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Bankruptcy Court Sale Order Binds Owner of Copyright, Permitting Purchaser to Make and Sell Copies of Software

The U.S. Seventh Circuit Court of Appeals recently warned owners of intellectual property to monitor carefully the bankruptcy proceedings of persons to whom they have licensed their intellectual property or risk losing it. Although not so plainly stated by the court, that is the essential message of *ITOFCA, Inc. v. MegaTrans Logistics, Inc.*, 322 F.3d 928 (7th Cir. 2003), in which the owner of a copyright was bound by the terms of a bankruptcy court's sale order despite the fact that the order approved the sale of greater rights in the intellectual property than the owner intended the debtor to possess.

Background

The *ITOFCA* case arises out of a copyright infringement action filed by ITOFCA against MegaTrans Logistics (MegaTrans). In the action, ITOFCA alleged that it was the owner of the copyright to certain computer software and that MegaTrans, as the holder of a mere non-exclusive license to use the software, was improperly copying and selling modified versions of the software in violation of ITOFCA's copyright rights.

In 1986, ITOFCA developed and sold an interest in the software to ITOFCA Consolidators, Inc. (ICI). In 1991, ICI filed a Chapter 11 bankruptcy case and sold its interest in the software to

Amerifreight. The order approving the sale provided, in part, that:

The Debtor is authorized to sell to Amerifreight the Debtor's right, title, and interest in all patent, copyright and trade secret rights in and to all computer software and corresponding documentation developed or acquired by the Debtor (the "Software") in consideration for \$25,000. Amerifreight expressly acknowledges that the Debtor may sell additional copies of the Software to other parties and that by virtue of the proposed assignment it has only a non-exclusive right to the Software.

In the same sale order, ICI also transferred identical rights in the software to another entity, Southern Pacific, using parallel language. ITOFCA had notice of the sale to Amerifreight and appeared at the sale hearing, but did not object to the sale. Following the sale, Amerifreight conveyed to MegaTrans all rights in the software that it had acquired from ICI. Thereafter, MegaTrans modified the software and began to license it to third parties.

In 1999, ITOFCA, which had been dormant since the transfer to ICI, registered a copyright on what it described as a "comprehensive intermodal program" (i.e., the software). In the registration, ITOFCA stated that the program had been created in 1991 and listed ICI as a co-author. ITOFCA asserted, however, that it was the owner of the original, underlying program that had been developed in 1986.

Copyright owner was bound by bankruptcy order approving the sale of greater intellectual property rights than it intended to transfer.

The Court's Decision

The court held that since ITOFCA had notice of the sale by ICI, ITOFCA was bound by the sale order approving the sale to Amerifreight. The court interpreted the language in the sale order, which specifically acknowledged that ICI could "sell additional copies of the Software to other parties," to give Amerifreight the right to copy and sell the software. The court rejected ITOFCA's argument that the sale order conveyed only a mere license to use the software rather than a license to modify and sell the software or outright ownership of the copyright to the software. In the end, through some questionable analysis of the facts and inferences, the court affirmed the summary judgment awarded to the defendant, MegaTrans.

In an extensive concurrence, Judge Ripple cautioned that the facts made for a "close" case, but ultimately agreed that the wording of the sale order and other circumstances warranted preclusion of ITOFCA's claim to relitigate the issue of which interests had been transferred to ICI and its subsequent transferees. Unlike the majority opinion, the concurrence specifically emphasized that the sale order was vague and imprecise, thereby undermining the value of relying on the order to preclude ITOFCA's claim. However, the concurrence, like the majority, found compelling that the sale order had reserved to ICI the right to sell the software to others and, in fact, provided for the sale of identical rights to another party, Southern Pacific. Therefore, the concurrence reasoned that, because ITOFCA at least implicitly consented to ICI copying the software and selling non-exclusive licenses to Amerifreight and Southern Pacific by failing to object to the

sale order, it was proper to affirm the district court's grant of summary judgment in favor of the defendant.

Conclusion

The ITOFCA decision is an important reminder that any owner of assets who receives notice of a proposed transfer of such assets in bankruptcy must be extremely vigilant to review and understand the terms of the sale and promptly object if there is any concern that the sale might improperly include or negatively affect the owner's assets. Vigilance is particularly important when the proposed sale includes copyright or other intellectual property rights, which often by their nature are not easily defined and therefore may be imprecisely defined in the bankruptcy pleadings.

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