

IP License Agreements: Change of Corporate Control and Bankruptcy Issues

A Lexis Practice Advisor® Practice Note by Michael J. Kasdan, Wiggin and Dana LLP



Michael J. Kasdan
Wiggin and Dana LLP

Parties to an agreement cannot always predict how their business will develop and change over time, but they can count on the fact that they will change. Mergers and acquisitions raise a host of licensing issues, many of which surface time and again. Parties can plan and intelligently address how the license rights are to be treated in the event of future mergers and acquisitions transactions.

Mergers

Most courts have held that mergers with respect to intellectual property count as an “assignment.” Under many state corporate merger statutes, the effect of a merger is to automatically transfer all property by operation of law. For example, the ABA Model Business Corporation Act provides that every contract right possessed by “each corporation, or other entity that merges into the survivor is vested in the survivor without reversion or impairment.” ABA Model Business Corp. Act, 11.07(3). Many state statutes track this language or have similar provisions. See, e.g., Delaware General Corp. Law § 259 (8 Del. C. § 259); New York Business Corporation Law § 906; California Corporations Code § 1113(i). The “vest” language of these statutes has been repeatedly construed as denoting an assignment or transfer of rights. Nonetheless, such agreements frequently attach specific assignments of intellectual property as exhibits to be signed contemporaneously with the main agreement, as well as forms of assignment to be signed in the event future assignments are required.

Transferring Rights Under an Agreement to a Different Corporate Entity

Separate from the merger of all the assets, rights, and liabilities of two companies, a party may at some point entertain the possibility of transferring only its intellectual property, or its rights to certain intellectual property. The issue of whether rights under a license agreement may be transferred to a different corporate entity may arise, for example, when a licensee is acquired by a third party, when a licensee spins out of a division, or when a licensee acquires or creates a new subsidiary.

The default rule under federal law is that a non-exclusive intellectual property license is a personal right that is non-transferable absent the permission of the licensor. See, e.g., *Everex Sys. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673, 679 (9th Cir. 1996) (“In essence, every licensee would become a potential competitor with the licensor-patent holder in the market for licenses under the patents”). While, as a general matter contracts are freely transferrable, intellectual property agreements are considered to be “personal,” i.e., specifically between the two original contracting parties and hence *not* freely transferrable. This is because licensing a small non-competitor to use your intellectual property is very different from licensing with your large direct competitor.

As a result, if the agreement is silent on transferability, it is non-transferable and not assignable to a new corporate entity, without the other party’s consent. If the parties agree that the license should be non-transferable and not assignable, it is advisable that they include such statements in the language of the agreement. Moreover, if the parties want to address in what future situations it is permissible to

transfer the license to a different party, this must be done so expressly in the agreement. The parties may want to address future contingencies for possible transactions such as exiting a particular market, spinning off a company, acquiring a company or division, later-created subsidiaries, merger into a third party, sale of intellectual property, consolidation of intellectual property in a holding company, transfers for tax reasons, reorganization, insolvency, bankruptcy, and the like.

On the licensor side, that party may want to consider a clause that provides flexibility to dispose of the licensed assets. For example:

“For clarification, the terms of this Agreement including the foregoing license, covenants and releases shall survive any sale, exclusive license, or assignment by licensor to another entity of any licensed asset, or termination, for any reason. If Licensor should sell, assign, or exclusively license any licensed asset to any third party, then licensor covenants to obligate such third party to honor the covenants and non-assertions provided herein with respect to licensee. All licenses and covenants herein shall run with the licensed assets and shall be binding on any successors-in-interest, assigns, transferees, equitable or legal owners, or the like thereof of this Agreement, whom the licensor will notify of this Agreement and bind to the terms of this Agreement.”

This clause gives the licensor freedom to sell the licensed assets with no restrictions beyond binding the purchaser to the licensor’s agreement with licensee. Licensees often look for such a guarantee and confirm that the obligations under the agreement will run to any entity that acquires the licensed assets for any reason.

Similarly, the licensee may desire a certain degree of freedom to divest certain areas of its company, to shift assets to related or subsidiary companies, or to consolidate assets with subsidiary or related companies that may not yet exist at the time of the agreement, and still remain covered by the license. What is permissible is a matter of negotiation and an assessment of risk on the business side. Often, in cases where an entire business or substantially all the business is transferred, there is a provision for licensee rights to continue, but with certain limitations to protect the licensor. For example:

“If licensee transfers all or a substantial portion of its business or restructures any business to which the Licensed Assets relate, licensee may assign its rights under this Agreement upon written notice to licensor, and licensee shall cause the assignee thereof to take such assignment subject to the provisions of this Agreement, but such rights will only apply to the business transferred

to or acquired by the assignee and not to any other pre-existing business or any other business separately acquired or created by the assignee. Any subsidiary or division of licensee that is divested after the Effective Date may, at licensee’s option, retain the benefit of the rights, licenses, privileges, releases, covenants and immunities granted under this Agreement, but such rights will only apply to the business of such subsidiary or division and not to any other business of any acquiring company.”

The foregoing clause addresses two considerations: internal restructuring and divestiture. While both considerations are discussed separately for clarity, the mechanisms are the same.

The licensee is free to transfer, restructure or wholly divest the portion of the business concerned with the licensed assets while retaining the benefit of the license. On the other hand, the licensor receives notice of the transfer and confirmation that the scope of the license will not materially change due to the transfer, restructuring, or divestiture.

For the licensor, the limitation that the license only extends to a “pre-existing business” limits the licensee from spinning off the division to a much larger entity that will take the benefit of the license, perhaps at a much lower price than it would have if it had negotiated for the larger company.

Bankruptcy

Should one of the parties file for bankruptcy protection, the fate of the license and the licensed assets is a critical concern. Indeed, when a party files for bankruptcy, the interests of the bankrupt entity become the property of the bankruptcy estate. 11 U.S.C. § 541(c). So what becomes of the parties’ carefully-negotiated license?

The trustee in bankruptcy ordinarily has the right to terminate so-called “executory contracts,” i.e., a contract with material performance remaining on both sides. While there is some contrary authority, non-exclusive patent and copyright license agreements are typically considered “executory contracts.” This classification extends even to paid-up licenses, i.e., fully paid lump sum license agreements with no future or ongoing royalty payments. There is a circuit split on whether a trademark license is an executory contract. For this reason, it makes sense to include provisions in trademark licenses to protect one side and/or the other in the event of a bankruptcy, since it is unclear whether the statutory bankruptcy framework, described below, will apply.

The bankruptcy trustee has power to assume, assign, or reject any executory contract. 11 U.S.C. § 365(f). In other words, the bankruptcy trustee could theoretically: (1)

terminate the license or (2) assume the license on behalf of the estate so it can be transferred or assigned to a third party, both of which are undesirable consequences.

Luckily for the parties, the Bankruptcy Code prohibits the bankruptcy trustee from assuming and assigning an executory contract where applicable non-bankruptcy law forbids it. This significant exception is codified in 11 U.S.C. § 365(c) and protects the parties (perhaps more the licensor) in the event of a bankruptcy. The weight of authority mainly holds that because an intellectual property license is involved, the applicable law is federal common law, which makes intellectual property agreements non-assignable without consent of licensor. See, e.g., *Everex Sys. v. Cadtrak Corp.* (In re CFLC, Inc.), 89 F.3d 673, 679-80 (9th Cir. 1996). Therefore, a bankruptcy trustee may not freely assume and assign intellectual property license agreements.

The Bankruptcy Code also contains explicit provisions to protect the intellectual property licensee. See 11 U.S.C. § 365(n). In the event of a licensor bankruptcy, the licensee has the option of: (1) treating the license as terminated and seeking remedy for breach or (2) providing written notice to the bankruptcy trustee and electing to retain the licensed rights. Of course, the licensee must continue to pay royalties if called for under the agreement.

However, this framework was viewed as not applicable to trademark licenses, since trademarks were not included within the definition of “intellectual property” under the Bankruptcy Code (see, 11 U.S.C. § 101). Significantly, the U.S. Supreme Court considered this issue in 2019. In *Mission Product Holdings, Inc. v. Tempnology, LLC*, 139 S.Ct. 1652 (2019), the Court resolved a circuit split over whether the Bankruptcy Code views rejection of a trademark licensing agreement as a licensor’s breach or as a unilateral revocation of the agreement. In an 8-1 decision, the Supreme Court held that a licensor in bankruptcy cannot prevent a licensee from continuing to operate under the license in that rejection had the same effect as a breach of that contract outside of bankruptcy.

In the wake of the Supreme Court’s decision, trademark licensees are assured that rejection under Section 365 will not in itself disturb rights of continued use of licensed marks for the duration of an agreement and consistent with its terms. However, as Justice Sotomayor pointed out in concurrence, the holding in *Mission* does not prevent future licensors from negotiating termination provisions with an eye towards potential bankruptcy. In such cases, contract law principles, rather than the operation of Section 365, will determine the parties’ respective rights.

From the perspective of a licensee, the bankruptcy clause of all intellectual property agreements (including trademarks) should be clear that the license is one of rights to “intellectual property” so as to clearly invoke 11 U.S.C. § 365(n). For example:

“All rights, licenses, privileges, releases, non-assertions and immunities granted under or pursuant to this Agreement by licensor to licensee shall be deemed to be, for purpose of Section 365(n) of the U.S. Bankruptcy Code licenses of rights to ‘intellectual property’ as defined under *Section 101 of the Bankruptcy Code.*”

Additionally, out of an abundance of caution, the licensee should expressly reserve all rights to continue the license and bind the licensor to aid in continuing the licensee’s rights should the agreement be rejected by the trustee:

“The Parties hereto agree that licensee and its subsidiaries, as licensee of such rights under this Agreement, shall retain and may fully exercise all of their rights and elections under the Bankruptcy Code. The Parties hereto further agree that, if a Bankruptcy Code case is commenced by or against licensor and this Agreement is rejected as provided in the Bankruptcy Code, then licensor and their successors and assigns shall take such steps as are necessary to permit licensee and its subsidiaries to exercise their rights under this Agreement.”

Finally, it should be kept in mind that although many licenses include provisions providing for a right of termination in the event that one of the parties enters bankruptcy, this is expressly forbidden by statute. See 11 U.S.C. § 365(e)(1). This statute trumps even the express written agreement of the parties. However, an agreement may include a termination provision that is based on a trigger event that occurs prior to formal bankruptcy, such as insolvency, failure to make royalty payments over an extended period of time, or leveraging intellectual property assets as collateral to take on debt.

Assistance provided by Christina Williams and Abraham Kasdan, Wiggan and Dana LLP

Michael J. Kasdan, Partner, Wiggin and Dana LLP

Michael J. Kasdan is a partner in the Intellectual Property Practice at Wiggin and Dana LLP. Michael has spent his career handling litigations, licensing matters, and transactional work, performing analyses and providing opinions, and advising companies on all aspects of intellectual property. Trained in electrical engineering and with a business background as a technology consultant, Michael works with a broad range of technologies, including consumer electronics, mobile devices, computer architecture, semiconductor chips, Internet and e-commerce, and medical devices.

In addition to his diverse experience as outside counsel, Michael has served as in-house patent counsel to Panasonic Corporation in Japan while working on secondment in Panasonic's licensing center. In that role, he acted as lead counsel in numerous third-party patent assertions and license negotiations, negotiated complex agreements, including portfolio cross-license agreements, and worked with the company to identify high value patents and strengthen their protection.

Michael also teaches as an adjunct professor at his alma mater, NYU School of Law, and has served as an adjunct professor at Seton Hall University School of Law, addressing topics such as patent and trade secret law, IP Licensing, global patent litigation, patent exhaustion, and inequitable conduct. He also frequently writes and speaks on a range of topics including IP litigation, patent monetization and licensing practices, strategic portfolio development, patent eligibility, patent exhaustion, willful infringement, patent misuse and standards estoppel, standards essential patents, damages and patent valuation, inequitable conduct, social media and privacy issues, and legal ethics.

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