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## *In re Qimonda AG*: Protections for Intellectual Property Licensees in Cross-Border Insolvencies

2011-11-04

On October 28, 2011, the U.S. Bankruptcy Court for the Eastern District of Virginia (the "U.S. Bankruptcy Court") issued a decision important to the rights of intellectual property licensees, and creditors generally, in cross-border insolvency proceedings. On remand from the U.S. District Court for the Eastern District of Virginia (the "U.S. District Court"), the U.S. Bankruptcy Court held that the protections afforded to licensees of intellectual property under Section 365(n) of the U.S. Bankruptcy Code<sup>1</sup> must apply to the administration of U.S. patent licenses by the foreign insolvency administrator in the Chapter 15 proceeding of Qimonda AG, a German company with its main insolvency proceeding pending in Germany. The U.S. Bankruptcy Court found that without the application of Section 365(n), the U.S. patent licensees' rights would not be "sufficiently protected" under Section 1522(a) of the U.S. Bankruptcy Code, and the administration of the licensed patents in the Chapter 15 case would be "manifestly contrary" to U.S. public policy.<sup>2</sup>

### **Background**

Qimonda, a manufacturer of semiconductor memory devices with headquarters in Munich, Germany, commenced a German insolvency proceeding in January 2009. On the petition of the German court-appointed insolvency administrator, the U.S. Bankruptcy Court recognized the German proceeding as a "foreign main proceeding" pursuant to Chapter 15 of the U.S. Bankruptcy Code in July of the same year. Chapter 15 of the U.S. Bankruptcy Code allows a foreign debtor's representative to commence a proceeding in a United States bankruptcy court to administer U.S. assets of the debtor's estate. In connection with its recognition of the German proceeding, the U.S. Bankruptcy Court issued an order pursuant to Section 1521(a) of the U.S. Bankruptcy Code, making Section 365 applicable in the Chapter 15 proceeding.<sup>3</sup>

As part of the German administrator's plan to monetize Qimonda's valuable patents by re-licensing them to third parties (and potentially to the existing licensees) for new royalties, the administrator sent letters to licensees of Qimonda's U.S. patents in which he elected "non-performance" of the licenses, pursuant to German procedure. Certain of the U.S. patent licensees responded by asserting rights under Section 365(n) of the U.S. Bankruptcy Code—applicable in U.S. bankruptcy

proceedings to the rejection of certain licenses—which they argued would allow them to retain their license rights, notwithstanding the administrator's action in Germany.

The U.S. patent licensees' position prompted the administrator to move the U.S. Bankruptcy Court to modify its initial order applying Section 365, either to render Section 365 wholly inapplicable or to restrict the statute's applicability by providing that it would apply only if the administrator rejected a license pursuant to Section 365 (rather than exercising his non-performance rights under German procedure). Because the administrator had not rejected the licenses under Section 365 of the U.S. Bankruptcy Code, but had instead determined not to perform the licenses under German procedure, such a modification was intended by the administrator to have the effect of denying licensees their license retention rights under Section 365(n) of the U.S. Bankruptcy Code.

The U.S. Bankruptcy Court granted the administrator's motion and issued an amended order (the "Amended Order") that restricted the applicability of Section 365 essentially in the manner requested by the administrator.<sup>4</sup> On the U.S. patent licensees' appeal of the Amended Order, the District Court affirmed in part, but remanded to the U.S. Bankruptcy Court for determination of two issues: (1) whether limiting the applicability of Section 365(n) appropriately balanced the interests of the foreign debtor and the U.S. patent licensees and provided "sufficient protection" to the licensees<sup>5</sup>, and (2) whether the U.S. Bankruptcy Court's restricting the application of Section 365(n) would be "manifestly contrary" to U.S. public policy.<sup>6</sup>

### **U.S. Bankruptcy Court Decision on Remand**

The U.S. Bankruptcy Court separately considered the two questions presented to it on remand, but its analysis for each of the two questions was similar. The U.S. Bankruptcy Court began from the premise that under German law, an insolvency administrator's election of non-performance of a patent license agreement terminates a licensee's right to use the debtor's patents.<sup>7</sup> On that premise, the U.S. Bankruptcy Court first balanced the interests of the foreign debtor and the U.S. patent licensees, pursuant to Section 1522(a) of the U.S. Bankruptcy Code, to determine if the licensees' interests were "sufficiently protected." The U.S. Bankruptcy Court found that failure to apply Section 365(n), and the inability of the licensees to retain their license rights, would put at risk substantial investments in research and manufacturing that the U.S. patent licensees had made in reliance on the "design freedom" deriving from their licenses. On this basis, the U.S. Bankruptcy Court determined that the foreign administrator's treatment of the U.S. patents should be subject to Section 365(n) constraints.

Second, the U.S. Bankruptcy Court considered whether the inability of patent licensees to exercise license retention protections under Section 365(n) would be "manifestly contrary to the public policy of the [U.S.]," within the meaning of Section 1506 of the U.S. Bankruptcy Code. In answering this question in the affirmative, the U.S. Bankruptcy Court considered the legislative history of Section 365(n), in which Congress expressed concern regarding the "threat to American Technology" that would result from allowing licenses to be cancelled in bankruptcy.<sup>8</sup> The U.S. Bankruptcy Court also relied heavily on expert testimony that eliminating licensees' protections under Section 365(n) would

result in "increased uncertainty regarding the enforceability of patent licenses," which, in turn, would result in "decreased investments," and "less innovation," which is "key to the continued health of the [U.S.] economy."<sup>9</sup> Ultimately, the U.S. Bankruptcy Court determined that depriving patent licensees of protections under Section 365(n) would, under the circumstances of the case, "undermine a fundamental U.S. public policy promoting technological innovation."<sup>10</sup> Therefore, on this additional basis, the U.S. Bankruptcy Court held that Section 365(n) must apply to the administration of the U.S. patent licenses in the Chapter 15 case.

## The Bottom Line

The *Qimonda* decision is the only reported decision addressing the applicability of Section 365(n) in the Chapter 15 context, and one of very few decisions interpreting whether relief under Chapter 15 "sufficiently protects" creditors in the U.S. or is "manifestly contrary" to U.S. public policy. This decision is therefore important to the continuing definition of the rights of parties in Chapter 15 cases generally and, more specifically, of the rights of intellectual property licensees whose counterparties become subject to cross-border insolvency proceedings.

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<sup>1</sup> References herein to the U.S. Bankruptcy Code and its sections are to 11 U.S.C. §§ 101-1532. Section 365(n) of the U.S. Bankruptcy Code prevents a licensor from unilaterally terminating the license rights of a licensee under an "intellectual property" license by rejecting the license under Section 365(a).

<sup>2</sup>*In re Qimonda AG*, No. 09-14766-SSM (Bankr. E.D. Va. Oct. 28, 2011).

<sup>3</sup> Section 365 of the U.S. Bankruptcy Code is not one of the sections made mandatorily applicable to Chapter 15 proceedings under Section 1520. Instead, according to the District Court, its applicability is within the court's discretion under Section 1521. *In re Qimonda AG Bankruptcy Litigation*, 433 B.R. 547, 560 (E.D. Va. 2010).

<sup>4</sup>*In re Qimonda AG*, 2009 WL 4060083 (Bankr. E.D. Va. Nov. 19, 2009).

<sup>5</sup>See 11 U.S.C. § 1522(a) (U.S. court may grant relief under Section 1521, including entrusting the debtor's U.S. assets to the foreign representative, only if the interests of "creditors and other interested entities, including the debtor" are "sufficiently protected.").

<sup>6</sup>*In re Qimonda AG Bankruptcy Litigation*, 433 B.R. at 571; see 11 U.S.C. § 1506 (U.S. court may refuse to take any action in a Chapter 15 proceeding if such action would be "manifestly contrary" to U.S. public policy.).

<sup>7</sup> This was the position taken by the administrator, and according to the U.S. Bankruptcy Court, this view prevails generally among German insolvency professionals, but technically remains an open question. Indeed, this result is presently the subject of challenges brought by various of the

licensees in Germany and elsewhere. See *In re Qimonda AG*, No. 09-14766-SSM, slip op. at 13 (Bankr. E.D. Va. Oct. 28, 2011).

<sup>8</sup> The enactment of Section 365(n), in effect, overturned the Fourth Circuit's ruling in 756 F.2d 1043 (4th Cir. 1985), cert. denied, 475 U.S. 1057 (1986), holding that a debtor's rejection of a license to use certain technology terminated the licensee's right to use the technology.

<sup>9</sup> *In re Qimonda AG*, No. 09-14766-SSM, slip op. at 18 (Bankr. E.D. Va. Oct. 28, 2011).

<sup>10</sup> *In re Qimonda AG*, No. 09-14766-SSM, slip op. at 34 (Bankr. E.D. Va. Oct. 28, 2011).

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