considered “executory contracts” because both sides have continuing material obligations (e.g., not to sue for infringement; maintain the IP; reporting; confidentiality; infringement action cooperation, defense or indemnity, etc.). But an exclusive license that only requires licensee royalties may not be executory in certain cases and the following provisions will not apply.
3. Under Bankruptcy Code § 365, executory contracts generally may be assumed in their entirety (not in part), assumed and assigned to a third party, or rejected. These rules, however, are much less straight forward with respect to IP licenses.
4. Bankruptcy Code § 365(c)(1) typically prohibits assignment of IP licenses to a third party without the non-debtor's consent because such assignment is not permitted under applicable intellectual property law. This prohibition is strongest with respect to non-exclusive licenses and may not apply to certain exclusive licenses. Moreover, courts may permit the assignment if the license agreement explicitly allows the type of proposed assignment or sale.
5. Courts are split on whether a debtor can assume IP licenses for their own continued use without the non-debtor's consent. Under the “hypothetical” test, courts do not allow the debtor to assume the IP license if it would be prohibited from assigning the IP license to a hypothetical third party. In such jurisdictions, it may be possible to allow the IP license to ride-through the bankruptcy and remain binding. Other courts follow an “actual” test and allow assumption if there is no actual assignment to a third party. It is important to consider your jurisdiction's controlling law on this issue before filing bankruptcy.
6. If permitted to “assume” the IP license, the debtor must cure defaults (dollar-for-dollar payment of missed royalty payments) and provide adequate assurance of future performance (royalties, quality maintenance, continued sales, etc.). Though a debtor cannot cherry-pick which provisions to assume, shifting leverage between the parties may lead to renegotiation of the terms.

7. Debtor may reject the IP license and the counterparty will be entitled to a claim in the bankruptcy case that often pays less than 100 cents on the dollar.
8. Notwithstanding, Bankruptcy Code § 365(n) permits non-debtor licensees to elect to retain their IP rights (with the possible exception of trademarks and certain foreign IP not included in the definition of “intellectual property” in the Bankruptcy Code) and continue making royalty payments during the duration of the license. Importantly, the election includes the right to enforce exclusivity but excludes any other claim to specific performance and the licensee gains no right to IP developed after the bankruptcy filing. Such election also waives any right to setoff or administrative expense.
9. The time period for the debtor to decide how to treat IP licenses is open ended in Chapter 11 restructurings and 60 days subject to extension in Chapter 7 liquidations. During this time the non-debtor party must continue to perform postpetition, but the non-debtor counterparty may ask the court for relief from the automatic stay to terminate the IP license for “cause,” including inability to cure defaults or assume or assign the IP license.
10. Intellectual property and IP licensing agreements are a very complex area of law outside bankruptcy and are further complicated in bankruptcy by conflicting interpretation and application of bankruptcy law in different jurisdictions. Therefore, it is important to speak with legal counsel experienced in corporate restructuring and intellectual property to determine your rights and the best course of action *both* before and after your IP licensing counterparty files for bankruptcy.

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