When Worlds Collide: The American Legal System Reconciles The Code's Policies and Language at the Intersection of Intellectual Property and Bankruptcy

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I. INTRODUCTION

Bankruptcy offers a fresh start for individuals and companies unable to pay their debts by liquidating assets or creating (or adjusting) payment plans. By contrast, intellectual property is the intangible asset of the mind.

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Along with this comes specific rights such as exclusivity, reproduction, and public display. Oftentimes, inventors and creators of intellectual property are not best situated to commercialize and reap the benefit of the rights that accompany their creations. Therefore, the mechanism of licensing may be critical to encourage investment in the arts and sciences, while allowing these individuals to capitalize on their investment. However, the freedom of contract in licensing intellectual property comes to a head in bankruptcy, where licenses are often the subject of bankruptcy proceedings. Traditionally distinct areas of the law, bankruptcy and intellectual property are bridged together by overlapping principles of contract, property, and securities law.

This Comment addresses the critical intersection of intellectual property and bankruptcy. Part II introduces the legal histories of bankruptcy and intellectual property, following their independent voyages to their eventual crossing in the twentieth century. Though the emphasis of this Comment is on Chapter 11 bankruptcy, or restructuring, it briefly touches on other chapters. The primary goal of Part II is to illustrate the breadth and interconnectivity of both industries, while highlighting the impendent consequences given the nature of today's business models. Part III examines specific issues when dealing with intellectual property assets in bankruptcy. This Part explains each of the following disputed issues: the interpretation of executory contracts, the assignability of exclusive copyrights, and the treatment of trademarks under the Bankruptcy Code ("The Code"). Notably, whereas most comments focus on a single circuit split or disputed issue, this Comment seeks to give the reader a broader understanding of the current range of issues, while providing the basic foundation to opine in-depth research to each.

II. INTELLECTUAL PROPERTY AND BANKRUPTCY IN THE UNITED STATES: A BRIEF HISTORY

A. *Intellectual Property Rights*

Intellectual property rights have long been recognized in the United States, tracing its origins to the 1623 English Statute of Monopolies.[1] The early colonial states continued to appreciate intellectual property as an important asset, writing legislation to protect it amongst their states.[2] This

1. Jacob R. Weaver, *The Forgotten History of the Intellectual Property Clause*, THE FEDERALIST SOC'Y (Apr. 8, 2021), https://fedsoc.org/commentary/fedsoc-blog/the-forgotten-history-of-the-intellectual-property-clause [https://perma.cc/357M-9D9A].

2. *Id.*

recognition would later be memorialized at the Constitutional Convention of 1787 in Article I, Section 8, Clause 8 of the Constitution, where the Framers granted Congress the power "[t]o promote the progress of science and useful arts . . . by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries."[3] In 1840, there were a mere 734 patents filed in the United States.[4] Almost 200 years later in 2020, 597,175 patents were filed.[5]

When intellectual property is brought up in policy conversations, a few words come to mind. Innovation. Expansion. Creativity. Research. The schemes that regulate each pillar of intellectual property—patents, copyrights, trademarks, trade secrets—have these attributes in common. Accordingly, intellectual property rights include such things as the rights to exclusivity, reproduction, and public display. To understand the rights afforded under each regulatory schema, it is important to understand each relevant form of intellectual property.

1. Forms of Intellectual Property

A patent offers a limited, finite monopoly in exchange for the public disclosure of inventions. Absent this protection, inventors would not have incentive to invest in creating, developing, and marketing new products. In order for a patent claim to be valid, it must contain five elements: patentable subject matter, utility, adequate disclosure, novelty, and nonobviousness. Patentable subject matter includes processes, machines, articles of manufacture, and compositions of matter, but explicitly precludes laws of nature, natural phenomena, and abstract ideas.

A patent (and patent application) is considered personal property[6] and, accordingly, will become part of the estate in bankruptcy.[7] This property can be either assigned or licensed.[8] This distinction is important because with assignment comes the right to exclude others from use; whereas a license only permits use.[9] A license can be exclusive or non-

3. *Id.*

4. *U.S. Patent Activity: Calendar Years 1790 to the Present*, USPTO, https://www.uspto.gov/web/offices/ac/ido/oeip/taf/h_counts.htm (last visited Mar. 5, 2023) [https://perma.cc/5Z3V-WWTP].

5. *Id.* This growth in applications can be traced over time with 39,673 patents filed in 1900 and 101,014 patents filed in 1975.

6. 35 U.S.C. § 261.

7. 11 U.S.C. § 541(a).

8. *Id.* § 261.

9. Waterman v. Mackenzie, 138 U.S. 252, 255 (1891) ("In equity, as at law, when the transfer amounts to a license only, the title remains in the owner of the patent; and suit must be

exclusive and offered in whole or in part. Unless explicitly permitted in the agreement, only exclusive licenses may assign interest to a third party.[10] Non-exclusive licenses may require licensor's consent to be assumed and assigned.[11]

Unlike patents, copyright protection is afforded at creation and not dependent on an application. Here, the Copyright Act protects "original works of authorship," which requires just a modicum of creativity.[12] This is relevant for purposes of creating the estate because it can be applicable to published and nonpublished works alike. This may result in the lines being blurred as to what the property of the estate may scoop up, but the scope of the estate is broad. Copyrights can be assigned, but there is a current circuit split as to whether they can be assigned when they are under a non-exclusive ownership license.[13]

Trademarks, by contrast, are "any word, name, symbol, or device, or any combination thereof" that allow consumers to identify a source of goods or services.[14] Recall that The Code does not explicitly recognize trademarks, nor are they an element of the Intellectual Property Clause of the Constitution. They are afforded different treatment that patents, copyrights, and trade secrets. Trademarks may be licensed, however their assignability has come under recent question.[15]

Lastly, trade secrets, emerging from common law torts, are governed by the Uniform Trade Secrets Act.[16] The UTSA defines a trade secret as any "information . . . [that] derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means."[17] Trade secret laws have two purposes: to encourage investment in proprietary information and to deter uncommercial behaviors.[18] Trade secrets are considered personal

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brought in his name, and never in the name of the licensee alone, unless that is necessary to prevent an absolute failure of justice, as where the patentee is the infringer, and cannot sue himself.")

10. In re CFLC Inc., 89 F.3d 673 (9th Cir. 1996) (holding that nonexclusive patent license was not assumable and assignable in bankruptcy under 11 U.S.C. §365(c) unless authorized by patent owner or by license itself).

11. *See generally* CRAIG B. YOUNG & PATRICIA S. ROGOWSKI, BANKRUPTCY AND ITS IMPACT ON INTELLECTUAL PROPERTY (Thompson Reuters 2d. ed.).

12. 17 U.S.C. § 102.

13. Emily Clark, *Trademarks are "Intellectual Property" Under Bankruptcy Code Section 365(n)*, 12 ST. JOHN'S BANKR. RSCH. LIBR. No. 7 (2020).

14. 15 U.S.C. § 1127.

15. Mission Prod. Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652, 1666 (2019).

16. Mark A. Lemley, *The Surprising Virtues of Treating Trade Secrets as IP Rights*, 61 STNLR 311, 316 (2008).

17. Uniform Trade Secrets Act (Unif. L. Comm'n 1985) § 1(4) [hereinafter UTSA].

18. Lemley, *supra* note 16, at 319.

property and may be freely licensed.[19] However, they must also be disclosed in bankruptcy proceedings.[20] This can be conflicting because the very nature of trade secrets are that they are not freely disclosed, and 11 U.S.C. § 107 provides that bankruptcy filings are "public records . . . open to examination by an entity at reasonable times."[21] With that said, subsection (b)(1) provides protection specifically against the revelation of trade secrets or confidential research—mandatorily on request of an interested party and discretionarily on the court's own basis.

B. Bankruptcy in the United States

In contrast to intellectual property jurisprudence, America's history with bankruptcy has been a turbulent journey.[22] Bankruptcy legislation was frequently enacted and repealed until 1898, at which point federal bankruptcy laws have existed continuously in the United States. The modern-day bankruptcy code was enacted as the Bankruptcy Reform Act of 1978, and now is referred to as The Bankruptcy Code. Until the enactment of certain statutory provisions in 1988, neither historical bankruptcy rules nor The Code specifically addressed the procedures for intellectual property.[23]

The Intellectual Property Bankruptcy Protection Act of 1988 defines intellectual property for the first time. Under The Code, intellectual property is defined as a trade secret, an invention or design under title 35 (patents), a patent application, a plant variety, a work of authorship under title 17 (copyright), or a semiconductor chip component.[24] Notably, the Code omits trademarks from the enumerated definition, which has led to a circuit split that was partially resolved by the Supreme Court in 2019.[25] Some argue that trademarks should be treated the same as its intellectual

19. *See* Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 475 (1974).

20. S. Rep. No. 100-505 (1988) at 4.

21. 11 U.S.C. § 107(b).

22. Jay Lawrence Westbrook & Kelsi Stayart White, *The Demystification of Contracts in Bankruptcy*, 91 AM. BANKR. L.J. 481, 492 (2018).

23. *See* 11 U.S.C. § 365(n); *see also* § 101.

24. § 101.

25. Notably, trademarks are not included under the Intellectual Property Clause of the Constitution, but instead reside under the Commerce Clause. *See* In re Trade-Mark Cases, 100 U.S. 82, 95 L. Ed. 550 (1879) (holding that the Copyright Clause of the Constitution gave Congress no power to protect or regulate trademarks); *see generally* Mission Prod. Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652 (2019); *see also* 15 U.S.C. § 1125 (regulating use of trademarks for "any goods or services . . . in commerce").

property counterparts Section 365(n).[26] Yet Congress noted that trademarks are largely dependent on control of the products or services sold by the licensee.[27] They did not simply forget trademarks but instead acknowledged their deliberate decision to "postpone congressional action [regarding trademarks in bankruptcy] and to allow the development of equitable treatment . . . by the bankruptcy courts."[28]

Congress enacted the intellectual property provisions "to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to Section 365 in the event of the licensor's bankruptcy."[29] Thus, in their own words, "no area of bankruptcy and reorganization is a proper understanding of the applicability of § 365 more important than in [intellectual property]."[30]

1. 11 U.S.C § 365: Assignment, Assumption & Rejection

Section 365 contains one of the most significant powers granted in a Chapter 11 bankruptcy. That is the power of the DIP to reject executionary contracts. The DIP may exercise significant control during Chapter 11 proceedings through their ability to assume, assign, or reject executory contracts.[31] A debtor may *assume* executory contracts that are critical to their operations or that continue to provide value to the estate, but such contracts must be accepted with the exact terms of the initial deal.[32] Before assuming the contracts, the debtor must promptly cure any breach and provide adequate assurance for future performance.[33] Alternatively, the debtor, after assuming a contract, may subsequently *assign* the contract to a third-party.[34] After assignment, the DIP and estate

26. Emily Clark, *Trademarks are "Intellectual Property" Under Bankruptcy Code Section 365(n)*, 12 ST. JOHN'S BANKR. RESEARCH LIBR. No. 7 (2020).

27. S. Rep. No. 100-505 (1988) at 4.

28. *Id.*

29. *Id.* at 1.

30. Westbrook & White, *supra* note 22, at 506.

31. Peter S. Menell, *Bankruptcy Treatment of Intellectual Property Assets: An Economic Analysis*, 22 BERKELEY TECH. L.J. 735, 767 (2007); *see* Brett T. Cooke, *Intellectual Property Licenses and Assignments under Chapter 11 of the Bankruptcy Code: A Brief Survey of the Nature of the Property Rights Conferred and Implications Due to Reorganization*, 15 TEX. INTELL. PROP. L.J. 213, 218 (2007).

32. 11 U.S.C. § 365(a); *see* Menell, *supra* note 31, at 767.

33. To cure means to resolve any default by getting up to date with any pre or post-petition obligations. 11 U.S.C. § 365(b). Though undefined in The Code, to provide adequate assurance means to reassure the creditor that the debtor will be able to make future payments.

34. § 365(f)(2); Menell, *supra* note 31, at 768.

are relieved from any liability arising from breaches post-assignment.[35] Additionally, the non-debtor party is obliged to deal with the assignee.[36] Last but most significantly, a debtor may *reject* contracts that are burdensome to the estate and need not provide any justification for doing so.[37] Upon rejection, the non-debtor party receives a general unsecured claim in the amount of the breach.[38]

There are two limitations to this authority—one applicable to all property, and one exclusively applicable to bankruptcy. First, the contract must be executory for the debtor to invoke one of the three options.[39] Executory contracts are not explicitly defined by The Code, but Vern Countryman's definition has been largely accepted by courts.[40] Thus, "[an executory contract is] a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other."[41] This accepted definition, however, will be discussed later in this Comment as the Ninth Circuit Bankruptcy Appellate Panel passively challenged this interpretation in 2017.[42]

The second limitation is found in Section 365(n), applicable only to intellectual property. The Intellectual Property Bankruptcy Protection Act acknowledges specific circumstances for rejection when a licensor-DIP rejects an executory contract.[43] When this happens, the licensee may elect to either treat the contract as terminated if rejection would amount to a breach entitling them to damages under applicable non-bankruptcy law per §365(n)(1)(A) or, according to §365(n)(1)(B), retain its rights that existed immediately before the case was filed for the duration of the contract under applicable non-bankruptcy law.[44]

35. 11 U.S.C. § 365(k).

36. *Id.*

37. *Id.*; *see* Menell, *supra* note 31, at 767.

38. 11 U.S.C. § 365(g).

39. § 365(a) ("[T]he trustee . . . may assume or reject any *executory contract* . . . of the debtor.") (emphasis added).

40. Sharon Steel Corp. v. Nat'l Fuel Gas Distrib. Corp., 872 F.2d 36, 39 (3d Cir. 1989).

41. Vern Countryman, *Executory Contracts in Bankruptcy, Part 1*, 57 MINN. L. REV. 439, 460 (1973).

42. In re Eustler, 585 B.R. 231, 235-36 n.4 (B.A.P. 9th Cir. 2017) (recommending that the court of appeals revisit the Countryman definition of an executory contract); *see* Lawrence & White, *supra* note 22, at 482.

43. 11 U.S.C. § 363.

44. § 365(n).

If the licensee chooses to treat the contract as breached, they will have an unsecured claim against the licensor-debtor.[45] This is what happens when non-intellectual property contracts are rejected and would most likely result in limited recovery with no further recourse for the shorted now-creditor. The next outcome is unique to intellectual property. If the licensee opts for the (n)(1)(B) option and retains its rights, then (1) the trustee shall allow the licensee to exercise the rights, (2) the licensee must continue making all royalty payments, and (3) the licensee waives any right of setoff and claim arising from performance of the contract (in other words, proceed at your own risk).[46] Similarly, the licensor-DIP cannot interfere with these rights.[47] Congress recognized the importance of the continuity amongst intellectual property dealings and decisively restricted the DIP's otherwise broad power of rejection.[48]

As already illustrated, the DIP is designated considerable negotiating power throughout the bankruptcy proceeding. In addition to the general ability to reject contracts, the debtor is allowed a discretionary period that is restricted only by the rule that a debtor must decide how to handle a contract before the confirmation of the plan.[49] During this period, negotiating frequently occurs as the creditor seeks to convince the debtor to assume their contract or renegotiate the terms in a new agreement.[50] Through negotiation, the creditor hopes to avoid a situation where the debtor rejects a contract as the rejection is considered a breach subject to a prepetition unsecured claim. This breach often leaves the creditor with little to no recovery.[51] Further, until the debtor formally rejects the contract, the other party is contractually bound to continue their performance.[52] In the absence of their performance, the other party will be in breach of the contract or, worse, in violation of the automatic stay.[53]

45. *Id.*
46. *Id.*
47. *Id.*
48. S. Rep. No. 100-505 (1988) at 3.
49. If the case is converted to a Chapter 7, the debtor will have 60 days from the conversion to accept, reject, or assign, otherwise the contract will automatically be rejected. 11 U.S.C. § 365(d)(1).
50. *Id.*
51. *Id.*
52. *See* § 363.
53. *Id.*

2. 11 U.S.C. § 363—The Sale of All or Substantially All Assets

Chapter 11 also outlines another provision that is highly relevant for intellectual property owners—the sale of all or substantially all assets.[54] In recent years, there has been an uptick in companies filing Chapter 11 bankruptcy and selling assets under Section 363.[55] This provision is advantageous by allowing the sale of companies to be executed free and clear of all liens, a stark contrast to liquidation or a sale of assets outside of bankruptcy.[56]

Moreover, Section 363 allows for the execution of the sale in a matter of weeks or short months, whereas a full-on plan confirmation can take months to meet the requirements.[57] Section 363 is considered superior to Delaware General Corporate Law § 271 ("Sale, lease or exchange of assets; consideration; procedure") as Delaware requires a shareholder vote for the sale of substantially all assets.[58] Looking to intellectual property, the procurement of a company via traditional merger or sale will involve significant intellectual property assets.[59] Here, the avoidance of a shareholder vote represents a significant difference in the traditional procurement procedure.[60] The use of § 363 may be subject to approval by the bankruptcy court if such a sale is not in the ordinary course of business.[61]

C. The Importance of Intellectual Property in Bankruptcy

Intellectual property is usually a company's most significant asset. Treatment of such property in bankruptcy dramatically impacts not only insolvent companies and their stakeholders in a dramatic fashion, but also effects the innovation that intellectual property laws seek to stimulate. Data shows that as of 2020, intangible assets made up *ninety percent* of the value of S&P 500 companies, with an estimated net value of $21

54. *Id.*

55. *See* Robert G. Sable, et al., *When the 363 Sale Is the Best Route*, 15 J. BANKR. L. & PRAC. 121, 122 (2006).

56. *See id.* at 123.

57. *See id.*

58. *See* 2 DE Code § 271; *see also* Hollinger v. Hollinger, 858 A.2d 342, 377-86 (Del. Ch. 2004) (applying the *Gimbel* test to the sale of substantially all asset).

59. The "good faith" requirement prohibits debtors from filing for Chapter 11 bankruptcy in violation of § 1129 (e.g., solely to avoid a shareholder vote) in an effort to balance interests of debtors and creditors, prevent abuse of the bankruptcy system, and protect the equitable power of the bankruptcy courts. *See* 11 U.S.C. § 1112(b).

60. *Id.*

61. 11 U.S.C. § 363.

trillion.[62] For example, Amazon's trademark is valued at $705 billion.[63] This makes up approximately seventy percent of their current market capitalization of $1.04 trillion[64]—both astronomical numbers in their own right. Moreover, the value of intellectual property assets has tripled since 1985, leaving traditional assets and real property as the remaining ten percent of companies' value.[65]

Additionally, companies are constantly pursuing growth, which requires capital. The two most common methods of raising capital are through equity financing and debt. To obtain debt financing, companies use their assets, including their intellectual property assets, as collateral. Thus, intellectual property is often a critical component of a bankruptcy case—not only for the success of the newly formed estate, but for many companies that may be dependent on the estate's continuity.

As previously discussed, intellectual property rights initially lie with their creator: the author of a story, the maker of an invention, or the supervisor of the trademark. However, this creator may not be best situated to commercialize and reap the benefit of the rights that accompany their respective creation. Here, licenses play a critical role, allowing owners to profit on their creations, while often outsourcing the legwork in doing so.[66] Licensing increases a company's ability to scale up, invest in new products and services, and expand into a wider range of geographic markets. Congress noted that in the absence of the ability to license, the alternative was outright sale, which "sharply curtails" who can participate in new technological development.[67] Ultimately, Congress viewed the treatment of intellectual property in bankruptcy as so significant that mismanagement "threaten[ed] an end to the system of licensing intellectual property . . . that has evolved over many years to mutual benefit" and had the potential to stifle innovation entirely.[68]

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62. Bruce Berman, *Latest Data Show That Intangible Assets Comprise 90% of the Value of S&P 500 Companies*, IP CLOSEUP (Jan. 19, 2021), http://ipcloseup.com/2021/01/19/latest-data-show-that-intangible-assets-comprise-90-of-the-value-of-the-sp-500-companies [https://perma.cc/MQ79-QS4Y].

63. Tiffany Lever, *Amazon Slips to Third-Most Valuable Brand*, KANTAR (July 21, 2022), https://www.kantar.com/north-america/inspiration/brands/amazon-slips-to-third-most-valuable-brand [https://perma.cc/96FF-KP99].

64. *Amazon.com, Inc. (AMZN) Stock Price*, YAHOO! FINANCE (current as of Oct. 31, 2022), https://finance.yahoo.com/quote/AMZN/.

65. *See* Berman, *supra* note 62.

66. S. Rep. 100-505, (1988) at 3-4.

67. *Id.*

68. *Id.* at 3 ("[L]icensing provides the mechanism by which the original innovator can retain sufficient ownership of his innovation so that he shares in the ultimate economic reward.").

To illustrate these concepts in practical terms, imagine a company that owns a license to a software that is critical to the operations of the business, such as the software that processes credit card payments made to an online boutique. If the software licensor files for bankruptcy, the licensee's ability to maintain its property interest and continue to make sales becomes contingent on the status of the license during the bankruptcy case.[69] In the case of the online boutique, if the debtor elected to reject that license agreement, which would be well within their right to do absent special instructions for intellectual property, they would not be able to make a single sale pursuant to the Bankruptcy Reform Act of 1978 (The Code).[70] As a matter of fact, this very product—a software for secure online transaction management by Intertrust—is believed by some to be the most valuable patent in the world.[71]

Now imagine the impact this situation would have on a variety of other situations. Pharmaceutical companies seeking to license a life-saving drug therapeutic may depend on licenses for market exclusivity to back costly initial investments in research and development of pharmaceutical products.[72] Likewise, musicians depend on licenses to broadly distribute their work while retaining the ability to profit off said work.[73]

A debtor can be a licensor or a licensee.[74] The debtor's role is important in three recurring circumstances within this context of bankruptcy law. First, where the debtor is a licensor, the licensor-debtor-in-possession (DIP) may move to rescind the license agreement when the licensor goes bankrupt, pursuant to a provision in The Code that permits debtors to annul hindering contracts at their own discretion.[75] In this situation, the debtor-licensor seeks to maximize the value of the estate, while both the secured and unsecured creditors lay in wait hoping to recover; the licensee, by comparison, clings onto hope of preserving the integrity of the original agreement. Second, when the licensee enters

69. *See* Menell, *supra* note 31, at 765.

70. *Id*.

71. Bruce Berman, *Defensive Aggregator Says 'World's Most Valuable Patent' is Held By Tiny Intertrust Technologies*, IP CLOSEUP (Dec. 19, 2019), https://ipcloseup.com/2019/12/19/defensive-aggregator-says-worlds-most-valuable-patent-is-held-by-tiny-intertrust-technologies/ [https://perma.cc/ZAP8-XM8K].

72. GORDON V. SMITH & RUSSELL L. PARR, INTELLECTUAL PROPERTY: LICENSING AND JOINT VENTURE PROFIT STRATEGIES 2-3 (Wiley, 2004).

73. *See* Priya Sinha Cloutier, *Where Bankruptcy Law and Intellectual Property Law Intersect*, LANE POWELL LLC (2014).

74. *See id*.

75. Menell, *supra* note 31, at 736.

bankruptcy, the licensee-DIP may assign the license to a third party to maximize the value of the estate because the contract would be more valuable to the third party than to the debtor.[76] Here, the licensee is looking to relieve themselves of a burdensome contract, while the licensor is left to deal with a third-party who was not privy to the original agreement. This situation thereby necessarily interferes with the licensor's freedom of contract. Third, the holder of the intellectual property rights may attempt to use the right as collateral.[77] If the securitized asset becomes part of the estate, the secured creditor will be first in line to pursue the collateral. Yet both the valuation and transfer of the incorporeal assets presents challenges because they are intangible.

These contexts illustrate the significant competing interests in any bankruptcy case. Further, they highlight how intellectual property remains a critical concern for each of the involved parties. A company's ability to retain advantageous contracts while escaping unbeneficial ones is central to a successful reorganization. As bankruptcy purports to breathe life back into finically fraught companies, The Code attempts to preserve the viability of the already insolvent debtor while refraining from placing additional companies into the same turmoil. With tension, and in addition to this ex post model, intellectual property laws are simultaneously seeking to encourage innovation and the progression of society through the arts and sciences—a constitutionally-granted authority. In order to fully appreciate these schemes, it is necessary to consider their principles, their history, and their only recent juncture.

III. RECENT AND CURRENT DISPUTES

A. *Executory Contracts Dispute*

The majority view contends that intellectual property contracts are inherently executory, however, under the current executory contract scheme, this is not guaranteed.[78] The consequence of a contract being non-executory is that it becomes a mere traditional asset of the estate.[79] Recall that an executory contract is a contract "under which the obligation of both the bankrupt and the other party to the contract are so far

76. *Id.*
77. *See id.* For example, David Bowie pioneered the colloquial "Bowie Bonds," which granted investors rights to his future royalties. James Chen, *Bowie Bond*, INVESTOPEDIA (last updated Aug. 31, 2022), https://www.investopedia.com/terms/b/bowie-bond.asp [https://perma.cc/YV8H-S6LP].
78. Countryman, *supra* note 41, at 460.
79. 11 U.S.C. § 365.

unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other."[80] This definition of executory contracts can be translated into a two-part test: first, there must be performance yet to occur on both ends of the contract; and second, that performance must be sufficient to constitute a material breach. Intellectual property is one particular area of the law that is affected the most by the materiality requirement.[81] A licensor's forbearance from suing a licensee has been held to be material performance sufficient to make the agreement executory.[82]

The Eighth Circuit and the Third Circuit held that a perpetual, royalty-free exclusive trademark license agreement is not an executory contract.[83] Similarly, the Ninth Circuit held that where a licensee has the right to sell the licensed technology, the license is not executory.[84] Yet, affirmative and negative covenants have both been held to be executory contracts due to the continuing obligation of the terms.[85]

In *In re Exide Technologies*, the debtor, Exide, sold its business to EnerSys and licensed EnerSys their trademark. Exide, however, continued to operate under the trademark brand themselves.[86] Pursuant to their agreement, EnerSys paid $135 million and assumed Exide's liabilities, operating under the agreement for over ten years.[87] Though EnerSys had the continuing obligation to provide indemnity (among other commitments), the Third Circuit held that in the context of the agreement as a whole, EnerSys had substantially performed, thus making the agreement not executory.[88] Therefore, the licensing agreement could not be assumed or rejected.[89]

Strict adherence to the Countryman definition of executory contracts has resulted in unpredictable outcomes of licensing agreements as demonstrated by frequent litigation and inconsistent case law.[90] Yet,

80. Countryman, *supra* note 41, at 460.

81. *See* Menell, *supra* note 31, at 736.

82. In re CFLC Inc., 89 F.3d 673, 677 (9th Cir. 1996).

83. *See* In re Interstate Bakeries Corp., 751 F.3d 955, 962-64 (8th Cir. 2014); *see* In re Exide Tech., 607 F.3d 957, 962-64 (3d Cir. 2010).

84. *See* Microsoft Corp. v. DAK Indus., Inc., 66 F.3d 1091, 1095 (9th Cir. 1995).

85. *See* Lubrizol Enter., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1046 (4th Cir. 1985) (affirmative covenant); *see also* In re Rovine Corp., 6 B.R. 661, 666 (Bankr. W.D. Tenn. 1980) (covenant not to compete).

86. *In re Exide Tech*., 607 F.3d at 613.

87. *Id.*

88. *Id.*

89. *See id.*

90. *Id.*

licensing agreements were acknowledged by Congress as critical to the development of technology.[91] Moreover, these costly litigation efforts frequently result in outcomes that are at odds with The Code itself. If a debtor "rides-through," they will not benefit from the fresh start envisioned by the bankruptcy schema.[92] If the contract is non-executory and is "vaporized," the contract stands to disappoint either the debtor or the creditor, depending on whether the debtor is the licensor or licensee.[93]

The consequences of this structure are particularly unfortunate in the context of intellectual property because "the entire heart of licensing agreement" is directed at the material obligations of making royalty payments and the covenant not to sue.[94] Recently, the Ninth Circuit has challenged the Countryman definition of an executory contract, citing a law review article that proposed a "modern" approach to executory contracts where all contracts with *any* unperformed obligation on either side, material or not, would be considered "executory contracts" under Section 365.[95] Further, Congress has recognized the importance that bankruptcy plays in allowing intellectual property owners monetize their innovations and therefore advance our nation's arts and sciences.[96] Despite these pleas, the American Bankruptcy Institute has "rejected virtually every serious academic and professional recommendation made on the subject for the last thirty-five years," ignoring the "unanimous" consensus that the Countryman definition cannot stand.[97] It is now time for Congress —and the courts—to follow the Ninth Circuit's suggestion and reject the Countryman definition of executory contracts for a more simplistic, modern approach that better achieves bankruptcy policies.

B. Assumption or Assignability Dispute: Hypothetical or Actual Test?

Another circuit split exists regarding the statutory interpretation of "assume or assign" in Section 365(c)(1) of the Bankruptcy Code. Sister circuits are split as to whether the statute prohibits assumption or only assignment of executory contracts in the absence of consent by the non-debtor party.

91. *Id.*

92. *Id.*

93. *See* Westbrook & White, *supra* note 22, at 481 (2018).

94. *Id.*

95. In re Eustler, 585 B.R. 231, 235-36 n.4 (B.A.P. 9th Cir. 2017) (recommending that the court of appeals revisit the Countryman definition of an executory contract); *see* Westbrook & White, *supra* note 22, at 481.

96. Westbrook & White, *supra* note 22, at 482.

97. *Id.*

There are two interpretive tests adopted by the courts. The Third, Fourth, Ninth, and Eleventh Circuits have adopted the Hypothetical Test.[98] The Hypothetical Test prohibits a debtor from assuming or assigning an executory contract without the non-debtor's consent if non-bankruptcy law precludes assignment of the contract to a third party. This is a very literal interpretation of "assume *or* assign" and disregards whether the contract is going to be assigned because even the estate is seen as a legally distinct entity, construed as a *de facto* assignment.[99] Put another way, "a debtor-licensee who does not have the power to assign a license under the applicable law without the licensor's consent also may not assume the license even if the debtor has no intent to assign the license."[100]

The Ninth Circuit adopted the Hypothetical Test in *In re Catapult Entertainment, Inc.*[101] The court reasoned that statute "link[s] non-assignability under applicable law together with a prohibition on assumption in bankruptcy."[102] Therefore, the statute by its own expression is read to prohibit a DIP from assuming an executory contract without the non-debtor's consent if applicable law would otherwise preclude assignment of the contract to a third party.[103]

Conversely, the First, Fifth, and Eighth Circuits have adopted the Actual Test.[104] The Actual Test permits assumption without consent, but does consider whether the non-debtor was compelled to accept performance or provide services outside the original agreement. This test "requires on a case-by-case basis a showing that the nondebtor party's contract will *actually* be assigned or that the nondebtor party will in fact be asked to accept performance from or render performance to a party—including the trustee—other than the party with whom it originally contracted."[105]

98. Cinicola v. Scharffenberger, 248 F.3d 110, 126 n.19 (3d Cir. 2001); RCI Tech. Corp. v. Sunterra Corp., 361 F.3d 257, 262-63 (4th Cir. 2004); Perlman v. Catapult Entm't, Inc., 165 F.3d 747, 750 (9th Cir. 1999); Jamestown v. James Cable Partners, L.P., 27 F.3d 534, 537 (11th Cir. 1994).

99. In re Gordon Sel-Way, Inc., 270 F.3d 280, 290 (6th Cir. 2001); Laura D. Steele, *Actual or Hypothetical: Determining the Proper Test for Trademark Licensee Rights in Bankruptcy*, 14 MARQ. INTELL. PROP. L. REV. 411, 434 (2010).

100. Steele, *supra* note 99, at 434 (internal quotations omitted).

101. 165 F.3d at 750.

102. *Id.* (citing EPSTEIN, DAVID G., ET AL., BANKRUPTCY § 5–15 (1992)).

103. *Id.*

104. Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 493 (1st Cir. 1997) (abrogated on other grounds by Hardemon v. City of Boston, 144 F.3d 24 (1st Cir. 1998)); In re Mirant Corp., 440 F.3d 238, 251 (5th Cir. 2006).

105. *In re Mirant*, 440 F.3d at 248 (emphasis added).

Both the Hypothetical Test and the Actual Test have their downfalls. The Actual Test strays from the statutory language of The Code while the Hypothetical Test strays from the policy goals of The Code. The difference in approaches is significant, particularly for a debtor-licensee. Under the Hypothetical Test, non-assignable contracts, such as patent, copyright, or trademark licenses, which generally cannot be assigned without the licensor's consent, can no longer even be assumed. The effect of such rigid anti-assignment and assumption may incumber the debtor's ability to reorganize successfully.[106] Additionally, the Hypothetical Test prevents DIPs from continuing to exercise their rights under non-assignable contracts, such as patent and copyright licenses.[107]

Many contracts, licenses in particular, contain *ipso facto* clauses which makes filing for bankruptcy an event that triggers default of the agreement.[108] The Code, however, does not enforce these clauses.[109] Instead, until a nondebtor's contract is rejected, which might not happen until the plan is confirmed, the nondebtor is obligated to continue performing.[110] This creates an inconsistency because "while a licensor may not preemptively protect its licensed mark from becoming part of a bankruptcy estate through an *ipso facto* contract clause, a licensor may still later strip a debtor-licensee of its rights in a license even if the licensee does not intend to assign the license to a third party."[111] However, the protection of the licensor is unnecessary. The Hypothetical Test redistributes the bargaining power critical for reorganization from the debtor to the nondebtor.[112] The fallout of this in intellectual property cases can be dramatic, given the modern day makeup of a business's assets.

Consider a patent license agreement for a chemical compound licensed to a pharmaceutical company. If the licensee of the chemical compound filed for bankruptcy, the Actual Test would allow the licensee to assume the contract and continue producing the drug that is critical to their reorganization and the patient consumers dependent on the chemical compound. By contrast, the Hypothetical Test would prevent the licensee from assuming the contract without consent from the producer of the

106. *See generally* NCP Mktg. Grp. v. BG Star Prods., 556 U.S. 1577 (2009).

107. *Id.*

108. Steele, *supra* note 99, at 421-23.

109. 11 U.S.C. §§ 365(e)(1), 541(c)(1).

110. A plan may be extended up to eighteen months, which is a significant amount of time for the creditor to perform. § 1121(d)(2)(A).

111. Steele, *supra* note 99, at 422-23.

112. Such redistribution, however, is contradictory to the intent and purpose of The Code. *See also* Hirshman, et al., *Is Silence Really Golden? Assumption and Assignment of Intellectual Property Licenses in Bankruptcy*, 3 HASTINGS BUS. L.J. 197, 212-13 (2007).

chemical compound when applicable law would prevent assignment. The prevention of assuming the license would deteriorate the debtor-licensee's ability to reorganize by eliminating an extreme source of production, even though the licensor is dealing with the same party they originally agreed to deal with. Here, the posed hypothetical would favor the Actual Test because the results of the Hypothetical Test does not track the intent of The Code.

Comparatively, a trademark is "defined by the perceptions that exist in the minds of the relevant buying public," incentivizing the trademark owner to control who puts their trademark to the public.[113] Under the Lanham Act, trademark owners maintain a right and duty to control the quality of goods sold under the mark.[114] Thus, under applicable trademark law, trademarks are personal and non-assignable without the consent of the licensor.[115] Under the Hypothetical Test, trademarks are per se not assumable without the consent of the licensor. Though the Hypothetical Test may be more tempting to justify in this scenario, as trademark owners are given the additional right to control the quality of the mark and greater discrepancy may be necessary, this justification again conflicts with the intent of the Code.[116]

Additionally, Section 365(c)(1) must be read in conjunction with Section 365(f)(1). Section 365(f)(1) states that assignment is permitted notwithstanding any provision in the contract or applicable law that "prohibits, restricts, or conditions" assignment.[117] A literal reading of Section 365(c)(1), as required by the Hypothetical Test, "would appear to render subsection (f)(1) meaningless . . . . [I]f 'applicable law' prohibited assignment, then no assumption could occur pursuant to subsection (c)(1), and without assumption, no assignment can ever occur under subsection (f)(1)."[118] By contrast, the Actual Test maintains consistency with other provisions, such as the *ipso facto* provision in Section 365(e) and the assignment provision in Section 365(f).[119] Here, the Actual Test furthers the purpose of The Code, which includes giving the debtor negotiating power at this step in the bankruptcy proceeding.[120]

113. In re N.C.P. Mktg. Grp., Inc., 337 B.R. 230, 236 (D. Nev. 2005) (*quoting* Power Test Petroleum Distribs., Inc. v. Calcu Gas, Inc., 754 F.2d 91, 96 (2d Cir. 1985)).

114. 15 U.S.C. § 1060.

115. § 365(e)(1).

116. Hirshman et al., *supra* note 112, at 216-17.

117. 11 U.S.C. § 365(f)(1).

118. Roger A. Clement, Jr., *Going for Broke with Intellectual Property*, 17 ME. B.J. 178, 184 (2002).

119. Hirshman et al., *supra* note 112, at 213-15.

120. *Id.*

Amidst the competing interest of the prevailing tests, there is yet a third test out of the Southern District of New York that is worth mentioning.[121] Importantly, the third test resolves the discrepancy between the debtor, the original contracting party, and a familiar but still different party. The court in *In re Footstar* agreed with the Actual Test over the Hypothetical Test, but sought out for a better analysis for the assumption of executory contracts. Ultimately, the *Footstar* Test "achieved the results of the Actual Test while following the literal reading of §365(c)(1) used in the Hypothetical Test."[122]

Footstar recognizes that the "key word" in Section 365(c)(1) is "trustee."[123] On this critical feature, the prohibition applies only to the trustee, not to the DIP.[124] Although many Chapter 11 cases do not have a trustee unless the DIP violates a broad-based sound business judgment, nowhere in the Code is a trustee synonymous with a DIP.[125] The linguistical analysis dissected in the case is extremely complex, but the basic premise can easily be understood by distinguishing the trustee from the DIP. The *Footstar* Test is least frequently used, but addresses the aims of The Code while holding true to the language of the statute.

In case it been unclear up until this point, assignment clauses in intellectual property licensing agreements are absolutely critical. Perhaps the most important clauses in consideration of future insolvency. In jurisdiction where the Hypothetical Test is used, they are the most important because of the imputation of non-bankruptcy view on assignment. However, regardless of the jurisdiction, the exclusion of ipso facto provisions and the applicability of assignment clauses retain their relevance across the board.

C. A Trademark Dispute

The first concern for the future of intellectual property was raised in 1984 when the Fourth Circuit held that the trademark contract was executory and its continued use could be revoked upon rejection.[126] In *Lubrizol Entertainment, Inc. v. Richmond Metal Finishers, Inc.*, the debtor, RMF, licensed Lubrizol the rights to use RMF's metal-coating

121. In re Footstar, 323 B.R. 566, 569-74 (Bankr. S.D.N.Y. 2005).

122. Saul Ehrenpreis, *Trademark Licenses: Even in a Hypothetical World, Footstar Got It Right*, 30 AM. BANKR. INST. J. 60 (2011).

123. *In re Footstar*, 323 B.R. at 570.

124. *Id.*

125. *Id.* at 570-71.

126. Lubrizol Enter., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1047-48 (4th Cir. 1985) (affirmative covenant).

technology.[127] Though not an exclusive right, the license contained a most-favored-licensee provision that prohibited RMF from offering anyone else more favorable terms than Lubrizol's contract.[128] In exchange, Lubrizol would make royalty payments and satisfy other agreed upon conditions.[129] When RMF filed for bankruptcy, RMF sought to reject their contract with Lubrizol.[130] The bankruptcy court held that rejection was permitted because the contract was executory in nature and rejection benefited RMF, the debtor.[131] On appeal, the Fourth Circuit affirmed the bankruptcy court, allowed RMF to revoke Lubrizol's right to RMF's product entirely.[132]

The effect of *Lubrizol* affords the debtor considerable power over the performing party because they would simply reject the contract and extort the highest possible price, an insult to their original agreement. This caused concern across the intellectual property world, but no greater worry was there than with computer software.[133] Accounting software, financial records upkeep, and customer relationship management systems are just a few services that are largely dependent on the continuity of licenses.[134] Congress hearkened the concerns and promptly enacted Section 365(n) to circumvent the consequences of *Lubrizol*.[135]

However, despite *Lubrizol* concerning a trademark, this was the very property that was not included in the code's definition of intellectual property, as previously emphasized. This has led to difficulty in handling trademarks in bankruptcy with the continuity of the rest of the intellectual property protections.[136] Upon the passing of the Intellectual Property Act of the Code, Congress recognized that "trademark, trade name and service mark licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee," and because they did not have enough information, they opted to instead "postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts."[137]

127. *Id.* at 1045.
128. *Id.*
129. *Id.*
130. *Id.*
131. *Id.* at 1045-47.
132. *Id.* at 1048.
133. *See generally* Viktoria L. Gres, *Rejection of Computer Software Licensing Agreements in Bankruptcy*, 8 CDZLR 361, 364-66 (1986).
134. *Id.* at 368-71.
135. 11 U.S.C. § 365(n).
136. § 101(35)(A).
137. S. Rep. No. 100-505, (1988) at 4.

This statue has led to a question of interpretation. On one hand, because Congress had the opportunity to include trademarks and explicitly opted against it, a plain-reading of the statute would provide that trademarks should not be treated as other forms of intellectual property. However, when taking into account their reason for not including trademarks, the other side could argue that they left it open for interpretation by the courts. The Supreme Court did exactly that when faced with the question as to what happens when a debtor rejects an executory trademark contract in bankruptcy in the post-§ 365 era.

In *Mission Product Holdings, Inc. v. Tempnology, LLC*, the debtor granted Mission distribution rights and a "non-exclusive, irrevocable, royalty-free, fully paid-up, perpetual, worldwide, fully-transferable license."[138] When the debtor filed for bankruptcy and rejected the contract, Mission argued that Section 365(n) allowed them to retain both the distribution rights and the intellectual property license.[139] The Supreme Court had to resolve the trademark discrepancy of Section 365.

The First Circuit took the plain-meaning approach and recognized that Congress intentionally excluded trademarks; therefore, if trademarks were to be protected from rejection in the same way that patents are, Congress must enumerate this in the statute.[140] While it is tough to argue with this approach, it is also not difficult to see why the Supreme Court took an alternate route in extending the protection to trademarks despite not being mentioned in the statute.

The Supreme Court ultimately held that Section 365(g) considers rejection a breach on the part of the debtor and that the rights previously granted by a marketing agreement cannot be rescinded.[141] The Court craftily bases its reasoning in larger part on Section 365(g) rather than Section 365(n).[142] They analogize this with an example of a photocopier being leased to a law firm.[143] If the owner agreed to service it in exchange for a monthly fee, when the owner stops servicing it, the firm can elect to continue to pay the monthly fee and sue for damages, or withhold payments and return the copier.[144] This decision critically lies with the firm, not the owner.

138. In re Tempnology, LLC, 559 B.R. 809, 812 (B.A.P. 1st Cir. 2016).

139. Mission Prod. Holdings v. Tempnology, LLC, 139 S. Ct. 1652, 1660 (2019).

140. *In re Tempnology*, 559 B.R. at 812.

141. *Mission Prod. Holdings*, 139 S. Ct. at 1665-66. Breach has the same meaning under The Code as it does in common law. Field v. Mans, 516 U.S. 59, 69 (1995).

142. *Mission*, 139 S. Ct. at 1665-66.

143. *Id.* at 1662.

144. *Id.*

The same is so in bankruptcy. When the debtor rejects a contract, this is a breach. The choice then lies with the creditor (likely the licensee in this context) to continue to make royalty payments and use the trademark or "return it" by no longer using it.

Again, neither interpretation can be said to be plainly wrong. However, it is critical to note that "[r]ather than amending either Section 365(a) or Section 365(g), Congress enacted a brand new section . . . [granting] a licensee of intellectual property rights a choice between treating the license as terminated and asserting a claim for pre-petition damages—a remedy the licensee held already under Section 365(g)—or retaining its intellectual property rights under the license."[145]

Although the Supreme Court's interpretation was not incorrect based on Section 365(g), Congress clearly imagined a different process for intellectual property.[146] Despite this, Congress' intent was to "allow the development of equitable treatment of this situation by bankruptcy courts."[147] This denotes the intentional granting of power to the courts. Therefore, the Supreme Court was well within their right to make such a ruling by reading into The Code what was otherwise ignored. Furthermore, this is currently the most equitable way to preserve the interests of the debtors and creditors—the debtor is still getting paid and the licensee is continuing the use of the trademark.

IV. CONCLUSION

Intellectual property is the primary source of value for most companies today. This Comment provided an artificial exposure to three primary issues at this intersection: executory contracts, assumption and assignment, and trademarks. Each of these issues has either seen recent developments (such as extending protection to trademarks in 2019), or will likely see developments in the near future (such as modifying the characterization of executory contracts and adopting the *Footstar* Test for assumption). Therefore, it is critical to remain aware of ever-changing practices and never forget the critical nature of a steadfast assignment clause. Congress will continue to monitor the effects of the current state of the law and its enforcement, and hopefully make adjustments accordingly. The author suggests that they start by responding to decades of near-unanimous pleading to redefine executory contracts.

145. In re Tempnology, LLC, 879 F.3d 389, 396 (1st Cir. 2018).
146. *See id.*
147. S. Rep. No. 100-505 (1988) at 4.