Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT™ JUNE 2014

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ISBN 978-0-76987-846-1

All or Nothing: Delaware Bankruptcy Court Decision in *Physiotherapy Holdings* Addresses Contract "Integration" for Purposes of Assumption Under Section 365(a)

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This article focuses on a recent case from the Bankruptcy Court for the District of Delaware that allowed the debtor to assume a license agreement while simultaneously rejecting other agreements with the licensor.

Among the many tools the Bankruptcy Code provides a debtor in bankruptcy is the ability to assume and reject executory contracts and unexpired leases. This powerful tool is not without limits, however. Among other things, it is an "all or nothing" proposition—a debtor must assume or reject the entire agreement. It cannot assume or reject only portions of the agreement. This rule ensures that a debtor must assume or reject the benefits of the contract with the burdens, "*cum onere*."

Though simple in theory, application of this principle can become complicated where the relationship between a customer and vendor is actual-

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Published by Matthew Bender & Company, Inc. in the June 2014 issue of *Pratt's Journal of Bankruptcy Law*. Copyright © 2014 Reed Elsevier Properties SA.

ly governed by a number of related agreements. It is not uncommon for commercial parties to have a relationship governed by a "master agreement" and related license, leasing, maintenance, operating, and other similar agreements. The recent case of *In re Physiotherapy Holdings, Inc.*,[1] highlights the risks to intellectual property rights when a debtor requests that a bankruptcy court treat each of the related agreements separately for purposes of assumption and rejection.

In *In re Physiotherapy Holdings, Inc.*, Judge Gross of the United States Bankruptcy Court for the District of Delaware allowed the debtor to assume a license agreement while simultaneously rejecting other agreements with the licensor. The licensor objected on the grounds that the contracts were all a single, integrated agreement, but the court effectively permitted the debtor to keep the one contract that was valuable to it, and to disavow the rest of the agreements.

THE CONTEXT: A LICENSE RELATED TO A MASTER AGREEMENT

In January 2011, Physiotherapy Holdings, Inc. and its affiliates (the "debtors")—providers of outpatient physical therapy services—hired Huron Consulting Services LLC ("Huron"), a healthcare consulting company, to assess opportunities for improving their revenue cycle. In connection with that engagement, in 2011 and 2012, the debtors and Huron entered into various agreements (the "Huron Agreements"), including a "Master Agreement" and a "License Agreement." Pursuant to the License Agreement, Huron granted the debtors the right to use certain computer software necessary to the debtors' billing and collection activities. Also of note, although the License and Master Agreements each contained provisions requiring the debtors to indemnify Huron, the indemnity under the Master Agreement was much broader than under the License Agreement.

The debtors filed a Chapter 11 petition in November 2013 and, in December 2013, the debtors' Chapter 11 plan was confirmed. Pursuant to the plan, the debtors and Huron agreed to defer disputes over the treatment of the Huron Agreements in the bankruptcy case—including the debtors' rights to assume or reject the Agreements—until after plan confirmation. Among

other things, the plan also transferred potential claims that the debtors had against Huron to a litigation trust. Huron was planning to seek indemnity from the debtors for those claims pursuant to the broad indemnity provisions in the Master Agreement.

Shortly after confirmation of the Chapter 11 plan, the debtors filed a motion to assume the License Agreement and reject all of the other Huron Agreements, including the Master Agreement. Huron objected, arguing that the debtors could not assume the License Agreement without also assuming the other Huron Agreements.

THE BANKRUPTCY COURT'S DECISION: SEPARATE CONTRACTS, SEPARATE ASSUMPTION AND REJECTION

In March 2014, Judge Gross issued an opinion granting the debtors' motion. The court first addressed two threshold matters. The court determined that the debtors' assumption of the License Agreement and rejection of the other agreements was a sound exercise of their business judgment—the standard for assumption or rejection of a contract under Section 365 of the Bankruptcy Code. With respect to assumption of the License Agreement, the court pointed to the debtors' assertion that the software licensed under the License Agreement was necessary for the continued operation of their business, at least in the short term,[2] and to the fact that because the debtors had already paid their obligations under the License Agreement in full, assumption would not require cure or result in an administrative claim against the estate. With respect to the debtors' decision to reject the other Huron Agreements, the court noted that "[i]ndemnifying Huron," as might be required under one or more of the agreements, "would be prohibitively expensive for Debtors."[3] In short, one contract had to be assumed for the debtors to be successful, and the other contract had to be rejected to prevent the debtors from failing—assumption or rejection of both contracts was not practicable if the debtors were to reorganize.

Second, the court determined that the License Agreement was generally of a type that was assumable by the debtors. Huron had argued that, pursuant to intellectual property law and Section 365(c) of the Bankruptcy Code, the debtors could not assume the License Agreement without Huron's consent—which Huron had not given. The court rejected Huron's argument

and relied on a provision in the License Agreement, which it interpreted to expressly permit assignment of the Agreement in the event of bankruptcy by the debtors. The court explained that "[t]he law is well settled in this Circuit that the right to assign by necessity creates the right to assume."[4] Because the License Agreement reflected Huron's prior consent to *assignment*, it could necessarily be *assumed* by the debtors.

The court then turned to the central issue: whether the debtors could assume the License Agreement while simultaneously rejecting the other Huron Agreements. The court noted that, in light of the potential indemnity obligations, the issue was "of great financial importance to Debtors and Huron."[5]

Huron relied on the well-established bankruptcy principle of "assumption *cum onere*," meaning that if a debtor assumes a contract, it must do so in its entirety—it cannot chose to assume the benefits without also assuming the burdens. It argued that the License Agreement and the Master Agreement were a single, integrated contract and that the terms of the Master Agreement were integrated into the License Agreement. As a result, the debtors could not simultaneously assume the License Agreement and reject the Master Agreement and other Huron Agreements. In support, Huron relied on provisions in the Master and License Agreements containing typical contract integration language in multi-agreement deals.

The court rejected Huron's position, distinguishing the Huron Agreements from the agreements found to be integrated in *In re Holland Enterprises, Inc.*[6] and *In re Buffets Holdings, Inc.*[7] The court first pointed to the indemnity provisions in the two contracts, noting that the indemnity under the Master Agreement was broader than under the License Agreement. It reasoned that "if the Master Agreement and License Agreement are to be read as a single agreement, there would be no need for indemnity language in the License Agreement" because "the broader provisions of the Master Agreement would be sufficient."[8] Second, the court noted that the agreements were not executed at the same time.[9] Third, the court pointed to language in the Agreements providing that in the event of a contradiction between the terms of the Master Agreement and the License Agreement (or one of the other agreements), "the Master Agreement takes the back seat."[10] Finally, the court explained that the standard integration language in the Master Agreement did not mean that the License Agreement was a "mere component" of

the Master Agreement; to the contrary, "the integration clause simply means all of the Agreements between the parties are reflected in the Agreements as written, thereby eliminating parol evidence."[11] As a result, the court concluded the Agreements "do not constitute an integrated arrangement which the Court should consider singular."[12]

THE BOTTOM LINE

Defining which agreements constitute the executory contract that is subject to assumption or rejection in bankruptcy is a key step in determining whether assumption or rejection is permissible. The decision in *Physiotherapy Holdings* demonstrates the importance of that analysis when crucial intellectual property licenses are at issue in a bankruptcy reorganization. Indeed, in *Physiotherapy Holdings*, it is impossible to ignore the fact that the feasibility of the debtors' reorganization plan apparently hinged on their ability to retain the License Agreement software and reject the indemnification obligation. According to the debtors, they could not operate without the License Agreement software and could not replace it for six to nine months, and they could not afford to indemnify Huron. A decision finding that the debtors could not separately assume the License Agreement would have apparently doomed the debtors' reorganization plan. So, this is a case where the specific facts put a great deal of pressure on the issue of contract "integration." But more generally, the case also serves as a potent reminder that clearly reflecting the intent of the parties in drafting integration, merger, and other clauses can be extremely important to the ultimate protection of intellectual property rights, especially where such rights are part of client relationships evidenced by multiple agreements.

NOTES

[1] No. 13-12965 (Bankr. D. Del.).

[2] The debtors were in the process of investigating alternative software, but it would take a number of months before any alternative could be implemented to replace the Huron software.

[3] Slip. Op. at 5.

[4] *Id.* at 7 (citing *In re Midway Airlines, Inc.*, 6 F.3d 492, 497 (7th Cir. 1993)).
[5] Slip. Op. at 7.
[6] 25 B.R. 301 (Bankr. E.D.N.C. 1982).
[7] 387 B.R. 115 (Bankr. D. Del. 2008).
[8] Slip. Op. at 11.
[9] Although the court was correct that not all of the Huron Agreements were executed at the same time, the License Agreement and Master Agreement had been executed on the same date.
[10] Slip. Op. at 13.
[11] *Id.*
[12] *Id.*