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ACCEPTING OR REJECTING AN EXECUTORY CONTRACT GOVERNING INTELLECTUAL PROPERTY IN BANKRUPTCY: LEGAL ANALYSIS OF H.R. 4657



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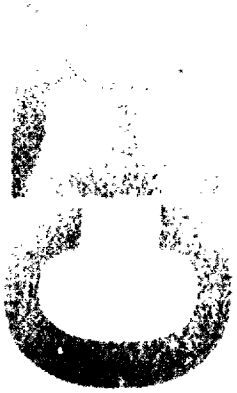

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ACCEPTING OR REJECTING AN EXECUTORY CONTRACT GOVERNING INTELLECTUAL PROPERTY IN BANKRUPTCY: LEGAL ANALYSIS OF H.R. 4657

SUMMARY

H.R. 4657, 100th Cong., 2d Sess. (1988), is a bill to amend the provision of the United States Bankruptcy Code which permits a trustee, with the court's approval, to assume or reject an executory contract. Specifically, 11 U.S.C. § 365, entitled "Executory contracts and unexpired leases" governs contract assumption or rejection. The purpose of this provision, generally, is to permit the debtor, through rejection, to relieve itself from burdensome contractual obligations, or, alternatively, to assume obligations which will be beneficial to the debtor's bankruptcy estate. An executory contract is one in which performance remains due to some extent on both sides.

In Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985), cert. denied, 475 U.S. 1057 (1986), a United States Court of Appeals found that a licensing agreement was an executory contract that could be rejected by a debtor in bankruptcy.

H.R. 4657 would amend § 365 of the Bankruptcy Code to alter the outcome in situations like that of the Lubrizol decision. If enacted, it would provide that nondebtor parties to contracts governing intellectual property, such as the licensing agreement in Lubrizol, could elect to retain certain contract rights despite a trustee's rejection of the agreement. The general approach of the bill is to treat executory contracts governing intellectual property in a similar manner to § 365's current treatment of unexpired leases, timeshare agreements, and contracts for the sale of real property.

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H.R. 4657, 100th Cong., 2d Sess. (1988), is a bill to amend the provision of the United States Bankruptcy Code, 11 U.S.C. § 101 et seq., which permits a debtor to accept or reject an executory contract. Specifically, 11 U.S.C. § 365, entitled "Executory contracts and unexpired leases," authorizes a trustee, or debtor-in-possession,[1] to assume or reject any executory contract or unexpired lease of the debtor, with the court's approval.

This report provides an overview of 11 U.S.C. § 365; it examines the judicial decision which has led to the introduction of H.R. 4657; and, it analyzes the effect that H.R. 4657, if enacted, would have upon a debtor's right to assume or reject an executory contract.

I. BACKGROUND.

A licensing agreement which grants rights to intellectual property -- rather than an outright transfer or sale of ownership in the property -- is a widespread business practice with important commercial consequences. Licensing agreements facilitate the flow of technology between entrepreneurs, large and small corporations, and research institutions, such as universities. Indeed, the information technology industry, which represents almost six percent of the

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[1] In a reorganization under chapter 11 of the Code, 11 U.S.C. § 1101 et seq., a debtor is permitted to continue to operate a business unless removed from possession by the court. 11 U.S.C. § 1104. A debtor who retains control over the bankruptcy estate is known as a "debtor-in-possession" and may exercise the rights, functions, and duties of a trustee. 11 U.S.C. § 1107.

U.S. gross national product, is of major significance to the nation's economy.[2] Royalties and fees received by U.S. companies from international licensing transactions are also substantial. The flexibility afforded parties through a wide variety of exclusive and nonexclusive licensing agreements promotes an efficient, effective, and affordable means for developing and distributing new technology-based products. But, when a licensor of intellectual property files for protection under the U.S. Bankruptcy Code, the contractual relationship between the licensor and licensee may be terminated. Because of the importance of intellectual property licensing agreements to the licensee, in particular, and to industry, in general, many perceive a need to amend the Bankruptcy Code to limit the extent to which the licensing agreement may be altered by the debtor, and to afford the nonbankrupt licensee greater protection of its contractual interests. The manner in which the Bankruptcy Code currently treats licensing agreements governing intellectual property is examined below.

II. 11 U.S.C. § 365: AN OVERVIEW.

Section 365(a) allows a trustee, subject to the court's approval, to assume or reject an executory contract or unexpired lease. This permits the bankruptcy estate to shed obligations which are burdensome and impede the likelihood of a successful reorganization, or, conversely, to retain advantageous contractual commitments which will benefit the estate and its creditors.

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[2] Statements of James Burger and Thomas Hemnes in Hearing on H.R. 4657, A Bill to Amend the Bankruptcy Laws With Respect to Rejection of Intellectual Property Licenses before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, June 3, 1988.

The Code does not define what constitutes an "executory contract," but the legislative history suggests that "it generally includes contracts on which performance remains due to some extent on both sides."[3]

Subsections (b), (c), and (d) provide limitations on the trustee's power to assume or reject a contract. Subsection (b) requires the trustee to cure any default in the contract or lease (other than a default by virtue of filing in bankruptcy) and to provide adequate assurance of future performance if there has been a default, before he may assume. Subsection (c) prohibits the trustee from assuming or assigning a contract or lease if applicable nonbankruptcy law excuses the other party from performance to someone other than the debtor, unless the other party consents. Subsection (d) places time limits on assumption and rejection. In a liquidation case, the trustee must assume within 60 days (or within an additional 60 days if the court, for cause, extends the time). If not, the contract is deemed rejected. In a reorganization case, the time limit is not fixed, although a party to the contract may request the court to specify a time by which the trustee must make a determination.

Subsection (e) invalidates bankruptcy clauses in executory contracts which purport to automatically terminate the contract or lease in the event of bankruptcy. Subsection (f) permits the trustee to assign the contract, notwithstanding a contrary provision within it, if assignment is permissible

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[3] H.R. Rep. No. 595, 95th Cong., 1st Sess. 347 (1977). Indeed, what constitutes an executory contract and whether it comes within the ambit of § 365 is often a question for the court to determine. See, e.g., National Labor Relations Board v. Bildisco, 465 U.S. 513 (1984)(collective bargaining agreements); In re Speck, 798 F.2d 279 (8th Cir. 1986)(contract for deed of sale of real property); Johnson v. Fairco Corp., 61 B.R. 317 (U.S.D.C.,N.D.Ill. 1986) (stock redemption agreement); and, Matter of B. Siegal Co., 51 B.R. 159 (Bkrtcy., Mich. 1985)(insurance contract).

under applicable nonbankruptcy law. Subsection (g) deals with subsequent rejections of previously assumed contracts and leases, and specifies when the rejection and consequent breach will be calculated.

Subsections (h), (i), and (j) deal with unexpired leases of real property of the debtor in which the debtor is the lessor, contracts for the sale of property in which the debtor is seller, and timeshare interests under a timeshare plan in which the debtor is the seller.

When a contract or lease is rejected by the debtor under § 365, the other party to the agreement may assert a claim for damages arising from the breach. Pursuant to 11 U.S.C. §§ 365(g) and 502(g), such a claim is treated as a prepetition, unsecured claim against the estate. Assumption of the contract is an act of administration of the estate, and the expenses and liabilities connected therewith are high priority expenses of administration.[4]

III. LUBRIZOL ENTERPRISES, INC.: A U.S. COURT OF APPEALS PERMITS REJECTION OF A TECHNOLOGY LICENSE AGREEMENT.

In Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985), cert. denied, 475 U.S. 1057 (1986), the court permitted Richmond Metal Finishers (RMF), a chapter 11 debtor-in-possession, to reject as executory a technology licensing agreement with Lubrizol Enterprises (Lubrizol). In doing so, it reversed a district court finding that the contract was not executory as contemplated by § 365, and that rejection would not substantially benefit the debtor.

In 1982, RMF had entered into a contract granting Lubrizol a nonexclusive license to utilize a metal coating process technology owned by RMF. The

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[4] 2 Collier on Bankruptcy ¶ 365.03 (L. King, Ed., 15th Ed. 1988).

contract provided that Lubrizol would defer use of the process until May, 1983. On August 16, 1983, RMF filed under chapter 11 of the Bankruptcy Code. As part of its reorganization plan, RMF sought to reject its contract with Lubrizol in order to facilitate sale or licensing of the technology unhindered by restrictive provisions in the Lubrizol agreement. The bankruptcy court decision which had permitted rejection, finding the contract to be executory, and rejection advantageous to the bankrupt, was subsequently reversed by a U.S. district court.

The U.S. Court of Appeals, in reviewing the district court's decision, identified the reciprocal duties owed the parties under the contract:

> RMF owed the following duties to Lubrizol under the agreement: (1) to notify Lubrizol of any patent infringement suit and to defend in such suit; (2) to notify Lubrizol of any other use or licensing of the process, and to reduce royalty payments if a lower royalty rate agreement was reached with another licensee; and (3) to indemnify Lubrizol for losses arising out of any misrepresentation or breach of warranty by RMF. Lubrizol owed RMF reciprocal duties of accounting for and paying royalties for use of the process and of cancelling certain existing indebtedness.[5]

The court applied its legal standard to determine whether a contract is executory, namely, whether "the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other",[6] and concluded that the contract was indeed executory.

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[5] 756 F.2d at 1045.

[6] Id., citing Gloria Manufacturing Corp. v. International Ladies' Garment Workers' Union, 734 F.2d 1020, 1022 (4th Cir. 1984) (quoting Countryman, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 460 (1973)).

The court addressed the question of whether a licensing agreement comes within the scope of § 365 in passing. In a footnote, it observed:

> We disagree with the district court's characterization of the [licensing] transaction as effectively a completed sale of property. If an analogy is to be made, licensing agreements are more similar to leases than to sales of property because of the limited nature of the interest conveyed. Congress expressly made leases subject to rejection under § 365 in order to "preclude any uncertainty as to whether a lease is an executory contract" under § 365.[7]

Hence, having found the RMF-Lubrizol contract to be executory by its terms, the court had no hesitation finding it to be subject to the assumption and rejection powers of a trustee under § 365.

The court then proceeded to consider whether rejection of the licensing agreement was advantageous to the bankrupt. In doing so, it articulated the proposition that the bankrupt's decision regarding rejection "is to be accorded the deference mandated by the sound business judgment rule as generally applied by the courts to discretionary actions or decisions of corporate directors".[8] In a bankruptcy context, the "sound business judgment rule" requires that the court accept the bankrupt's decision to reject unless it is shown that the decision was taken in bad faith or was a gross abuse of the bankrupt's business discretion.

The court rejected the district court's determination that RMF's contingent obligations under the agreement were not sufficiently onerous that relief from them would constitute a substantial benefit to the bankruptcy estate, and that because rejection could not deprive Lubrizol of all its rights to the technology, rejection could not reasonably be found to be beneficial.

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[7] 756 F.2d at 1049. (Citation omitted.)

[8] Id. at 1046.

With respect to the latter point, the court concluded that "the district court was under a misapprehension of controlling law in thinking that by rejecting the agreement the debtor could not deprive Lubrizol of all rights to the process."[9] It explained at length that Lubrizol had only a monetary claim for damages as a consequence of breach, but retained no enforceable claim to the technology process itself after rejection.[10]

The court concluded by observing that to permit a bankrupt party to reject an executory licensing agreement imposes "serious burdens" on contracting parties such as Lubrizol. It acknowledged that its decision could be expected to have a general chilling effect on the willingness of parties to contract for technology licenses with businesses in possible financial difficulty. But it found that the Bankruptcy Code leaves no discretion to indulge in equitable considerations with respect to the rejection of the type of contract at issue:

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[9] Id. at 1048.

[10] Specifically, the court reasoned:

> "Under 11 U.S.C. § 365(g), Lubrizol would be entitled to treat rejection as a breach and seek a money damages remedy; however, it could not seek to retain its contract rights in the technology by specific performance even if that remedy would ordinarily be available upon breach of this type of contract. . .Even though § 365(g) treats rejection as a breach, the legislative history of § 365(g) makes clear that the purpose of the provision is to provide only a damages remedy for the non-bankrupt party. . .For the same reason, Lubrizol cannot rely on provisions within its agreement with RMF for continued use of the technology by Lubrizol upon breach by RMF. Here again, the statutory "breach" contemplated by § 365(g) controls, and provides only a money damages remedy for the non-bankrupt party. Allowing specific performance would obviously undercut the core purpose of rejection under § 365(a), and that consequence cannot therefore be read into congressional intent."
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> (Citations omitted.)
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> Id.

> Congress has plainly provided for the rejection of executory contracts, notwithstanding the obvious adverse consequences for contracting parties thereby made inevitable. Awareness by Congress of those consequences is indeed specifically reflected in the special treatment accorded to union members under collective bargaining contracts, see Bildisco, ___U.S. at ___, 104 S.Ct. at 1193-96, and to lessees of real property, see 11 U.S.C. § 365(h). But no comparable special treatment is provided for technology licensees such as Lubrizol. They share the general hazards created by § 365 for all business entities dealing with potential bankrupts in the respects at issue here.[11]

The Lubrizol decision has contributed to the perceived need for legislation clarifying the ability of a trustee to assume or reject an executory contract involving licensing agreements in particular, and intellectual property, in general.[12] Examined below is the manner in which H.R. 4657 would address this class of executory contract.

IV. H.R. 4657, 100TH CONG., 2D SESS. (1988).

This bill, introduced on May 23, 1988,[13] would add a new subsection (n) to 11 U.S.C. § 365 dealing exclusively with the trustee's right to reject or assume contracts involving the rights to intellectual property. More precisely, the bill permits the nonbankrupt party to a contract governing intellectual property to retain an interest under the agreement.

Section 1(a) of H.R. 4657 would amend the definitional section of the Bankruptcy Code, 11 U.S.C. § 101 by adding a new subparagraph (52) defining the term "intellectual property," and a new subparagraph (53) defining "mask work."

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[11] Id.

[12] 134 Cong. Rec. H3491 (daily ed. May 23, 1988)(Statement of Rep. Edwards introducing H.R. 4657).

[13] See note 12, supra. See also, S. 1626, 100th Cong., 1st Sess. (1987).

"Intellectual property" means "(A) trade secret; (B) invention, process, design, or plant variety; (C) work of authorship; or (D) mask work" subject to protection under 17 U.S.C. chapter 9 which provides for the protection of semiconductor chip products.

Although various federal statutes and regulations deal with trade secrets in general, there is neither a comprehensive body of federal trade secret law nor a statutory definition of that term. There are, however, federal statutes and regulations which provide sources for trade secret law and definition, and federal case law defines the term as well. For example, § b(4) of the Freedom of Information Act (FOIA), 5 U.S.C. § 552(b)(4), exempts trade secrets from its coverage. And although courts have traditionally relied upon the broad definition provided by § 757 of the Restatement of Torts,[14] this definition was rejected in a recent decision, Public Citizen Health Research Group v. F.D.A., 704 F.2d 1280 (D.C.Cir. 1983). In this opinion, the court, applying the term under the FOIA, defined trade secret as a "secret, commercially valuable plan, formula, process, or device that is used for the making, preparing, compounding, or processing of trade commodities and that can be said to be the end product of either innovation or substantial effort." 704 F.2d at 1288. The Food and Drug Administration, by contrast, has promulgated a definition for the

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[14] This definition states that "[a] trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers." 4 Restatement of Torts § 757 comment b (1939) cited in Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 474-475 (1974).

concept of trade secret which is based on the Restatement model.[15] And, although there is a federal Trade Secrets Act, 18 U.S.C. § 1905, which provides criminal sanctions for unauthorized disclosure of trade secrets by federal employees, it does not contain a statutory definition of the term. In addition to these sources under federal law for a definition of trade secret, state laws having comprehensive definitions of trade secret would further assist in defining this category of intellectual property.

The second group of terms, i.e., "invention, process, design, or plant variety" appears to encompass the body of federal patent law set forth at 39 U.S.C. § 101 et seq. Reference to "work of authorship" seems to refer to the body of federal copyright law, 17 U.S.C. § 102. The last term, "mask work," is a series of related images fixed in a semiconductor chip product. Proposed subsection 101(53) refers directly to the definition of "mask work" set forth at 17 U.S.C. § 901(a)(2), i.e., a series of fixed or encoded images having a predetermined three-dimensional pattern of metallic, insulating, or semiconductor material of a semiconductor chip and in each series image has the pattern of the surface of one form of the semiconductor chip product.

The bill qualifies all of the definitional categories by providing that they include those areas protected by applicable nonbankruptcy law. These protected areas would include copyright and patent laws.

Section 1(b) of the bill would add a new subsection (n) to § 365 governing the assumption or rejection of executory contracts under which the debtor is a licensor of a right to intellectual property, as defined above. Specifically,

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[15] 21 C.F.R. § 20.61(a)(1988) states " [a] trade secret may consist of any formula, pattern, device, or compilation of information which is used in one's business and is of a type which gives him an opportunity to obtain an advantage over competitors who do no know or use it."

it would confer upon the nondebtor licensee an option to elect to retain contractual rights despite a trustee's rejection.

Pursuant to proposed § 365(n)(1)(A)[16], a licensee, upon rejection, could elect to treat the contract as terminated when the rejection "amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity."[17] As an alternative to treating the contract as terminated, the licensee has the option of retaining its contractual rights to the intellectual property, or its embodiment, "other than

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[16] Proposed § 365(n)(1) expressly states:

> (n)(1) If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect --
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> (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or
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> (B) to retain its rights (other than a right under applicable nonbankruptcy law to specific performance of such contract) under such contract, and any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for --
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> (i) the duration of such contract, and
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> (ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.

[17] It is not readily apparent how the latter condition, i.e., "an agreement made by the licensee with another entity," would legally operate to excuse contract performance between the debtor-licensor and the licensee. This language, however, appears to be patterned after identical language in § 365(h)(1) which governs rejection by a debtor-lessor of an unexpired lease of real property, and by a debtor-vendor of a timeshare interest under a timeshare plan. The legislative history of the language of § 365(h)(1), which was enacted pursuant to the Bankruptcy Amendments and Federal Judgeship Act of 1984, P.L. 98-353, § 402, does not clarify what type of third-party agreement was contemplated by this clause. See 1984 U.S. Code Cong. & Adm. News 576.

a right under applicable nonbankruptcy law to specific performance" of the contract "as such rights existed immediately before the case commenced". See proposed § 365(n)(1)(B).[18] The retention rights of the licensee would extend for the duration of the contract term, or for any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.

If the licensee elects to retain its rights, pursuant to subsection (n)(2), the trustee must allow the licensee to exercise them. The licensee is required to make all payments due under the contract for its duration and for any period during which it may be legally extended. The licensee must waive "any right of setoff it may have with respect to such contract" under either the Bankruptcy Code or applicable nonbankruptcy law, and any claim arising from the performance of the contract that would qualify as a high priority administrative expense.

If the licensee elects to retain contractual rights, the trustee must, upon written request from the licensee, provide any intellectual property required to be provided by contract or supplementary agreement, and must not interfere with the rights of the licensee as provided in the contract. Proposed § 365(n)(3).

Unless and until the trustee rejects such contract, i.e., presumably in the absence of and prior to a court-approved assumption or rejection, on written request of the licensee, the trustee shall perform the contract, or provide the licensee with the intellectual property, including any embodiment thereof, and refrain from interfering with the rights of the licensee as

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[18] Note 16, supra.

provided by the contract, including any right to obtain the property from a third entity, presumably an escrow agent. Proposed § 365(n)(4).

The approach of proposed subsection 365(n) appears to be generally patterned upon § 365's treatment of real property leases, timeshare agreements, and executory contracts for the sale of real estate under subsections (h) and (i). Basically, these statutory provisions allow nonbankrupt lessees and vendees to elect to treat a contract which is rejected by a debtor lessor/vendor as terminated, or to remain in possession for the remaining contract term. When a debtor-landlord rejects an unexpired real property lease under subparagraph (h), the tenant may retain the estate which includes all enforceable renewal terms which the tenant may invoke unilaterally. The tenant may offset all damages arising from the rejection against future rent reserved under the lease. The offset, however, may only go against rent accruing under the lease; damages based on the rejection may not be asserted against the estate. The tenant may offset only those damages caused by the debtor-landlord's nonperformance after the date of rejection.[19]

Likewise, a purchaser of real property or a timeshare interest who is in possession may remain in possession despite contract rejection by the debtor-seller, or may treat the contract as terminated. Like the nonbankrupt lessee, the purchaser in possession may offset damages accruing after the date of rejection but may not assert any general claims against the estate on account of damages arising post-rejection. Upon completion of the payments by the purchaser, the debtor is required to deliver title, but is relieved of all other obligations under the contract.[20]

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[19] 2 Collier on Bankruptcy, supra note 4 at ¶ 365.09.

[20] Id. at ¶ 365.10.

Under H.R. 4657, a nonbankrupt licensee's interest in an executory contract governing intellectual property would be analogous to that of the real property lessor/purchaser, discussed above. As in real property executory contracts, the licensee's option to retain contract rights under § 365(n) may promote a legal result more akin to contract reformation, rather than assumption or rejection.[21] In other words, when the licensee exercises its retention rights, a new or "reformed" contract will be created between the parties, but the rights, means of enforcement, and terms will be altered.

And there may be cases in which there is ambiguity as to exactly what rights the licensee is retaining pursuant to the § 365(n) election. Pursuant to § 365(n)(1)(b), a nondebtor licensee may elect

> "to retain its rights (other than a right under applicable nonbankruptcy law to specific performance of such contract) under such contract. . .to such intellectual property. . .as such rights existed immediately before the case commenced[.]"
> (Emphasis supplied.)

This language suggests that a licensee retains not just a right to the intellectual property as it existed immediately before the bankruptcy filing, but to its contractual rights, i.e., the benefit of its bargain, as they existed prior to the bankruptcy filing. Hence, executory contractual provisions that entail requirements of future performance of a licensor/debtor remain theoretically viable. The nondebtor/licensee, however, is stripped of

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[21] When a trustee or debtor in possession assumes a contract, it is assumed subject to all its provisions and conditions. It may not be assumed in part and rejected in part. Thompson v. Texas Mexican Ry. Co., 328 U.S. 134 (1946); Richmond Leasing Co. v. Capital Bank, N.A., 762 F.2d 1303, 1311 (5th Cir. 1985); Kirby v. United States, 329 F.2d 735 (10th Cir. 1964); and, In re Nitec Paper Co., 43 B.R. 492 (D.C.,S.D.N.Y. 1984). 2 Collier on Bankruptcy, supra note 3 at ¶ 365.01, 365.03. As § 365 itself and cases thereunder demonstrate, the rights and liabilities of parties after a contract is rejected are less clear. Cf., Lubrizol, supra with In re Select-A-Seat Corp., 625 F.2d 290 (1980).

the remedy of specific performance of the contract, so enforcement of those future performance requirements against the debtor may be illusory. The statute does not address the question of post-petition breach of contract by a trustee when the licensee has elected to retain its contractual rights.

The licensee would remain obligated to make all payments due under the contract, and would waive any right to setoff or to assert high priority administrative claims against the estate. In the situation, discussed above, where a tenant elects to remain in possession after the lessor/debtor rejects the lease, the statute contemplates that the lessor may stop performing its executory obligations (i.e., covenants to pay utilities and maintain the premises) and permits the tenant to offset those expenses from the rent payments due to the lessor. With an executory contract governing intellectual property, however, there would be no right of offset or administrative claim against the estate for nonperformance by the debtor of future executory obligations.

Hence, a licensee would appear to retain its contractual rights, including rights to future performance, but the bill specifically ensures only that the debtor provide the intellectual property itself, or its embodiment, and not interfere with the licensee's exercise of its rights. In the absence of a right of setoff under the contract or a right to assert a claim against the estate, the licensee would have to make a business determination as to whether its payments under the contract would remain financially viable in the event of the debtor's abandonment of future executory obligations.

In, for example, In re Select-A-Seat, 625 F.2d 290 (9th Cir. 1980), the court permitted a debtor's trustee to reject an executory contract which had given the nondebtor licensee exclusive rights to use and license the debtor's

software package. The court rejected the licensee's argument that exclusive licensing rights, once transferred, became property of the licensee which the trustee could not abrogate through contract rejection, reasoning:

> The trustee merely sought to reject the executory portions of the contract, the continuing warranty and exclusive dealing obligations. These obligations are analogous to executory covenants in leases to provide heat or electricity; the lease (here the license) cannot be summarily terminated, but rejections can cancel covenants requiring future performances by the debtor.[22]

Under proposed § 365(n), the licensee would retain its rights to future performance by a debtor (assuming those rights existed immediately before the case commenced). Thus, in the case of an exclusive licensing agreement, § 365(n) should protect the licensee's right to exclusivity, but, if that remedy is enforceable only through a suit for specific performance, the right may not be enforceable.[23]

In a clear-cut, nonambiguous contractual clause governing exclusivity, a licensee may prevail upon the court to enjoin the debtor from "interfering" with its rights under the contract. The bill is less clear with respect to conflicts which may arise over the licensee's retained contract rights where the debtor/licensor does not merely fail to perform future executory obligations or acts in direct contravention of them, but disputes the obligation itself. In the Select-A-Seat case, supra, assume that the licensee

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[22] 625 F.2d at 292-293.

[23] Section 365(n) would not be the first provision under the statute that is not entirely clear with respect to enforcement of the trustee's obligations to perform. Section 365(d)(3) requires that, in a case under chapter 7, the trustee must "timely perform all the obligations of the debtor" arising from and after the order for relief under any unexpired lease of nonresidential real property until such lease is assumed or rejected. The statute is silent as to the consequences of failure to perform. See 2 Collier on Bankruptcy ¶ 365.03[2].

elected to retain its exclusive contract rights, but that the debtor modified or perfected the original software package to the extent that it contended that it was a new product, not subject to the license agreement and was therefore marketable by it to others. Proposed subsection 365(n) does not address the manner in which parties may resolve contractual disputes that may arise from the contract reformation effected thereunder.

With the exception of unexpired leases and real property sales agreements, § 365 generally limits itself to the procedures governing contract assumption or rejection, not reformation. Implicit in the provision is the notion that a successful rehabilitation may require that a debtor be freed from burdensome contractual obligations in order to obtain a fresh start.[24] Rejection must be advantageous to the bankrupt and to its creditors in general.[25] In this respect, § 365(n) appears to excuse the debtor/licensor from performance of future executory obligations but does not seem to contemplate resolution of issues that may arise when a licensee elects to retain its contractual rights and disputes arise between it and the debtor in the course of the

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[24] In re Norquist, 43 B.R. 224 (Bkrtcy., E.D.Wash. 1984). 2 Collier on Bankruptcy, supra note 3 at ¶ 365.10[1]; 2 Cowans Bankruptcy Law and Practice § 11.11 (1986 Ed.).

[25] Bee, Matter of Minges, 602 F.2d 38 (2d Cir. 1979); In re G-N Partners, 48 B.R. 462 (Bkrtcy., Minn. 1985); In re Norquist, supra, note 21.

Cf., In re Petur U.S.A. Instrument Co., Inc., 35 B.R. 561 (Bkrtcy., W.D.Wash. 1983)(court refusal to authorize debtor's rejection of license agreement where rejection would result in destruction of nondebtor's business and damages to nondebtor would be grossly disproportionate to any benefit derived by general creditors.)

reorganization.[26] Because intellectual property licensing agreements encompass a wide variety of potentially complex contractual arrangements,[27] there may be a great likelihood for disputes to arise from the debtor's actions in reorganization with respect to its obligations under the contract.

The concept for the election of rights by a nonbankrupt party to an intellectual property contract is based upon the Bankruptcy Code's treatment of unexpired leases and real property sales contracts. Clearly, the outcome of the situation addressed by the court in the Lubrizol decision would be altered applying § 365(n). Lubrizol could have elected to retain its rights under the licensing agreement. Current § 365 attempts to create a balance between the interests of those who contract with a debtor and the debtor's need for relief from burdensome contractual commitments in order to rehabilitate. Whether unexpired leases and real property sales agreements are sufficiently analogous to contracts governing intellectual property to maintain the balance embedded in § 365 will be revealed as the courts apply the statute, if it is enacted.

Subsection 365(n)(4) would alter the time frame for acceptance or rejection by a trustee that would otherwise govern. Currently, § 365(d)(2) provides that in a case under chapters 9, 11, 12, or 13, the trustee may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before confirmation of a reorganization plan. On request of a party, however, the court may order the

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[26] The troubled relationship between a debtor/licensor and licensee and the likelihood of continued legal battles between them compelled a bankruptcy court to approve the debtor's rejection of an exclusive software distribution agreement despite the licensee's contention that rejection would result in the destruction of its business. In Re Logical Software, Inc., 66 B.R. 683 (Bkrtcy., D.Mass. 1986).

[27] See Hemmes and Montgomery, The Bankruptcy Code, The Copyright Act, And Transactions in Computer Software, 7 Computer L.J. 327 (1987).

trustee to make the determination within a specified period of time.[28] Subsection (n)(4) would provide that unless and until the trustee rejects a contract, on written request of the licensee, the trustee shall perform the contract, or provide to the licensee such intellectual property covered by the agreement and refrain from interfering with the rights of the licensee under the contract. Presumably, licensee-initiated performance under this subsection will not constitute an assumption. Again, an important distinction in the debtor's duty to perform under this subsection will depend upon whether performance by the debtor is passive -- i.e., maintaining the contractual status quo by providing the intellectual property and refraining from interfering with the licensee's rights under the contract -- or whether the licensee may demand performance of more onerous contractual obligations by the debtor. In the latter case, a trustee's prerogative to determine the timing of assumption or rejection in the absence of a court order may be eroded by the licensee's right to compel performance pending a decision.

Section 2 of H.R. 4657 provides that the amendments take effect prospectively upon enactment.

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[28] In a liquidation under chapter 7, if the trustee does not act within 60 days, or within an additional time that the court may allow, the contract or lease is deemed rejected. § 365(d)(1). The same time frame obtains with respect to unexpired leases for nonresidential real property for which the debtor is lessee. § 365(d)(4).