Restructuring Dilemmas for the High Technology Licensee: Will “Plain Meaning” Bring Order to the Chaotic Bankruptcy Law for Assumption and Assignment of Technology Licenses?

David R. Kuney*

TABLE OF CONTENTS

I. INTRODUCTION.............................................................................................................124
II. THE CORE TENSION .................................................................................................127
   A. Intellectual Property Law And Policy.................................................................127
      1. The Patent and Copyright Monopoly..............................................................127
      2. Federal Common Law of Non-assignability..................................................130
   B. The Bankruptcy Policy of Free Assignability of Contracts and Ease of Liquidation ..............................................................................................................134
      1. The Principles of Free Assignment as Key to Reorganization.......................134
      2. The Bankruptcy Code’s Limits on Free Assignment: Understanding the Reach of “Applicable Law” in Executory Contract Theory......................................................137
      3. The Stage is Set .................................................................................................138
III. THE TENSION PLAYED OUT ...................................................................................139
   A. The Treatment of Non-exclusive Licenses under the Bankruptcy Code .........139
      1. Assignment vs. Mere License .........................................................................139
      2. Non-exclusive Licenses as Executory Contracts .........................................141
      3. Nonassignability of a Non-exclusive License Under Section 365(c)...............142
   B. Development of the Clash between the Hypothetical Test and the Actual Test ......................................................................................................................145
      1. The Hypothetical Test ......................................................................................145
      2. The Actual Test ...............................................................................................149
IV. THE EMERGING TREND .........................................................................................152
V. CONCLUSION ...........................................................................................................157

* David R. Kuney is a partner in the Corporate Reorganization and Bankruptcy Group at Sidley Austin LLP. Mr. Kuney is also an Adjunct Professor at Georgetown University Law Center, where he teaches corporate bankruptcy. The views expressed in this article are solely that of the author and do not reflect the views of Sidley Austin LLP.
I. INTRODUCTION

This article examines an unresolved tension between intellectual property law, which is premised on the power of an owner or creator to exclude others from the use of a patent or copyright (the “monopoly power”), and the principle that property should be freely assignable, which is intrinsic to restructuring under U.S. bankruptcy law. This tension manifests itself when a troubled company, which is heavily reliant upon copyright or patent licenses for its core business operations, files for relief under Chapter 11 of the Code only to discover that its legal right to either use, sell or assign its intellectual property is circumscribed or prohibited, thus making reorganization either untenable, or more costly and less likely. In short, prevailing bankruptcy law, contains “perverse and anomalous consequences . . . under which a debtor may lose the benefit of a non-assignable contract vital to its economic future solely because it filed for bankruptcy.”

This is not an academic issue, but one rooted in the hard practicalities of the commercial world. Two recent cases highlight the problem. In In re Sunterra Corp., the debtor’s primary business was wholly reliant upon a copyright license to use software for its resort management business. The copyright owner was able to challenge the debtor’s proposed plan of reorganization and divest the estate of the copyright license on the grounds that a debtor may not “assume” a non-exclusive license. A similar result occurred in In re Aerobox Composite Structures, LLC, in which the debtor’s principal assets depended upon the use of a non-exclusive license, and yet the court ruled that the debtor could be divested of its license because of the bankruptcy filing.

3. 361 F.3d 257, 260 (4th Cir. 2004).
4. Id. at 261.
5. 373 B.R. 135, 137, 142 (Bankr. D.N.M. 2007). On January 23, 2007 Aerobox Composite Structures filed for bankruptcy protection in New Mexico. Id. at 137. The debtor employed approximately seventy personnel in its leased premises located in Rio Rancho, New Mexico. Its primary business was the manufacture of a key panel for an Air Cargo Container Unit Load Device, used in commercial aircraft and certified by the Federal Aviation Administration. These containers were introduced into the market place in 2003 and by 2004 had begun to appear at airports worldwide. The company was extremely successful and the order book rose from 650 units ordered in 2005 to 9,675 in 2006. The company experienced financial difficulty in 2006 when its recently recruited Production Director unexpectedly died, throwing the company into temporary disarray and leading to losses. The bankruptcy filing ensured.

Aerobox relied on a License Agreement with Tubus Bauer GmbH (“Tubus Bauer”) pursuant to which it had both an exclusive and a non-exclusive license to use certain patented rights and
This recurring problem stems in large measure from the problems confronted by licensees, who have struggled with fundamental notions of “executory contracts” under the Code, and with the conflicting statutory Code language that either does or does not override statutory and contractual limits on the power to assign contracts. The problem comes down to this: may a non-exclusive licensee continue to operate under its license once it files for bankruptcy, or does bankruptcy law contain a prohibition against “assumption” of such licenses, meaning that the debtor can no longer use the license? While the loss of the license may be death knell for the licensee, it may be exactly what the licensor desires and expects, and what federal law requires.

The case law on the power of a debtor to assume and assign non-exclusive patent and copyright licenses has been highly inconsistent. Courts have exhausted themselves in search of the plain meaning of Code section 365. Instead of producing a consistent and sensible answer, they have split and generated two conflicting rules, known as the “actual” test and the “hypothetical” test. One court noted that there may be as many as seven lines of case, each offering its own view of the plain meaning of 365(c) and its counterpart, 365(f). The cases have continued to offer splintered views of the Code, with yet additional theories being offered on what the Code means and how it should be interpreted. The split among the Circuit Courts has likewise deepened, with the Fourth Circuit affirming an interpretation of the Code that would effectively preclude high technology companies from using their technology licenses after they file for bankruptcy, and the Fifth Circuit reaching the confidential information for the in house manufacturing of the key panels. Id. at 137. Presumably, without the right to use the patent, Aerobox could not remain in business, nor could it reorganize. The License Agreement was for fifteen years and it provided that it could not be assigned without the consent of Tubus Bauer, which it agreed could not be unreasonably withheld. Id. All payments which were due under the license agreement had been paid in full. Id. at 138.

Shortly after the case was filed, Tubus Bauer filed a motion seeking to compel rejection of the License Agreement. Id. at 137. Its argument was that the Code’s prohibition on enforcing ipso facto clauses does not apply to patents because patents cannot be assigned under federal common law, and thus, under the Code cannot be “assumed,” that is, cannot be used at all by the debtor. Id. at 138. For reasons identified below, the Court denied the motion. Id. at 142. The Bankruptcy court’s order was appealed, but the appeal was later voluntarily dismissed.

7. But see In re Quantegy, Inc., 326 B.R. 467, 471 (Bankr. M.D. Ala. 2005) (holding that Sony’s copyright and patent license could be assumed and assigned despite applicable law because of a consent provision in the license).
9. In 2001, this author examined the then current case law, and suggested that the area of executory contract law as applied to high technology cases needed re-examination and a more consistent standard. See David R. Kuney, Intellectual Property in Bankruptcy Court: The Search for a More Coherent Standard in Dealing with a Debtor’s Right to Assume and Assign Technology Licenses, 9 AM. BANKR. INST. L. REV. 593, 595 (2001).
10. See In re Sunterra Corp., 361 F.3d 257 (4th Cir. 2004).
exact opposite conclusion. Efforts to have the Supreme Court review and reconcile the split have proven unsuccessful. Congress has refused to amend section 365, despite spending years rewriting other Code sections.

This lack of consistency in applying bankruptcy law principles to non-exclusive licenses has consequences which may be untenable for licensees, licensors, and those which provide financing to licensees. If the right to continue to use an essential asset is subject to conflicting rules of law, then none of the parties can be sure of its rights. The consequence of this can be substantial. If a lender cannot be assured of having a lien of a licensee’s technology license in the event of a bankruptcy filing, the lender might decide not to lend or demand a higher rate of interest.

Part II of this article suggests that there is a serious tension between the policies and values that underlie intellectual property law and the Code. On one hand, there is a body of non-statutory, federal law which holds that patent and copyright licenses are non-assignable without the consent of the patent or copyright owner. The policy underlying this rule is that free assignability could lead to multiple assignments and re-sale, and hence the entire monopoly and legal protection afforded to intellectual property would be at risk. On the other hand, there is the important bankruptcy policy of promoting free assignability of contracts to maximize the debtor’s bankruptcy estate. This policy that most commercial contracts are “assignable” is embedded in the complex provisions dealing with executory contracts found in section 365 of the Code. In particular, section 365 reflects the Code’s core value of free assignability by permitting assignments, often without regard to contract provisions or legal barriers that would otherwise prohibit assignment outside of bankruptcy.

Part III examines the basic rules that govern non-exclusive licenses in a bankruptcy case, with the focus being on understanding the role of section 365, and how it operates in general. It then looks at the leading cases that, to date, refuse to permit debtors to assume and assign their intellectual property licenses by adopting a “per se” rule arising from the so-called federal common law of patents. This body of case law has created legal barriers to assumption and assignment of patent and copyright licenses which pose nearly insurmountable barriers to successful reorganization.

Part IV suggests that despite the unresolved tension among the Circuit Courts, an emerging view appears to offer more balance between owners and licensees, and better reconciles the Code provisions that appear discordant and irascible. This new view, as evidenced in the case of In re Aerobox Composite Structures, LLC, rejects

12. “The Code generally favors free assignability as means to maximize the value of the debtor’s estate and, to that end, allows the trustee to assign notwithstanding a provision in the contract of lease, or applicable law, prohibiting, restricting, or conditioning assignment.” In re Rickel Home Centers, Inc., 209 F.3d 291, 299 (3d Cir. 2000).
both the hypothetical test and the actual test. Instead, it focuses on the plain meaning of the term ‘trustee,’ and questions whether prior courts have correctly understood this most basic of all bankruptcy terms. By defining trustee as not including the debtor in possession (at least not always), a few courts have detoured around the framework of the hypothetical and actual tests and developed a test which might actually both make sense in the pragmatic world and be true to principles of statutory construction. In addition, the Fifth Circuit in Mirant has questioned whether the barriers to assumption are being made in the abstract, and without the kind of record that courts typically require, suggesting that the “per se” rule against assumption is incorrect.¹⁴

Other than picking a winner, is there a principled middle ground that is consistent with existing law and reasonably accommodating to the business community? The ultimate result should be simple; the goals of chapter 11 should be harmonized with the needs to protect patent owners. The monopoly power should be preserved through rigorous rules against assignment, and the ability to reorganize kept in tact through the ability to assume the contracts. Assignment should be precluded unless consent is obtained; assumption should be permitted with the usual requirement for curing prepetition defaults, if any. The answer must be found under the guise if “plain meaning,” then perhaps the Aerobox approach will gain momentum.

Throughout this Article, the major focus will be on patent law, with some attention being given to copyright law as well. It is hoped, however, that the general principles of intellectual property law and bankruptcy law will provide useful guidance and insight on a broad range of related issues in this field.

II. THE CORE TENSION

A. Intellectual Property Law And Policy

1. The Patent and Copyright Monopoly

To understand the nature of the conflict between intellectual property and bankruptcy law, it is useful to examine the core values that underlie intellectual property law. By intellectual property law I mean generally the bodies of law dealing with patents and copyrights.¹⁵ The underlying values are essential if bankruptcy courts are to utilize a standard which seeks out the congressional purposes that animate this area of the law.


15. The Code defines intellectual property as meaning, among other things, trade secrets, an “invention, process, design or plan protected under title 35,” a patent application and a “work of authorship protected under title 17.” 11 U.S.C. § 101(35A) (2000). Trademarks are not included in this definition and courts have held that trademarks are not “intellectual property” for purposes of section 365(n). See, e.g., In re Dynamic Tooling Sys., Inc., 349 B.R. 847, 856 (Bankr. D. Kan. 2006).
Patent law finds its elemental expression in Article I, clause 8, section 8 of the United States Constitution, which authorizes congress “[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.” Pursuant to this grant of power, Congress has enacted the Patent Act.

The Patent Act supports the economic engine of high technology by providing that one who “invents or discovers any new or useful process, machine, manufacture, or composition of matter” may apply for a patent. One of the most valuable rights of a patent is the power to exclude all persons from exploiting the patented invention during the effective period of the patent. Indeed, a recent case points out that the power to exclude is essentially what a patent right is: “[T]he granting of a patent does not grant a person the right to use, make or sell a product . . . What is granted is the right to exclude others from using one’s invention; thus, the language of the statute, “Every patent shall contain . . . a grant to the patentee . . . of the right to exclude others from making, using or selling the invention . . .” This power to exclude others gives the holder of a patent a monopoly sanctioned by the U.S. Government, and that monopoly is the “essence of the patent.”

Ownership and assignment of patents is controlled to a limited extent by the Patent Act. The Patent Act states that “patents shall have attributes of personal property.” Because a patent is a recognized property interest, a patent or an application for a patent “shall be assignable in law by an instrument in writing.” And nothing in the Patent Act in any way limits or restricts the assignability of patents.

The terminology used with respect to patent transfers has acquired a somewhat specialized meaning, with important distinctions between “assignment” and “license” and further distinctions between a non-exclusive license and an exclusive license. “An assignment of a patent is a transfer of an ownership interest in the patent” and is...

23. Id.
specifically authorized by the Patent Act.\textsuperscript{24} As the Supreme Court put it, there are three types of assignments:

The patentee . . . [may] convey, either (1) the whole patent, compromising the exclusive right to make, use and vend the invention throughout the United States; or (2) an undivided part or share of that exclusive right; or (3) the exclusive right under the patent within and throughout a specified part of the United States. A transfer of these three kinds of interests is an assignment, properly speaking, and vests in the assignee a title or so much of the patent itself . . . Any assignment or transfer, short of one of these is a mere license.\textsuperscript{25}

Thus, an exclusive license is a type of assignment. When an owner of a patented technology grants an exclusive license to a transferee, the transferee generally acquires full ownership and control of an undivided part or share of the whole, or for a specific geographic area. From this perspective an exclusive license is somewhat like a sale.

Conversely, patented technology may be distributed or transferred to end users through non-exclusive licenses. Here, the owner/inventor of the patented technology is not relinquishing full title. The holder of the patent has a limited right to use the technology, but not the right to distribute or sell the technology to third parties. The owner typically covenants to defend against infringement. For this reason, some courts do not consider a non-exclusive license as a transfer, “but simply an agreement by the patent owner not to sue a party for infringement for engaging in specific acts.”\textsuperscript{26}

Copyright law follows much of the same pattern. The Copyright Act\textsuperscript{27} combines the essential attributes of a monopoly with the notion of non-assignability. “The Copyright Act, the spirit of which is embodied in section 106, grants a limited monopoly to the copyright owner to exploit his creation.”\textsuperscript{28} Likewise, the policy

\begin{itemize}
\item \textsuperscript{24} In re CFLC, Inc., 89 F.3d 673, 676 n.2 (9th Cir. 1996).
\item \textsuperscript{25} Waterman, 138 U.S. at 255.
\item \textsuperscript{26} See In re Supernatural Foods, LLC, 268 B.R. 759, 802 (“A license of a patent is merely an agreement between the patentee and the licensee that the patentee will not sue the licensee for infringement of his exclusive right (in return for consideration of some sort.”). See also Carole A. Quinn and R. Scott Weide, Violation of the Erie Doctrine: Application of a Rule of Federal Common Law to Issues of Patent License Transferability, 32 CREIGHTON L. REV. 1121, 1122 (1999). As a pair of commentators stated, “[a] license agreement, in turn, basically is a waiver of the owner’s (i.e., the licensor’s) right to sue the entity (i.e. the licensee) for infringement of the intellectual property and technology.” Richard M. Cieri and Michelle M. Morgan, Licensing Intellectual Property and Technology from the Financially-Troubled or Startup Company: Prebankruptcy Strategies to Minimize the Risk in a Licensee's Intellectual Property and Technology Investment, 55 BUS. LAW. 1649, 1650 (2000).
\item \textsuperscript{27} 17 U.S.C. §§ 101-805 (2000).
\end{itemize}
behind this federal monopoly is to stimulate and protect creativity: "It is intended to motivate the creative activity of authors and inventors by the provision of a special reward, and to allow the public access to the products of their genius after the limited period of exclusive control has expired." 29

The Copyright Act recognizes the distinction between an exclusive license and a non-exclusive license. Thus, transfer of copyright ownership includes the grant of an exclusive license, but not a non-exclusive license. 30 The holder of the exclusive license is entitled to all the rights and protections of the copyright owner to the extent of the license. 31 Conversely, "the nonexclusive license does not transfer any rights of ownership; ownership remains in the licensor." 32 This distinction was recently summarized by the Bankruptcy Court for the District of Delaware as follows:

Under copyright law, "a nonexclusive licensee . . . has only a personal and not a property interest in the [intellectual property]," which "cannot be assigned unless the [intellectual property] owner authorizes the assignment . . . ." By contrast, however, an exclusive licensee does acquire property rights and "may freely transfer his rights, and moreover, the licensor cannot transfer the same rights to anyone else." 33

2. Federal Common Law of Non-assignability

The notion that an owner of technology has a monopoly and yet can transfer and license discrete interests is unique and has created difficult issues when applied in the bankruptcy arena. It is safe to say that most bankruptcy courts have long accepted the notion that federal common law prohibits the assignment of a patent license without the consent of the licensor and that this federal common law pre-empts any state law or bankruptcy policy, which permits assignment despite the licensor's opposition. "It is well settled that a non-exclusive license of a patent has only a personal and not a property interest in the patent and that this personal right cannot be assigned unless the patent owner authorizes the assignment or the license itself permits assignment." 34 Nevertheless, despite being "well-settled," there is ample authority that doubts that federal common law does or should apply. 35

34. Gilson v. Republic of Ir., 787 F.2d 655, 658 (D.C. Cir. 1986). See also Stenograph Corp. v. Fulkerson, 972 F.2d 726, 729 n.2 (7th Cir. 1992) ("Patent licenses are not assignable in the absence of express language."); PPG Indus., Inc. v. Guardian Indus. Corp., 597 F.2d 1090, 1093 (6th Cir. 1979) ("It has long been held by federal courts that agreements granting patent licenses are personal
A threshold question that continues to linger, however, is whether there is a federal common law of non-assignability of patents and copyrights. The phrase "federal common law" refers to a body of judge made law that is based on perceived policies and goals, and deals with such matters as "general commercial law." It is to be distinguished from both state and federal statutory law. In considering the propriety of applying federal common law, one must keep in mind the Supreme Court's admonition that the creation and application of federal common law is to be the exception, not the rule. In general, there is no federal common law. The common law is primarily a creature of state law, and federal courts, when sitting in a diversity case, must typically look to state common law as the basis for decision making. This, of course, is the central thesis of the famous decision of *Erie Railroad Co. v. Tompkins.* In *Erie,* the Supreme Court rejected the then current view that there was a body of law, general in nature and not dependent upon local law or statutes, which applied to the "construction of contracts or other written instruments and especially to questions of general commercial law."  

Prior to *Erie,* the Supreme Court had announced the general principle that patent licenses are not assignable without the consent of the patent owner. This principle, that a patent license is not assignable unless expressly made so, "has been the rule at least since 1852 when the Supreme Court decided *Troy Iron & Nail v. Corning.*"  

Subsequent to *Erie,* federal courts have continued to apply this general principle of non-assignability of patents. For example, in 1972, the Seventh Circuit, in *Unarco Industries, Inc. v. Kelley Company,* held that patent licenses are an exception to the *Erie* doctrine, they are non-assignable as a matter of federal common law, and that this federal limit on assignment applies regardless of state law, which sometimes provides for free assignability. This exception to *Erie* was justified, the court concluded, because the policy of patent law is "so dominated by the sweep of federal statutes that legal relations must be deemed governed by federal law having its source in those statutes rather than by local law."

---

37. Id.
38. Id. at 83 (Butler, J., dissenting).
41. Id. at 1306-07.
42. Id. at 1306. The court added that "this monopoly conferred by federal statute as well as the policy permeating this monopoly, so affects the licensing of patents, and the policy behind such licensing is so intertwined with the sweep of federal statutes, that any question with respect thereto must be governed by federal law." Id.
The Ninth Circuit embraced the applicability of federal common law to the assignability of patent licenses in 1996. In doing so, the court expressly acknowledged that federal policy justifies the application of federal law. Specifically, permitting states to provide for the free assignability of nonexclusive patent license "would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee."  

Most lower federal courts have agreed. As one explained, the rationale for the non-assignability of a patent rests on the nature of a non-exclusive license, which amounts to little more than the licensor's contractual promise not to sue the licensee for infringement. "It would strain credulity to argue that a promise not to sue one person can be transferred by that person to another person, thus preventing the licensor from suing the third party to whom the licensor" made no such promise.

Nevertheless, some courts and commentators have challenged the applicability of federal common law to this issue. The leading case to have done so is *Farmland Irrigation Co. v. Dopplmaier*. In Dopplmaier, Justice Traynor concluded that state law, not federal law, should govern the assignment of patent licenses for three reasons. First, the doctrine that all patent licenses are not assignable, without express consent, was decided before *Erie* and thus did not address the issue of whether state or federal law should apply. Second, the early cases were based on fact patterns where the underlying license agreement was based on the personal skill of the licensee. Many patent licenses are not truly based on personal services, but rather are more in the nature of a "commodity," and hence the decisions do not reflect the underlying commercial reality of the license agreements. Third, the federal common law rule undercuts important state rules, which favor free assignability.

Several commentators agree with Justice Traynor. One pair noted that neither the Seventh Circuit nor the Ninth Circuit determined if there was any conflict between state and federal policy and even if there were a conflict, whether it would be significant enough to justify the displacement of state law. Another has observed that a proper economic analysis leads to the conclusion that federal patent policy should not preempt state law that allows for the free assignment of a patent license.
because that state law allows “the parties to maximize the value of the licenses to themselves and to society.”

More recently, in *Superbrace v. Tidwell*, a California Court of Appeals addressed at length the notion that there was a federal common law of assignability and adopted the view of another commentator that the “federal courts appear to have overreached themselves in continuing to invent federal common law to forbid the assignment of a license agreement.” The court concluded there was no basis for federal pre-emption because the patent act is silent on assignment of licenses and state law does not undermine the federal public policy of giving adequate reward to authors and inventors.

Still, the cases holding that the matter is governed by federal common law continue to be dominant. Indeed, in adopting its position, the Ninth Circuit acknowledged that Justice Traynor had raised significant questions but, nevertheless, concluded that federal common law controls:

> Allowing free assignability—or more accurately, allowing states to allow free assignability of non exclusive patent licenses would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee. In essence, every licensee would become a potential competitor with the licensor-patent holder in the market for licenses under the patents.

Generally, the same concepts of non-assignability apply to copyrights. Thus, in referring to the “historic kinship between patent law and copyright law,” one court framed the rule of non-assignability of copyrights by borrowing from the law pertaining to patents, ruling that a non-exclusive license is personal to the transferee and cannot be assigned to a third party without the licensor’s consent.

---

54. *Id.* at 412. The court cited to various scholars who had questioned the notion that there was an applicable body of federal common law, including Quinn and Weide. *Id.* at 411-12.
56. *In re CFLC, Inc.*, 89 F.3d 673, 679-80 (9th Cir. 1996).
The rule with respect to trademarks appears to be the same, although the case law is divided.\textsuperscript{58} A recent article suggests that the rights of a trademark holder regarding control over the use of its mark are limited, and thus the assignment of a trademark without the consent of the owner does not have the same implications.\textsuperscript{59} Accordingly, a number of courts have permitted trademark licenses to be assumed or assigned in bankruptcy.\textsuperscript{60} More recently, however, one district court ruled that trademarks are subject to the same rule of non-assignability as copyrights.\textsuperscript{61}

In sum, the prevailing rule is that federal common law does apply, that patents and copyright licenses are not freely assignable, and that this principle reflects a fundamental and important value protecting owners of technology.

B. The Bankruptcy Policy of Free Assignability of Contracts and Ease of Liquidation

1. The Principles of Free Assignment as Key to Reorganization

These fundamental concepts of monopoly and non-assignability, which are core values under patent and copyright law, have led to a much-noted conflict with equally important policies and goals of the bankruptcy system.\textsuperscript{62} A central premise of bankruptcy law generally and of Chapter 11 in particular is that the on-going value of

\textsuperscript{58} Recent case law holds that the same rule apparently applies to trademarks. Although the Ninth Circuit has not addressed whether the sub-licensing rule applies to trademark licenses, the courts that have addressed the issue have uniformly held it does and thus that a trademark licensee may not sub-license a mark without express permission from the licensor. See Tap Publ’ns, Inc. v. Chinese Yellow Pages (New York) Inc., 925 F. Supp. 212, 218 (S.D.N.Y. 1996); In re Travelot Co., 286 B.R. 447, 455 (Bankr. S.D. Ga. 2002); Raufast S.A. v. Kicker's Pizzazz Ltd., 208 U.S.P.Q. 699, 703 (E.D.N.Y. 1980); 3 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:43 (4th ed. 2008) [hereinafter McCarthy]. The reasoning behind the courts’ extension of the sub-licensing rule to the trademark context is that, “since the licensor-trademark owner has the duty to control the quality of goods sold under its mark, it must have the right to pass upon the abilities of new potential licensees.” McCarthy, supra at § 25:33. See also Miller v. Glenn Miller Prods., 318 F. Supp. 2d 923, 933 (C.D. Cal. 2004).

\textsuperscript{59} Madlyn Gleich Primoff & Erica G Weinberger, E-Commerce and Dot-Com Bankruptcies: Assumption, Assignment and Rejection of Executory Contracts, Including Intellectual Property Agreements, and Related Issues Under Sections 365(e), 365(e) and 365(n) of the Bankruptcy Code, 8 AM. BANKR. INST. L. REV. 307 (2000).

\textsuperscript{60} See In re Superior Toy & Mfg. Co., 78 F.3d 1169, 1176 (7th Cir. 1996); In re Rooster, Inc., 100 B.R. 228, 229 (Bankr. E.D. Pa. 1989).

\textsuperscript{61} In re N.C.P. Mktg. Group, Inc., 337 B.R. 230, 236 (D. Nev. 2005) (“The grant of a non-exclusive license is an assignment in gross, that is one personal to the assignee and thus not freely assignable to a third party.”).

\textsuperscript{62} See, e.g., G Larry Engel, Intellectual Property and Related Asset Considerations in Bankruptcy Cases; Recent Developments Illustrate a Future Trend of Dysfunctional Conflict Among Competing IP and Commercial Laws in Need of Reconciliation for Good Business, 767 PLI/Comm 1009, 1037 (1998).
a business should be preserved and the economic return to all constituents—creditors, employees and owner-shareholders—should be maximized. This goal is reflected in various sections of the Code including section 365, which gives the trustee or the debtor in possession the right to assign most contracts regardless of non-bankruptcy law and contractual provisions to the contrary.64

The core clash between intellectual property and bankruptcy law has arisen most commonly in the context of the Code's treatment of "executory contracts" under section 365, which controls a debtor's right to "assume" and "assign" executory contracts.65 The term executory contract is not defined in the Code, but the conventional view is that an executory contract is one in which performance remains due and owing by both parties, the failure of which to complete would constitute a material breach.66 Non-exclusive license agreements are almost uniformly regarded as executory contracts.

At the outset of a bankruptcy case, a debtor will typically decide which of its prepetition executory contracts are valuable and which are not. The debtor will usually reject those contracts that lack value or are too burdensome or costly, leaving the counter-party with a bankruptcy claim for the resulting breach.67 The debtor will want to assume those executory contracts that are valuable and then either retain the contracts as part of a reorganization or assign—i.e., sell—the contracts to generate capital for a reorganization or cash for distribution to creditors. In many non-technology cases, the debtor's decision to assume some or all of its executory contracts is not challenged, other than to determine if there are any prepetition defaults that must be cured, and frequently requires only a modest showing by a debtor of sound "business judgment."68

Once a debtor has assumed an executory contract (which requires court approval), the debtor then possesses the legal power (in most cases) to assign the

63. See, e.g., United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983) ("Congress presumed that the assets of a debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.'").
64. "Section 365 expresses a clear Congressional policy favoring assumption and assignment. Such a policy will insure that potential valuable assets will not be lost by a debtor who is reorganizing his affairs or liquidating assets for distribution to creditors. This policy parallels case law which disfavors forfeiture." In re U.L. Radio Corp. 19 B.R., 537, 544 (Bankr. S.D.N.Y. 1982).
66. The traditional test is that a contract is executory where the obligations "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 the performance of the other." Vern Countryman, Executory Contracts in Bankruptcy: Part I, 57 MINN. L. REV. 439, 460 (1973).
68. "From over thirteen years of case law under the Bankruptcy Code, it is clear that the "business judgment" standard is the majority view... There are cases suggesting that the business judgment standard effectively means no review." 1 DAVID G. EPSTEIN, STEVE H. NICKLES, & JAMES J. WHITE, BANKRUPTCY § 5-8 (1992).
contract to third parties. The right to assign valuable contract rights is often what makes a Chapter 11 reorganization feasible because it provides value to the estate and a raison d’etre for the bankruptcy filing. In recognition of this, the debtor’s right to assign an executory contract overrides most non-bankruptcy law and contractual prohibitions that restrict assignment. Specifically, section 365(f) provides as follows:

(f)(1) Except as provided in subsection (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.69

Courts have applied the principle of free assignability codified in section 365(f) in a strikingly broad manner, especially with respect to commercial real estate leases. Many have interpreted section 365(f) to mean any provision in a commercial lease which has the “effect” of making assignment more difficult is likely to be unenforceable.70 Thus, landlords’ efforts to prohibit or limit the assignment of a lease to new tenants without the landlord’s consent have met with nearly wholesale failure in the bankruptcy courts. Even under the more restrictive rules that pertain to shopping center leases,71 courts have generally looked only to the credit worthiness of the assignee to insure that the landlord’s “bargain” is protected.72 In a recent decision, Judge Gerber underscored the importance of this notion of free-assignability:

Code Section 365(f) implements a Congressional policy determination that executory contracts are valuable assets of the estate, and that except in those relatively rare cases where the realization of their value gives rise to a material prejudice to the contract counterparty other than the loss of a prospective windfall, the economic value in such contracts should go not to the contract counterparty, but rather to the debtor’s community generally.73

Thus, the normative bankruptcy rule is that prepetition contracts are assets of the bankruptcy estate and that such contracts should be freely assignable in the context of a bankruptcy case subject to certain minimal notions that protect the counter-party from “material prejudice.” Case law strongly supports such a view.74 This right to

---

70. See, e.g., In re U.L. Radio, 19 B.R. at 543.
72. See, e.g., In re Service Merchandise Co., 297 B.R. 675, 682 (Bankr. M.D. Tenn. 2002) (“The statute’s prime purpose is to provide adequate assurance for the payment of future rent.”).
74. “It is clear from the language of section 365(f), and the cases applying the language, that contractual clause prohibitions or restrictions on assignment are not enforceable in bankruptcy. A provision in a lease granting the landlord a right of first refusal in connection with any assignment
freely assign contracts creates a business result that cannot be obtained under normal state-law rules, and in this sense, bankruptcy notions have pre-empted state law. Free assignability, therefore, is a core bankruptcy value and a fundamental element of the business strategy of a Chapter 11 case.

2. The Bankruptcy Code’s Limits on Free Assignment: Understanding the Reach of “Applicable Law” in Executory Contract Theory

The limits on free assignability are embedded in a related concept which itself has given rise to enormous confusion and contradictory decision: the notion of “applicable law.” While the normative rule favors free assignability in bankruptcy, the Code also recognizes that in many important areas assignment of contracts should be prohibited or restricted. Unfortunately, in trying to carve out the exception to free assignment and to articulate a coherent test, Congress drafted a rule that lacks clarity and has confounded courts.

Section 365(f) contains the general rule that assignment is typically permitted notwithstanding a provision in “applicable law” or a provision in a contract which prohibits or restricts assignment. However, subsection (f) is expressly subject to subsection (c), which states that the debtor may not assume or assign an executory contract if “applicable law excuses a party, other than the debtor, to such contract from accepting performance from or rendering performance to an entity other than the debtor . . . and such party does not consent.”

Courts and commentators strongly disagree about how to reconcile these two provisions. Section 365(f) states that a contract may be assigned notwithstanding “applicable law” that prohibits assignment, but subsection (c) states that the contract may not be assumed or assigned if “applicable law” would excuse the counter-party from accepting performance from or rendering performance to an assignee. Is it possible that the phrase “applicable law” has two different meanings within one code section? For example, “applicable law” in 365(c) could be restricted to the law governing personal services contracts. The need for such a statutory limit on assignability may be readily understood in the hypothetical example of whether a law partner may “assign” a partnership interest or a rock star could assign a contract to

was held unenforceable. A provision in a lease requiring payment of proceeds from the assignment to the landlord was held unenforceable. A lease provision increasing the rent on assignment would not be enforceable.” 1 DAVID G. EPSTEIN ET AL., supra note 68, at BANKRUPTCY § 5-17.

75. 11 U.S.C. § 365(c).
77. 11 U.S.C. § 365(c).
78. Cf. Dewsnup v. Timm, 502 U.S. 410 (1992) (concluding that the phrase “allowed secured claim” meant different things in subsections (a) and (d) of Bankruptcy Code section 506).
79. See, e.g., Matter of Midway Airlines, Inc., 6 F.3d 492, 495 (7th Cir. 1993) (“Some courts have held that § 365(c) applies only to ‘personal service contracts.’”) (quoting In re Taylor Mfg., Inc., 6 B.R. 370 (Bankr. N.D. Ga. 1980)).
perform at Madison Square Garden. The instinctive and legally correct answer is that
the counter-party (e.g., the non-debtor) cannot be compelled to accept a new law
partner, or a new concert performer in place of the one with whom he or she
contracted. That is, such contracts cannot be assigned because the performance by
the debtor itself is highly material to the non-debtor. Thus, in the area of personal
services contracts, and other similar contexts, the bankruptcy norm is non-
assignability as it is under state law. However, while “personal services” contracts
may be the paradigm of the kind of contract to which section 365(c)(1) refers, most
courts acknowledge that “section 365(c)(1) is not limited to personal services
contracts.”

If “applicable law” means the same thing in both subsections, then reconciling
the provisions is near impossible. Indeed, several courts have observed that if section
365(f) is read literally, and if it applies except when section 365(c) applies, then
section 365(f) has no application. Others concede that the conflict between the two
sections is irreconcilable. As District Court Judge Motz observed in In re Antonelli,
no one can say “with any sense of intellectual honesty” that there is any “principled
conclusion” that one can draw from the efforts to reconcile these two code sections.

3. The Stage is Set

Thus we have two competing principles, each of which is reflected in section
365 of the Bankruptcy Code. A patent or copyright monopoly depends for its very
lifeblood on limiting and preventing assignment. For this reason, federal common
law appears to bar assignment without the licensor’s consent. This rule appears to be
incorporated into section 365(c). Bankruptcy law, in contrast, seeks to maximize the
recovery of creditors. One of the major ways it does this is to make the debtor’s
assets freely assignable. This rule is undeniably expressed in section 365(f). How
these competing tensions are reconciled can be extremely important when a
technology debtor files for bankruptcy and then seeks to assume, and perhaps assign,
its principal licensing agreements.

courts agree that section 365(c) should not be read so narrowly. See, e.g., In re Matter of West Elec.,
Inc., 852 F.2d 79, 83 (3d Cir. 1988); In re Pioneer Ford Sales, Inc., 729 F.2d 27, 29 (1st Cir. 1984); In
re Braniff Airways, Inc., 700 F.2d 935, 943 (5th Cir. 1983).
81. In re Antonelli, 148 B.R. 443, 447 (D. Md. 1992) (“What section 365(f) appears to give,
section 365(c) seems to take away.”).
82. In re Catron, 158 B.R. 629, 637 (Bankr. E.D. Va. 1993) (“The two clauses at the
beginning of section 365(f) simply cannot be reconciled.”).
III. THE TENSION PLAYED OUT

A. The Treatment of Non-exclusive Licenses under the Bankruptcy Code

1. Assignment vs. Mere License

The threshold issue to tackle, particularly with respect to patents, is whether the debtor acquired the intellectual property from the owner in an assignment of the whole (or an exclusive part of the whole) or whether the debtor holds the intellectual property as a mere licensee. If the transfer is an assignment of the whole, then the contract may be considered "non-executory" because the transfer has been completed. In such a case, all of the impediments to assumption (outlined below) may be avoided. However, it should be noted that some courts have held that even exclusive license agreements are executory contracts.

A well known case that analyses whether a transfer of patent rights was an assignment or a license is In re Access Beyond Technologies, Inc. In Access Beyond, the debtor, Hayes Microcomputer Products, Inc. ("Hayes"), was the transferee of rights to use certain patented assets which it had acquired under a cross license agreement with Megahertz. When Hayes sought to liquidate its assets, it conducted an auction sale of all of its assets, which included the license agreements for which it was offered $4 million. The license agreement was a cross-license, meaning that both Hayes and the licensor had each agreed to permit the other to use some of its patented technology. In addition, the patent license was irrevocable and royalty free, thus creating, at least, a plausible argument that the transfer was a

84. Cf. Thompson v. Lil' Joe Records, Inc., 476 F.3d 1294 (11th Cir. 2007) (debtor in possession, which had rejected prepetition contract with musician under which debtor acquired copyright to songs and agreed to pay royalties, was not liable for copyright infringement for postpetition use because the transfer of the copyright was completed and the copyright did not revert back to musician upon rejection of the contract).


87. Id.
88. Id. at 37.
89. Id. at 36.
completed assignment and not a mere license. The license agreement, however, was non-exclusive.

Because Hayes needed to sell the license agreement in order to pay creditors, Hayes argued that the underlying license agreement was actually a "sale" (or assignment) to it of the patented technology and not a mere license. Because it was a sale, Hayes argued, it could freely transfer and assign the valuable right.

The bankruptcy court ruled against Hayes and held that the patent license was not a sale, but a mere license. Judge Walrath described the necessary elements in order to make a transfer of patented technology a completed assignment or sale, stating as follows:

An agreement is a sale of patent rights only if it conveys: (1) the whole patent, comprising the exclusive right to make, use and sell the invention; (2) an undivided share of that exclusive right; (3) an exclusive right to practice the invention within a specified territory. . . . Unless the writing conveys some or all of the right to exclude others from practicing the invention, it will not convey an interest in the patent, but a mere license.

Applying this test, the court held that the license was "by its very terms" a non-exclusive right to make, use or sell the patented technology. Thus, the license agreement did not "convey any part of the patent monopoly or the underlying patents" and was not a sale, but a license. The court also held as a matter of law that any non-exclusive grant of the right to make, use or sell a patented invention "by its very terms, is not an assignment, but a naked license." The breadth of this ruling and the reputation of its author make Access Beyond a case of major import, one likely to be followed by other courts. Thus, under Access Beyond all non-exclusive

90. Id. at 40.
91. Id. The court did not provide any of the other material terms of the license agreement.
92. Id. at 43.
93. Id. at 44.
94. Id.
95. Id.
96. Id.
97. Id.
98. Id. (citing with approval Preload Enters., Inc. v. Pacific Bridge Co., 86 F. Supp. 976, 979 (D. Del. 1949) ("if the rights conferred upon the assignee are not exclusive rights investing in him alone or him jointly with the assignor, the monopoly is not transferred and the conveyance is a license.").
99. A leading case to the contrary is In re DAK Indus., Inc., 66 F.3d 1091, 1095 (9th Cir., 1995), where the Ninth Circuit found that a non-exclusive license which permitted a computer hardware seller to bundle and sell computers with Microsoft Word for Windows was actually a sale, and not a license. The Court in Access Beyond distinguished DAK on the grounds that the debtor had the right to sell the technology, not merely to use it. 237 B.R. at 43 n.12. Even in view of DAK, it
technology licenses are executory contracts, and all are subject to the rules and problems dealing with assumption and assignment.

2. Non-exclusive Licenses as Executory Contracts

Once a court determines that the transfer is a license, not a sale, it is but a short step to then conclude that a license is an executory contract. Conceptually, the issue is almost identical—that is, whether or not the transfer is complete or whether duties remain due and owing on both sides. Historically, courts have found license agreements to be executory contracts. This general trend has also applied in technology cases. A well-known case is *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, in which the court ruled that a non-exclusive license to use a patented metal coating process was an executory contract based on the “unperformed, continuing core obligations of notice and forbearance in licensing.”

In *Access Beyond*, Judge Walrath regarded the issue of whether a license agreement was an executory contract as separate and distinct from whether the agreement was really a license or a transfer of the whole. But she nevertheless held that the license agreement at issue was an “executory contract” because it satisfied the classic test under bankruptcy law known as the “Countryman” test. Under the Countryman test, a pre-bankruptcy contract is considered to be executory if there is a material duty owing and still unfulfilled by both parties to one another. In the context of a cross-license agreement, Judge Walrath found that such material duties were still due and owing. While the licensor might be viewed as having completed its conveyance, the court found an incomplete, material duty, namely the duty to refrain from suing the licensee for infringement. The court added that “this would be reasonable to predict that most bankruptcy courts are likely to conclude that non-exclusive license agreements are not sales, but licenses. See also *Chesapeake Fiber Packaging Corp. v. Sebro Packaging Corp.*, 143 B.R. 360, 368 (D. Md. 1992) (holding that an assignment of a patent right was absolute, noting that the agreement conveyed all of the patent owner’s right, title and interest).”

100. “Generally speaking, a license agreement is an executory contract as such is contemplated in the Bankruptcy Code.” *In re Kmart Corp.*, 290 B.R. 614, 618 (Bankr. N.D. Ill. 2003) (quoting *In re Novon Int’l, Inc.*, 2000 WL 432848, at *4 (W.D.N.Y. 2000)).


102. The traditional test is that a contract is executory where the obligations “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 the performance of the other.” *Countryman*, supra note 66, at 460.

103. Id.


105. Id.
performance is material since the licensor’s promise to refrain from suing the licensee for infringement is the raison d’être for a patent license.”

A similar decision from the Ninth Circuit supports this view. In *Everex Systems, Inc. v. Cadtrak Corp. (In re CFLC, Inc.),* the court found that the licensee’s duty to mark all products made under the license with the proper statutory patent notice was a material performance still due by the licensee.

These two cases together make it clear that even a minimal “duty” remaining by each party will be enough to render a license as executory for the purposes of bankruptcy law. It would seem fair to conclude, for now, that under the prevailing legal theory of what constitutes an executory contract, most courts are likely to conclude that: (a) patent and copyright transfers are not assignments, but licenses; (b) license agreements are executory contracts; and (c) license agreements are thus governed by the rules of assignment and assumption under section 365.

3. Nonassignability of a Non-exclusive License Under Section 365(c)

Once a bankruptcy court determines that a patent or copyright license is an executory contract governed by section 365, the next critical issue is whether the debtor will be able to assume the license and perhaps thereafter to assign (i.e., sell) the license to fund its reorganization. If it cannot assume the license, then the debtor will be severely hampered in its efforts to utilize chapter 11 to its full potential.

Perhaps the earliest reported bankruptcy decision to rule that the federal common law of non-assignability would foreclose the transfer of a patent license in the context of a bankruptcy case is *In re Alltech Plastics, Inc.,* decided in early 1987. In *Alltech,* the chapter 7 debtor had been in the business of manufacturing reinforced plastic containers by using a patented process known as “Airopak.” The debtor had acquired its rights under a non-exclusive license.

When the debtor sought to sell its interest, the patent owner asserted that under the federal common law, an assignment was prohibited without its consent. The patent owner also asserted that section 365(c) governed and precluded assumption or assignment since the contract was non-delegable. The debtor urged the court,

---

106. *Id.* (citing with approval *In re CFLC, Inc.*, 89 F.3d 673, 677 (9th Cir. 1996) which held that a licensor’s obligation to forbear from suing the licensee and to mark all products made under the license, was both a significant and continuing performance that made the contract executory as to the licensor).

107. 89 F.3d at 677 (stating that the duty to mark was material “[s]ince failure to mark deprives the patent holder of damages in an infringement action before the infringer has actual notice of infringement, 35 U.S.C. section 287, the licensee’s performance of this duty is material.”).


109. *Id.* at 687.

110. *Id.*

111. *Id.*

112. *Id.*
instead, to apply the more liberal rule of assignment found in section 365(f), which holds that an anti-assignment clause in “applicable law” is not enforceable.\textsuperscript{113}

The court held that the federal common law rule of non-assignability was enforceable under section 365(c), regardless of the mandate of section 365(f) to disregard applicable law which restricts assignment, saying “the rights of the patent owner to license the use of his invention is a creature of federal common law as is the right of the licensee to have the license construed.”\textsuperscript{114} Relying on the line of cases from \textit{Troy Iron \& Nail \textit{v.} Corning} through \textit{Unarco}, the bankruptcy court concluded that:

although their nonassignment is not statutorily mandated, the century old common law classification of patent licenses appears to place them within the realm of the types of contracts traditionally associated with section 365(c). As such, in accordance with the interpretation of sections 365(c) and (f) discussed above, the Trustee in this instance does not have the power to assign the patent license absent consent from the licensor.\textsuperscript{115}

In \textit{Alltech} the court made two key legal rulings that hamper the ability of technology companies to reorganize under Chapter 11. First, it held that federal common law is the applicable law under section 365(c), and secondly, it held that section 365(c) should control and not section 365(f).\textsuperscript{116} The court reached this later conclusion even though it recognized that section 365(c) presumably only applied to contracts “dependent upon a special relationship, special knowledge or unique skill.”\textsuperscript{117} The court did not explain what was unique or special about a license arrangement for packaging materials or why the identity of the debtor’s assignee would be material.

The earliest Circuit Court decision to consider carefully whether the federal common law of non-assignability should pertain in the context of a bankruptcy case was \textit{Everex Systems, Inc. v. Cadtrak Corporation (In re CFLC, Inc)}, decided in 1996.\textsuperscript{118} The intellectual property in question concerned a non-exclusive license to use certain computer graphics technology owned by Cadtrak. The debtor used this technology in its business of manufacturing personal computers.\textsuperscript{119} When the debtor sought to sell substantially all of its assets, Cadtrak objected on the grounds that the patent license was not assignable under federal common law.\textsuperscript{120}

\begin{flushleft}
113. \textit{Id.} at 687-88.
114. \textit{Id.} at 689.
115. \textit{Id.}
116. \textit{Id.} at 689-90.
117. \textit{Id.} at 688.
118. 89 F.3d 673 (9th Cir. 1996).
119. \textit{Id.} at 674.
120. \textit{Id.} at 675.
\end{flushleft}
In what may be viewed as a lukewarm endorsement of the view that federal common law applied, the Ninth Circuit began with the fundamental proposition that "there is no federal general common law;" which is the heart and soul of *Erie R.R. Co. v. Tompkins*. Further, the Ninth Circuit agreed that the statutes governing patents are basically silent on the issues of licenses and that "the construction of a patent license is generally a matter of state contract law." Finally, the court acknowledged that "most questions with respect to the construction of patent licenses are governed by state law." Nevertheless, the Ninth Circuit was concerned that the state law notion of "free assignability" would undermine the federal monopoly rights which underlie federal patent law and provide the critically important economic incentive that encourages invention.

The same result of non-assignability has been reached with respect to copyright licenses. In *In re Patient Education Media, Inc*, the New York bankruptcy court applied the conventional rules as to both copyright law and bankruptcy law. In *Patient Education*, the debtor was a producer and distributor of educational materials for various medical conditions. Part of its assets consisted of videotapes pertaining to specific diseases. The videotapes included certain still photography images that the debtor had acquired by virtue of a non-exclusive copyright license from a photographer.

When the debtor filed for bankruptcy, it sought to sell its inventory of videotapes. The photographer-licensor objected and argued that under long-standing copyright theory, a copyright was "personal" and not an assignable property right. The court agreed. It first employed the classic distinction between non-exclusive and exclusive licenses, finding that the former was not a completed sale. This led the court to conclude that a non-exclusive copyright license is typically an executory contract and hence governed by section 365. Finally, the court looked to cases applying analogous patent doctrines and held that the videotapes could not be sold because such a sale would be an assignment of a copyright license without the

---

121. *Id.* at 678 (citing *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938)).
122. *Id.* at 677.
123. *Id.* at 679.
124. *Id.*
126. *Id.* at 239.
127. *Id.*
128. *Id.*
129. *Id.* at 240.
130. *Id.*
131. *Id.* at 239.
132. *Id.* at 240.
133. *Id.* at 241.
In reaching this result, the court recognized the clear clash between bankruptcy policy and intellectual property law: although the assignment of the license would increase the assets available to creditors, "this goal must give way to the countervailing considerations expressed in section 365(c)."

B. Development of the Clash between the Hypothetical Test and the Actual Test

1. The Hypothetical Test

As the preceding discussion illustrates, the clash between intellectual property law and bankruptcy law has focused mostly on the tension between subsections (c) and (f) of section 365. This tension has generated two main judicial approaches to their interpretation: the "hypothetical test" and the "actual test."

Read literally, section 365(c) states that a trustee may not assume or assign an executory contract if "applicable law" restricts assignment. According to some courts, this means that if a debtor cannot assign an executory contract, the debtor may not even assume it. If a debtor cannot "assume" a technology license, then the license effectively terminates as a matter of law upon bankruptcy unless the licensor agrees otherwise. This interpretation of section 365(c) is known as the "hypothetical test." It has been adopted by four circuits and applied with particular force in the area of technology companies. It has been suggested, however, that most bankruptcy courts do not follow it.

The hypothetical test was first announced in In re West Electronics, Inc., a case which did not involve a technology license, but an executory contract between the United States and a defense contractor for the supply of missile launchers used by the Air Force. West was having operational problems, and the government questioned its serious accounting irregularities and lateness in delivery the components. The government had sought to terminate the agreement before the bankruptcy case began, thus evidencing that there was a serious (e.g., material) problem with performance.

---

134. Id. at 242-43.
135. Id. at 243.
138. In re Sunterra Corp., 361 F.3d 257 (4th Cir. 2004); In re Catapult Entm't, 165 F.3d 747 (9th Cir. 1999); In re James Cable Partners, L.P., 27 F.3d 534 (11th Cir. 1994); In re West Elecs., Inc., 852 F.2d 79 (3d Cir. 1988).
140. 852 F.2d at 83.
141. Id. at 80.
142. Id. at 80-81.
The government moved for an order lifting the stay so it could terminate the agreement.\textsuperscript{144} West argued that the government contract was an executory contract, that it was entitled to cure any defaults, and that it should be entitled to assume the contract.\textsuperscript{145} Both the bankruptcy court and district court, on review, held that the government was not entitled to relief from the stay.\textsuperscript{146}

On appeal, the Third Circuit reversed.\textsuperscript{147} The question presented in \textit{West Electronics} was whether a debtor could assume a government contract even if it had no intention of assigning it.\textsuperscript{148} The “applicable non bankruptcy law” which made assignment impermissible was 41 U.S.C. § 15 which bars parties to a government contract from assigning such contracts to third parties.\textsuperscript{149} The Third Circuit held that the agreement could not be assumed and adopted a rule which it held applied to “any contract subject to a legal prohibition against assignment.”\textsuperscript{150} The court itself referred to its test as a “hypothetical test,” stating as follows:

\begin{quote}
11 U.S.C. § 365(c)(1) creates a hypothetical test – i.e., under the applicable law, could the government refuse performance from ‘an entity other than the debtor or the debtor in possession.’ . . . [t]hus, the relevant inquiry is not whether 41 U.S.C. § 15 would preclude an assignment from West as a debtor to West as a debtor in possession, but whether it would foreclose an assignment by West to another defense contractor.\textsuperscript{151}
\end{quote}

\textit{West Electronics} did not address the issue of the federal common law of patents, nor did it look to the materiality of performance. Its analysis was purely legal; it was based on its reading of the plain language of the Code and its view of Congress’ intent.\textsuperscript{152}

Six years later, in apparent reliance on \textit{West Electronics} but without much explanation, the Eleventh Circuit followed the hypothetical test in the context of a franchise agreement.\textsuperscript{153} Again, there was no discussion of the federal common law of patents or other intellectual property because of the case’s context.

In 1996, the Ninth Circuit held that the debtor could not assume or assign a patent license under section 365(c), albeit without reference to \textit{West} and without expressly adopting the “hypothetical” test.\textsuperscript{154} That is, the court did not directly

\begin{footnotes}
\footnotetext{144}{Id.} \\
\footnotetext{145}{Id. at 80.} \\
\footnotetext{146}{Id. at 81.} \\
\footnotetext{147}{Id. at 82.} \\
\footnotetext{148}{Id. at 82-83.} \\
\footnotetext{149}{Id. at 83.} \\
\footnotetext{150}{Id.} \\
\footnotetext{151}{Id.} \\
\footnotetext{152}{Id. at 82-83.} \\
\footnotetext{153}{In re James Cable Partners, L.P., 27 F.3d 534, 537 & n.6 (11th Cir. 1994).} \\
\footnotetext{154}{In re CFLC, Inc., 89 F.3d 673, 680 (9th Cir. 1996).}
\end{footnotes}
address the relationship between non-assignability and non-assumability. However, as noted earlier, the court rejected the argument that there is no federal common law of patent assignments and that assignments are personal and non assignable.55

Three years later, the Ninth Circuit expressly adopted the hypothetical test in the context of intellectual property rights, holding that the “applicable law” was the federal common law of patents.56 That case concerned Catapult Entertainment, a California corporation engaged in the business of creating an online gaming network for 16-bit console video games.57 Catapult relied on two license agreements for the non-exclusive use of patents and patent applications.58 After Catapult filed for Chapter 11 bankruptcy protection, it proposed a plan of reorganization which contemplated assumption of the license agreement.59 The creditors and equity holders voted in favor of the plan, and it was confirmed by the court.60 The patent owner objected and, after confirmation was approved, appealed to the district court and then to the Ninth circuit.61

The circuit court reversed and in doing so became the first circuit court to hold that a non-exclusive patent license cannot be assumed in a bankruptcy case without the consent of the licensor.62 The question presented was whether a debtor could assume a prepetition executory contract if it had no intention of assigning it.63 To decide this, the court had to make two threshold determinations. First, the court concluded that section 365(c)’s reference to the “trustee” included debtors in possession, a point which neither party had disputed.64 The second threshold issue was whether a non-exclusive license was assignable under applicable non-bankruptcy law.65 In a short paragraph, the court disposed of a series of issues which it held “deserve no more than passing reference.”66 The issue of whether federal common law should be applied did not provoke any debate: “our precedents make it clear that federal common law constitutes ‘applicable law’ within the meaning of section 365(c) and that non-exclusive patent licenses are ‘personal and assignable only with the consent of the licensor.’”67

155. Id. at 679.
156. In re Catapult Entm’t, Inc., 165 F.3d 747, 750 (9th Cir. 1999).
157. Id. at 748.
158. Id.
159. Id. at 748-49.
160. Id. at 749.
161. Id.
162. Id. at 748.
163. Id. at 749.
164. Id. at 750 (citing Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 492 n.7 (1st Cir. 1997)) (relying upon 11 U.S.C. § 1107)).
165. Catapult, 165 F.3d at 750-51.
166. Id. at 750.
167. Id. at 750 (quoting In re CFLC, Inc., 89 F.3d 673, 680 (9th Cir. 1996)).
The court then moved to the central question and ruled that the patent license could not be assumed by the debtor even though there was not to be an assignment.\textsuperscript{168} As noted earlier, section 365(c) provides that a debtor may not “assume or assign” an executory contract if the contract is one where the non-debtor cannot be compelled to accept performance from another party.\textsuperscript{169} The Ninth Circuit interpreted the “hypothetical test” as follows:

The literal language of section 365(c)(1) is thus said to establish a hypothetical test: a debtor in possession may not assume an executory contract over the nondebtor’s objection if applicable law would bar assignment to a hypothetical third party, even where the debtor in possession had no intention of assigning the contract in question to any such third party.\textsuperscript{170}

The Fourth Circuit has since followed suit by adopting the hypothetical test in \textit{RCI Technology Corp. v. Sunterra Corp. (In re Sunterra Corp.)}.\textsuperscript{171} In \textit{Sunterra}, the debtor (Sunterra) and RCI entered into a software license agreement pursuant to which RCI granted Sunterra a nonexclusive license to use the software.\textsuperscript{172} Prior to the confirmation of Sunterra’s plan of reorganization, RCI filed a motion to have the license deemed as being rejected.\textsuperscript{173} RCI maintained that due to its refusal to consent to the assumption of the agreement, the court was required by law to deem the license rejected.\textsuperscript{174}

The bankruptcy court ruled that section 365(c) did not preclude the assumption of the agreement by Sunterra, because Sunterra never intended to assign the agreement.\textsuperscript{175} In essence, the bankruptcy court treated the disjunctive “or” in section 365(c) as the conjunctive “and.”\textsuperscript{176} Under this interpretation, “Sunterra, as debtor in possession, was entitled to assume the Agreement because it did not intend to assign, and RCI would not \textit{actually} be forced to accept performance from a party other than Sunterra.”\textsuperscript{177} On appeal, the district court agreed, ruling that because RCI would not be asked to accept performance from a party other that Sunterra, section 365(c) did not preclude Sunterra from assuming the agreement.\textsuperscript{178}

\begin{flushleft}
\textsuperscript{168} \textit{Id.} at 750-51.
\textsuperscript{169} 11 U.S.C. § 365(c) (emphasis added).
\textsuperscript{170} \textit{Id.} at 750 (citations omitted).
\textsuperscript{171} 361 F.3d 257 (4th Cir. 2004).
\textsuperscript{172} \textit{Id.} at 260.
\textsuperscript{173} \textit{Id.}
\textsuperscript{174} \textit{Id.}
\textsuperscript{175} \textit{Id.}
\textsuperscript{176} \textit{Id.} at 263.
\textsuperscript{177} \textit{Id.} (emphasis in original).
\textsuperscript{178} \textit{Id.}
\end{flushleft}
The Fourth Circuit reversed and held that the hypothetical test is correct. The court refused to read the term “or” in the phrase “assume or assign” as meaning “and.” The court also held that federal copyright law was the “applicable non-bankruptcy law” and that such law would excuse RCI from accepting performance from an entity other than the debtor. As a result, Sunterra was precluded from assuming the nonexclusive license on the grounds that federal common law prohibited assignment.

The collective impact of the Ninth Circuit’s rulings in Catapult and the Fourth Circuit’s rulings in Sunterra can be devastating to a company with critical intellectual property licenses that is seeking to reorganize under Chapter 11. Both courts treated section 365(c) as controlling over section 365(f). Both held that federal common law precludes assignment without consent, and that this common-law principle is the “applicable non bankruptcy law” under section 365(c). Finally, both held that bankruptcy law precludes assumption even where an assignment is not intended. These rulings may well leave the debtor with the choice of either purchasing the licensor’s consent—perhaps at a price that the debtor cannot afford to pay—or liquidating.

2. The Actual Test

The first major break from the hypothetical test occurred in 1995 when the First Circuit expressly rejected it and instead followed what has come to be known as the “actual test.” The question presented was whether the provisions of a limited partnership agreement, which purported to convert the general partnership interests into limited partnership interests based on the bankruptcy filing, was an invalid ipso facto clause. This in turn depended on whether the partnership interests could not be assumed by the debtors despite applicable state law that precluded general partners from assigning their general partnership interests.

In rejecting the hypothetical test, the court stated the statute should be read by reference to the “actual” intent to assign the contract or partnership interests and if there were no such intent, then section 365(c) did not prevent assumption. Further, looking to the legislative history of the Code, the court concluded the purpose of the

179.  Id. at 267.
180.  Id. The court also ruled that the term “trustee” in section 365(c) included “debtor in possession.” Id. at 261 n.5 (citing In re Catapult Entm’t Inc., 165 F.3d 747, 750 (9th Cir. 1999)).
181.  Id. at 262 n.7 (citing In re CFLC, Inc., 89 F.3d 673, 679 (9th Cir. 1996)).
182.  Id. at 271.
183.  Summit Inv. & Dev. Corp. v. Leroux, 69 F.3d 608, 612 (1st Cir. 1995).
184.  Id. at 609.
185.  Id. at 612.
186.  Id.
section was to provide the counter-party with the benefit of its bargain. This suggested that Congress did not envision the abstract analysis proposed by the hypothetical test, but instead "contemplated a case-by-case inquiry into the actual consequences to the nondebtor party." In other words, the non-debtor party "must make an individualized showing that it would not receive the 'full benefit of [its] bargain' were an entity to be substituted for the debtor from whom performance was due." 

The court drew support for its conclusion from the 1984 amendments to the Code. These amendments changed the test in section 365(c) from whether applicable law excused the non-debtor from accepting performance from someone other than the "debtor" to whether applicable law excused the non-debtor from accepting performance from someone other than "the debtor or the debtor in possession." This change, the court concluded, made it clear that the prohibition on assumption does not apply when the debtor in possession is the party who will be performing the debtor's prepetition duties and accepting performance from the counter-party.

The actual test was first applied in the context of intellectual property rights in *Institut Pasteur v. Cambridge Biotech Corporation*. That case involved a nonprofit French foundation engaged in AIDS-related research and development, which owned various patented procedures for diagnosing HIV Virus Type 2. Cambridge Biotech Corporation ("CBC") entered into a mutual cross-license agreement whereby it acquired the right to incorporate Pasteur's HIV diagnostic procedures into any diagnostic kits sold by CBC in the United States and in other countries. When CBC later filed for bankruptcy, its plan of reorganization called for CBC to "assume" the patent licenses and continue to operate its retroviral diagnostic divisions utilizing Pasteur's patented HIV2 procedures. The plan of reorganization called for all of the stock of CBC to be sold to bioMerieux, which was a direct competitor of Pasteur.

Pasteur objected to the plan of reorganization, arguing that under the hypothetical test, the debtor could not assume the license even if it did not intend to assign the license to a third party. On these facts, Pasteur had a somewhat sympathetic

---

187. *Id.* at 612-13.
188. *Id.* at 613 (dash omitted).
189. *Id.*
190. *Id.*
191. *Id.* (citing H.R. Rep. No. 1195, 96th Cong., 2d Sess. § 27(b) (1980)).
193. *Id.* at 490.
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.* at 490-91.
position. After all, a patent owner has a legitimate concern that its technology not be used by a competitor.

Nevertheless, the First Circuit was unmoved. First, it expressly reaffirmed its adherence to the actual test and that test’s case-by-case inquiry into whether the non-debtor party was truly being forced to accept performance from someone other than with whom it originally contracted. In that context, bankruptcy courts could not presume the debtor in possession was a legal entity “materially” distinct from the prepetition debtor. Instead, the focus must be on the performance and whether the non-debtor was being denied the full benefit of its bargain.

Second, the court permitted the stock sale, which in essence effectuated an assignment. Pasteur argued that even under this actual test, there was nevertheless a de facto assignment. After all, CBC was selling all of its stock to a direct competitor of Pasteur. The First Circuit saw it quite differently. It noted that the cross-license agreements expressly permitted the use of the license by an affiliate of the debtor. Thus, Pasteur should have foreseen that the CBC might undergo changes of stock ownership. Despite the foreseeability of such a change, Pasteur did not restrict changes in beneficial ownership in its license agreement and hence could not ask the bankruptcy court to restrict it.

At least one commentator has pointed out that the “actual test” may not always provide the debtor with the right to assume a license. Indeed, Professor Ward has suggested that “a sale of the debtor’s stock can still create a jarring change in management and control from the perspective of the licensor,” thereby undermining the benefit that the licensor expected from the bargain. If this were true, then most plans that extinguish the stock of existing shareholders and distribute equity to creditors might be challenged. There seems to date, however, to be little evidence of this argument gaining ground.

Thus, we have a stark contrast between the results under the hypothetical test and the results under the actual test. Under the former, which four circuit courts have embraced, intellectual property licensees are unable to assume their licenses in bankruptcy without the licensor’s consent. Under the latter, which the First Circuit and most bankruptcy courts prefer, licensees may assume their license agreements.

198. Id. at 493.
199. Id.
200. Id.
201. Id. at 494-95.
202. Id. at 492.
203. Id. at 490.
204. Id. at 494.
205. Id. at 495.
206. See Engel, supra note 62, at 1039.
207. THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE § 4:90 (2007).
208. Id.
This schism might grow as the remaining circuit courts pick sides, unless and until
the Supreme Court ends the debate. However, there is an emerging trend that tries to
resolve the issue in a somewhat different fashion: by focusing on different statutory
language and by possibly coming out with a more balanced view.

IV. THE EMERGING TREND

In 2006, the Fifth Circuit adopted the actual test in Bonneville Power
Administration v. Mirant Corp. (In re Mirant Corp.). The Fifth Circuit provided a
somewhat expanded justification for the actual test and may have provided the
correct balance to protect both patent owners and licensees.

Mirant involved a somewhat different issue, but nevertheless one that raised the
actual-hypothetical split. Mirant was a producer and seller of electrical power. One of its customers was the Bonneville Power Administration ("BPA"), a federal
power marketing agency within the United States Department of Energy. After
Mirant filed for bankruptcy, BPA sought to terminate the contract for the future
purchase of power. It claimed the right to do so under an ipso facto default
provision, which authorized BPA to terminate the agreement upon Mirant's
bankruptcy filing. The debtor argued that ipso facto clauses are generally invalid
under section 365(e). BPA argued that ipso facto clauses are "saved" – that is, they
remain enforceable – by section 365(c) if the contract is one under which the
non-debtor party is excused from accepting performance from a trustee or
assignee.

The Fifth Circuit noted this issue was essentially the same as that raised by the
seeming conflict between subsections (c) and (f), namely whether the prohibition on
assignment applies in a case in which no assignment is sought. In short, the issue was
whether the actual test or hypothetical test applies to the text of section 365(e)(2)(A),

209. 440 F.3d 238, 251 (5th Cir. 2006).
210. Id. at 241.
211. Id.
212. Id. at 241-43.
213. Id. at 242.
214. Id. at 245.
215. Id. at 246; see also section 365(e)(2) of the Bankruptcy Code:
(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired
lease of the debtor, whether or not such contract or lease prohibits or restricts assignment
of rights or delegation of duties, if–
(A)(i) applicable law excuses a party, other than the debtor, to such contract of lease from
accepting performance from or rendering performance to the trustee or to an assignee of
such contract or lease, whether or not such contract or lease prohibits or restricts
assignment of rights or delegation of duties; and
(ii) such party does not consent to such assumption or assignment.
which the Court regarded as substantially the same as under section 365(c) despite some important differences in Code language.\textsuperscript{216}

The Fifth Circuit stated that the "plain text" of section 365(e)(2) required use of the actual test because the prohibition on assignment was "tethered . . . to 'applicable law'" which excuses a party from performance and because "applicable law must apply to a set of circumstances."\textsuperscript{217} Put simply, "[t]he applicability of the law under § 365(e)(2)(A) is determined not in the abstract, but on the record at hand."\textsuperscript{218}

The court then ruled the actual test requires a case-by-case analysis of whether "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."\textsuperscript{219} In a case in which no assignment has occurred or is to take place, section 365(e)(2)(A)'s exception is not available and any ipso facto clause is invalid.\textsuperscript{220}

The Fifth Circuit's analysis was somewhat different from that of the other courts which had previously debated the actual test versus the hypothetical test. The court seems to be concerned with rendering an advisory opinion, and that is why it insists upon a "record" and "actual circumstances."\textsuperscript{221} This approach appears to protect the language of the Code while still protecting licensees of technology.

In other words, when the hypothetical test is used, courts are asked to decide whether an assignment would be permitted, even though the specific circumstances of a hypothetical assignment are not before the court and there is no "record." For example, what if the underlying license provided that assignment would be permitted only if the licensor consented, but that such consent could not be unreasonably withheld? How would a court in a jurisdiction following the hypothetical test determine whether such consent was being unreasonably withheld when such consent was not sought because assignment was not sought? How does the court avoid rendering an advisory opinion when there is no supporting record on the issue of whether assignment would be valid? Is a court supposed to rule on whether assignment might have been valid under a host of fact patterns not presented?\textsuperscript{222} In


\textsuperscript{217.} Id. at 249-50 (emphasis added).

\textsuperscript{218.} Id. at 250.

\textsuperscript{219.} Id. at 248.

\textsuperscript{220.} Id.

\textsuperscript{221.} Id. at 246, 250.

\textsuperscript{222.} For example, despite the federal common law barring assignment, courts permit it where the license contains certain provisions, such as the power to assign to affiliates. \textit{See} Institut Pasteur v.
short, the hypothetical test pre-supposes that assignment is barred by “applicable law” without any fact finding. The Fifth Circuit seemed to question whether this was the correct approach.\(^\text{223}\)

Another possible breakthrough in the conflict may have occurred with the decision by Judge Adlai S. Hardin, Jr. in *In re Footstar, Inc.*\(^\text{224}\) a case which did not deal with intellectual property, but which addressed squarely the conflict between the actual and the hypothetical test and suggested a different approach that, nevertheless, avoids the outcome of the hypothetical test. What makes Judge Hardin’s decision a potential turning point in the law on this area is that his decision is grounded in the “plain meaning” of the statute thus offering a possible counter-balance to the “plain meaning” approach of the hypothetical test.\(^\text{225}\) It may also strike the correct balance between the needs of owners and licensees.

*Footstar* involved the ability of the debtor to assume executory contracts with Kmart Corporation.\(^\text{226}\) The contracts at issue were certain “Master Agreements” that granted Shoemart (owned 51% by Footstar) the exclusive right to operate a footwear department in a Kmart store.\(^\text{227}\) The Master Agreement expressly prohibited assignment of the contract.\(^\text{228}\) When the Footstar went into bankruptcy and sought to assume the contracts, Kmart argued that assumption was prohibited by section 365(c).\(^\text{229}\)

The court held neither the hypothetical test nor the actual test applied. Instead, it concluded section 365(c) applies only when the trustee – not the debtor in possession – is the party seeking to assume the executory contract.\(^\text{230}\) While Judge Hardin expressed agreement with the actual test, he said that all the decisions were fundamentally flawed because they preceded from the premise that the term “trustee” in section 365(c)(1) includes a debtor in possession.\(^\text{231}\) This is wrong, the court held, because a trustee is legally distinct from a debtor and nowhere does the Code make the term “trustee” synonymous with “debtor” or “debtor in possession.”\(^\text{232}\) More to the point, the appointment of a trustee effects a statutory assignment of the debtor’s property.\(^\text{233}\) It is this “de facto statutory assignment of the contract to the trustee [that]
is in derogation of the basic objective of section 365(c)(1)," and why it makes perfect sense to restrict the trustee’s power to both assume and assign executory contracts.\textsuperscript{234} In contrast, the court rejected the notion that the debtor in possession is a different entity from the prepetition debtor, concluding that the Supreme Court had long ago laid that argument to rest.\textsuperscript{235} Accordingly, there is no reason for section 365(c) to restrict assumption by the debtor in possession. “The basic objective of Section 365(c)(1)—to protect the contract counterparty from unlawful assignment of the contract—simply is not implicated when a debtor in possession itself seeks to assume, but not assign, the contract.”\textsuperscript{236}

The court found this view still protected the rights of the counter-party because it fully protects the counter-party from having to accept performance from a party other than the debtor in possession.\textsuperscript{237} The court also concluded that its view was consistent with the plain meaning of all of the words in section 365(c)(1).\textsuperscript{238} Most important, it “avoids the perverse and anomalous consequence of the ‘hypothetical test’ rule under which a debtor may lose the benefit of a non-assignable contract vital to its economic future solely because it filed for bankruptcy.”\textsuperscript{239}

Two years later, in \textit{In re Adelphia Communications Corp.},\textsuperscript{240} a different judge in the same district followed and applied \textit{Footstar}. Although the case involved a franchise agreement,\textsuperscript{241} its applicability to the law of patents and copyrights is strong and the case may signal a growing disinclination to utilize the “hypothetical” test.

In \textit{Adelphia}, the question presented was whether the debtors could transfer their cable operations to interested buyers over the objection of certain local franchising authorities (LFAs).\textsuperscript{242} The specific issue was “whether the franchise agreements [could] be assigned . . . in the face of provisions in the applicable cable ordinances which prohibit assignment without” the consent of the LFAs.\textsuperscript{243}

Judge Gerber framed the threshold question as whether the franchise agreements could be \textit{assumed} without the LFA’s consent, in spite of the LFA’s contractual and statutory rights to prohibit \textit{assignment} without their consent.\textsuperscript{244} This required the

\begin{itemize}
  \item \textsuperscript{234} \textit{In re Footstar}, 323 B.R. at 573.
  \item \textsuperscript{236} 323 B.R. at 573-74.
  \item \textsuperscript{237} \textit{Id.} at 573.
  \item \textsuperscript{238} \textit{Id.} at 574.
  \item \textsuperscript{239} \textit{Id.}
  \item \textsuperscript{240} 359 B.R. 65, 72 (Bankr. S.D.N.Y. 2007).
  \item \textsuperscript{241} \textit{Id.} at 69.
  \item \textsuperscript{242} \textit{Id.} at 68-69.
  \item \textsuperscript{243} \textit{Id.} at 69.
  \item \textsuperscript{244} \textit{Id.} at 71 (emphasis in original).
\end{itemize}
court to determine whether an inability to assign a contract must always mean that a debtor can not assume it.

Writing at length, Judge Gerber rejected the hypothetical test, concluding the better view was that “the right to object to assignment does not by itself affect the right to assume.”245 His rationales for not following the hypothetical test were several. First, he strongly endorsed the view of Judge Hardin that the plain text of section 365(c)(1) applies only to a trustee and not to a debtor in possession.246 Second, plain meaning of the statute favored this new reading.247 “If section 365(c)(1) made it impossible even to assume the contract to be assigned, there would be no reason for having a section 365(c)(1) exception in section 365(f) [dealing with assignment].”248 Further, “if section 365(c)(1) made it impossible for a debtor in possession to assume an unassignable contract, the purpose of including ‘or debtor in possession’ in section 365(c)(1) would be difficult to explain.”249

Most important, perhaps, was the recognition that no purpose was served by disqualifying the debtor in possession from assuming an executory contract.250 The Supreme Court, he noted, had long since established that a debtor in possession is not a different entity than a debtor—thus making it equally plain that the debtor in possession was not a transferee and that no material change had occurred in the identity of the licensee.251 Thus, “when a debtor in possession, as contrasted to a trustee, wishes to assume, the underlying needs and concerns to be protected have nothing to do with each other.”252

Subsequently, in In re Aerobox Composite Structures, LLC,253 the Bankruptcy Court of the District of New Mexico applied the Footstar analysis in technology case. The debtor in that case, Aerobox, relied upon a non-exclusive patent license for the manufacture of its principal business product.254 Shortly after the case was filed, the patent owner filed a motion seeking a ruling that the license should be deemed

245. Id. at 72 (emphasis in original).
246. Id. But cf. In re Wellington Vision, Inc., 364 B.R. 129, 136-37 (S.D. Fla. 2007) (expressly concluding that § 365(c) applies to debtors in possession as well as to trustees and concluding that it prevented the debtor in possession from assuming a franchise agreement that included a non-exclusive trademark license).
247. Id.
248. Id. at 72 n.17 (emphasis in original).
249. Id. More generally, Judge Gerber explained that subsections (c) and (f) could be reconciled by focusing on the distinction between rules of law of general application, which should continue to restrict assignment pursuant to section 365(c), and those that “merely embody or make enforceable limitations on assignment that are contained within a contract,” which should generally be overridden by section 365(f). Id. at 77 (citing In re Supernatural Foods, LLC, 268 B.R. 759, 792).
250. Id. at 72 & n.18.
251. Id. at 72 n.18.
252. Id.
254. Id. at 137.
The motion did not cite any specific operational issue of the owner, but relied instead on the premise that, under the hypothetical test, the license could not be assumed or assigned. The bankruptcy court accepted the underlying logic of *Footstar*. It stated that the limitations contained in section 365(c)(1) were aimed at protecting the non-debtor party from being forced to accept performance from an entity other than the party with whom it originally contracted. It then ruled that a debtor in possession is not materially different from the pre-bankruptcy debtor. It agreed with the *Footstar* court that it makes no sense to read the term "trustee" to mean "debtor in possession" in section 365(c)(2) because doing so, as the court in *Footstar* stated, "would render the provision a virtual oxymoron, since mere assumption [by the debtor in possession](without assignment) would not compel the counterparty to accept performance from or render it to an "entity other than" the debtor."

Thus the court denied the motion to compel rejection. It held that when the debtor in possession seeks merely to assume and operate post-petition under the terms of the prepetition license, section 365(c)(1) does not stand in the way or permit the non-debtor to interfere. At the end of its opinion, the court noted that the license agreement at issue contained a provision stating the consent of the licensor to an assumption could not be unreasonably withheld. The creditors committee had argued that this provision was less restrictive than the general federal common law and either constituted a form of "pre-consent" to assumption or that the licensor had "opted out" of generally applicable law. The court declined to address this point, but by flagging it seemed to signify that it was a significant issue.

V. CONCLUSION

This article surveyed the deep lack of consistency in how technology licenses are treated in bankruptcy. The inconsistency is a product of tension between the principles of intellectual property law and the goals of bankruptcy. It is also the result of a very difficult problem of statutory interpretation and the limits on the plain meaning rule. Courts are divided, Congress has failed to address the problem, and efforts to obtain judicial review by the Supreme Court have failed. Pending some
resolution by Congress or the Court, the best solution is for bankruptcy courts to adopt useful, coherent principles which are true to both bodies of law and their underlying principles.

The resolution of the tension is necessary because it has far reaching implications. It renders confirmation of a reorganization plan highly problematic for any business that is a licensee of intellectual property. Because of that, it affects how such businesses are or can be financed. The stakes in this debate are high on both sides. Federal patent and copyright policy may well be part of the engine that supports and sustains creative activity in the area of technology and elsewhere. However, the federal policy encouraging rehabilitation of financially distressed companies is of equal or paramount import. A middle ground is needed that protects the benefit of the licensor’s bargain but which also permits reorganization to occur when that benefit will not significantly impair the legitimate interests of owners.