

# Protecting Your Intellectual Property in Bankruptcy Cases\*

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## Introduction

The bursting of the dotcom bubble within the last few years and the landslide of bankruptcy filings by telecommunications companies within the last six months<sup>1</sup> have spotlighted the importance of intellectual property assets in bankruptcy cases, especially those commenced under Chapter 11. Sometimes, these assets are the only valuable assets that may either be sold by order of the bankruptcy court or used as the basis for a reorganization plan. Consequently, it is becoming more and more important for bankruptcy counsel to become familiar with how intellectual property law interacts with the provisions of the Federal Bankruptcy Code. This article highlights the issues arising from this interaction.

## What Is Intellectual Property?

### **Bankruptcy Code Definitions**

The term *intellectual property* is defined in 11 USC 101(35A) to “mean” (and not to “include”)<sup>2</sup> the following categories of property “to the extent protected by applicable non-bankruptcy law”:

- trade secrets;
- inventions, processes, designs, or plants protected under federal patent law;
- patent applications;
- plant varieties;
- works of authorship protected under federal copyright law; and
- mask works protected under chapter 9 of title 17 of the United States Code.<sup>3</sup>

Congress added this definition to the Federal Bankruptcy Code in 1988 in conjunction with the provisions of 11 USC 365(n), which are discussed in the section “The Legislative History and Statutory Language of 11 USC 365(n)” later in this article. This Code definition does not include trademarks or trade names.<sup>4</sup> Senate Report Number 100-505 explains the meaning and operation of 11 USC 101(35A):

The first new defined term is “intel-

lectual property.” The definition is a listing of types of intellectual property. The definition sets forth in some instances both the actual type of property as to which the intellectual property proprietor obtains (e.g., invention, process, design, confidential research or development information, work of authorship) and the alternative legal mechanism for protecting that underlying property (e.g., trade secret, patents and copyrights). The amendment broadly defines “intellectual property” to include virtually all types of such rights (other than trademarks and similar rights) whether protected by federal or State law, statutory or common law. The bill in no way defines or alters any substantive intellectual property law, it merely refers to those rights which are already protected by applicable nonbankruptcy law. Proposed Section 101(52) makes clear that the operation of the bill is to cover both the intangible legal right associated with intellectual property and the tangible object or objects, such as books, blueprints and electronic media, in which such intellectual property may be fixed or recorded.

The definition of “intellectual property” is unusual for a federal statute because of its inclusion of trade secret, normally a concept reserved for development by the states. Because bankruptcy processes can alter rights created by state law, this inclusion is appropriate. Also included as a separate category is confidential research or development information. This was done because some states narrowly define trade secret, but accord protection to the developer of confidential technical information falling outside those definitions. The definition is broad and is to be inter-

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preted liberally to carry out the intent of Congress to remove the cloud cast by that recent interpretation of the Bankruptcy Code upon the intellectual property licensing system.<sup>5</sup>

### **Traditional Definitions of Intellectual Property**

**Trademarks.** A *trademark* is defined as a word, name, symbol, slogan, or device used to identify and distinguish the owner's goods or, in the case of a service mark, the owner's services. A trademark indicates the origin of those goods and services and connotes a particular standard of quality associated with them. The basic right of a trademark owner is the exclusive right to use the mark on or with the owner's goods and services and to prohibit others from using the mark or similar marks that are likely to confuse consumers about the source of the goods and services.<sup>6</sup>

The law recognizes and enforces common-law trademarks. Trademark owners will acquire such a mark merely by using the mark in their businesses. Trademarks that are used in interstate or international commerce may be registered with the U.S. Patent and Trademark Office (PTO) under the Lanham Act.<sup>7</sup> Federal trademark law also protects what is known as "trade dress." This concept encompasses the total image of a product and may include features such as size, shape, color or combinations, texture or graphics, viz., the way in which the product is presented for sale to the public. As the name implies, *trade dress* is the way in which the product is dressed for sale to the public.<sup>8</sup>

Finally, Michigan law of unfair competition provides protection for trademarks and trade dress similar to the Lanham Act.<sup>9</sup>

**Patents.** A *patent* is an exclusionary right granted by the federal government to the owner of the patent to exclude others from making, using, selling, offering to sell, and importing any products covered by a claim of an issued patent.<sup>10</sup> Patents may be issued for inventions such as processes, machines, and articles of manufacture.

**Copyrights.** A *copyright* is a right granted by the federal government to the creator or owner of an original work of authorship that is fixed in a tangible medium of expression from which it may be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or a device.<sup>11</sup> Works of authorship include literary works, computer programs, musical works,

and motion pictures.<sup>12</sup> A copyright owner's exclusive rights include the right to reproduce the copyrighted work, to prepare derivative works based on the copyrighted work, to distribute copies of the copyrighted work, to perform the work in public, and to display that work in public.<sup>13</sup>

**Trade Secrets.** To be protected from disclosure under Michigan trade secret law, the information must be subject to secrecy and must have some minimal novelty. The holder of a trade secret has the exclusive right to use the secret.<sup>14</sup>

### **Whose Intellectual Property Is It?**

The entities that normally will assert rights to and interests in intellectual property in bankruptcy cases will be the following: (1) owners of the property, who may sometimes be a licensor or licensee of that property; (2) secured creditors asserting security interests or liens in the intellectual property or its licenses; and (3) nondebtor licensees of the intellectual property.

### **The Debtor as Owner of Intellectual Property**

**Identification of Intellectual Property Assets.** The interests of a Chapter 11 debtor in intellectual property become "property of the estate" under the extremely broad definition of that term contained in 11 USC 541(a). Thus, the debtor's title to a patent, trademark, or copyright will pass to its bankruptcy estate once a voluntary or involuntary bankruptcy petition is filed by or against the debtor. The debtor and, more particularly, its management must act as fiduciaries for their creditors in bankruptcy cases.<sup>15</sup> These fiduciary duties include a duty not to divert, dissipate, or unduly risk assets that are necessary to pay the claims of creditors.<sup>16</sup>

Included among the documents that must be filed at or near the date on which a Chapter 11 case is commenced are the debtor's bankruptcy schedules, which identify, inter alia, the debtor's personal property and all executory contracts to which the debtor is a party (including nonexclusive intellectual property licenses). These schedules must be verified, under penalty of perjury, by an appropriate officer or other agent of the debtor as true and correct to the best of his or her knowledge, information, and belief. Debtor's counsel normally assists debtor's management in the preparation of these schedules. The information contained in these schedules must be as complete and accurate as possible, not only to avoid criminal penalties,<sup>17</sup> but also to assist the credi-

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tors and the bankruptcy court in administering the Chapter 11 case. Bankruptcy counsel must work closely with debtor's management in identifying all intellectual property for insertion in these schedules.<sup>18</sup>

**Valuation of Intellectual Property Assets.** Not only must the debtor's bankruptcy schedules describe the debtor's intellectual property, those schedules must also assign values to those assets. These values may be important at various stages in the Chapter 11 case, including the following:

- If a secured creditor holds a perfected security interest or lien in intellectual property of the debtor, this value will determine, in whole or in part, the amount of that creditor's secured claim under 11 USC 506(a).
- If the debtor proposes to sell these assets either by separate motion under 11 USC 363 or pursuant to a confirmed Chapter 11 plan, the value of these assets will often determine, in whole or in part, any stalking-horse bid for those assets.
- If a creditor with a perfected security interest in intellectual property seeks "adequate protection" under 11 USC 361, the value of these assets will influence the nature and extent of the adequate protection negotiated by the parties and/or awarded by the bankruptcy court.
- If the debtor seeks to assume or reject any intellectual property licenses under 11 USC 365, these values will influence the bankruptcy court in determining whether the debtor has exercised reasonable business judgment in deciding whether to assume or reject the licenses.
- The value of intellectual property assets will be important in determining whether a bankruptcy court may confirm a proposed Chapter 11 plan. For example, if an impaired creditor votes to reject a plan, the plan may be confirmed only if that creditor receives plan distributions in an amount not less than what the creditor would have received in a Chapter 7 liquidation of the debtor. This is the "best interest of creditors" test of 11 USC 1129(a)(7). In addition, if a class of secured or unsecured impaired creditors votes to reject the plan, the plan must provide for a proper "cram down" of those claims under 11 USC 1129(b)(2) for that plan to be confirmed. The bankruptcy court will consider the value of a debtor's intellectual property in determining whether the plan proponent has satisfied this confirmation standard.

Because these values may determine whether a Chapter 11 debtor lives or dies, a

debtor and its bankruptcy counsel should seriously consider retaining an expert appraiser to value the debtor's intellectual property before commencing a Chapter 11 case. Counsel should carefully examine the proposed appraiser's qualifications and abilities as a potential expert witness in the Chapter 11 case before retaining that professional.

### ***The Debtor as Licensor of Intellectual Property***

**The Lubrizol Enterprises Decision.** A Chapter 11 debtor may be the owner of intellectual property that has issued nonexclusive licenses of that property to third parties. These licenses are normally classified as "executory contracts" subject to assumption or rejection by a Chapter 11 debtor or a bankruptcy trustee.<sup>19</sup> In 1988, Congress enacted and then President Ronald Reagan signed into law section 365(n) of the Federal Bankruptcy Code, which restricts the power of a trustee or debtor in possession to modify a nondebtor licensee's rights. This amendment to the Bankruptcy Code was in response to the decision of the Fourth Circuit Court of Appeals in *Lubrizol Enterprises, Inc v Richmond Metal Finishers, Inc*, 756 F2d 1043 (4th Cir 1985), which permitted the debtor/licensor of intellectual property to reject a nonexclusive license to use its metal-coating process technology as an "executory contract" under 11 USC 365. As a consequence of this rejection, the nondebtor licensee was left only with an unsecured claim for damages in Lubrizol's Chapter 11 case and could no longer avail itself of the license. This result challenged a basic norm of intellectual property licensing law—that license rights could not be terminated unless the licensee breached the license agreement.

**The Legislative History and Statutory Language of 11 USC 365(n).** The legislative history of 11 USC 365(n) unmistakably reflects Congress' intent to alleviate the harsh results of *Lubrizol Enterprises*, which "relieved the debtor not simply of its ongoing affirmation performance obligations under the executory license agreement, but also of its passive obligation to permit the licensee to use the intellectual property as provided in the license."<sup>20</sup> Consequently, Congress drafted section 365(n) to permit a nondebtor licensee to continue using the license notwithstanding its rejection by the debtor/licensor:

The bill provides for treatment of intellectual property licenses under

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Section 365 in a manner that parallels generally the treatment of real estate leases in the existing provisions of Section 365(h)(1). While intellectual property plays a unique role in technological and economic development, the problems associated with the rejection of executory contracts are common with other special forms of property, such as real property leases. In both real estate leases and intellectual property licenses, the underlying property is unique. When the lessee or the licensee is threatened with loss of use of the property, it is not possible to obtain precise cover from another source.

In adopting the Code, Congress recognized this problem with respect to real property leases and enacted Section 365(h). That section clarified that, although a bankrupt lessor could avoid performance of future obligations under the unexpired lease, it could not cause through rejection of the lease an innocent lessee to forfeit the remainder of its leasehold. Neither the bar nor Congress then foresaw the need to protect similarly the reasonable expectations of intellectual property licensees. The bill corrects the perception of some courts that Section 365 was ever intended to be a mechanism for stripping innocent licensee of rights central to the operations of their ongoing business and stripping the American licensing system of its dependability and flexibility. Thus, the bill does not accord special treatment for intellectual property or the interests of its licensors or licensees beyond that which Congress has recognized in the past is required for these other unique property rights. The bill recognizes that there may be circumstances in which the future affirmative performance obligations under a license may not be performed in a manner that benefits the estate, but limits the consequences of the breach or rejection of the contract.<sup>21</sup>

Section 365(n) of the Bankruptcy Code appears as Exhibit A on page 23 of this arti-

cle. The statute offers the licensee a choice if the debtor/licensor rejects the license. The licensee may elect to retain the rights in the license and pay what is due (although future development of the product may be questionable), or it may return the product and file a claim. In the interim, though, the licensor may not interfere with the licensee's rights under the license, avoiding the tacit extortion employed by the debtor in *Lubrizol Enterprises*.<sup>22</sup>

### ***The Debtor as Licensee of Intellectual Property***

**Limited Scope of 11 USC 365(n).** Section 365(n) of the Federal Bankruptcy Code only addresses the situation where the debtor is a licensor of intellectual property. There are no corresponding provisions to address the situation where the Chapter 11 debtor is a licensee. In many Chapter 11 cases, an intellectual property license is the most valuable asset and the debtor/licensee's only hope of effecting a successful reorganization or liquidation plan is through the assumption (and, perhaps, the assignment to a third party) of that license. A recent series of judicial decisions, however, has severely limited the power of a debtor/licensee to assume/assign an intellectual property license under 11 USC 365.

**Catapult and Its Progeny.** The power of a Chapter 11 debtor to assume and assign an executory contract under 11 USC 365 is broad but is not limitless. One of the statutory restrictions on this power is set forth in 11 USC 365(c)(1) that reads, in relevant part, as follows:

The trustee [or debtor in possession] may not assume or assign any executory contract . . . of the debtor, whether or not such contract . . . prohibits or restricts assignment of rights or delegation of duties, if—

(1)(A) applicable law excuses a party, other than the debtor, to such contract . . . whether or not such contract . . . prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment.

A recent line of cases has applied this statutory prohibition against assumption and assignment to intellectual property that has been licensed to debtors, thereby causing much consternation among debtors and their counsel.

In general, executory contracts that may

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not be assumed or assigned under 11 USC 365(c)(1) are contracts where, under applicable nonbankruptcy law, the nondebtor party is excused from accepting performance of or rendering performance to someone other than the contracting party.<sup>23</sup> Under federal law, nonexclusive patent and copyright licenses that do not expressly permit their assignment by the licensee to a third party may not be so assigned over the licensor's objection.<sup>24</sup>

The Ninth Circuit Court of Appeals recently applied this statutory provision to prohibit the mere assumption of patent licenses by a Chapter 11 debtor/licensee. In *Perlman v Catapult Entertainment, Inc.*, the Ninth Circuit held that a Chapter 11 debtor could not assume patent licenses as part of a plan of reorganization over the objection of a licensor.<sup>25</sup> Because federal patent law makes nonexclusive patent licenses personal and nondelegable, it constituted "applicable law excus[ing the] party, other than the debtor, . . . from accepting performance" absent consent of the nondebtor party, and therefore, such licenses could not be assumed.<sup>26</sup> This decision aligns the Ninth Circuit with the Third, Fourth, and Eleventh Circuits.<sup>27</sup> The *Catapult* decision is particularly troubling because it allows an individual creditor to prevent confirmation of a plan to the detriment of the entire creditor body and the debtor under circumstances where that creditor's rights are not being negatively impacted.

In *Catapult*, Perlman licensed several patents to the debtor, a gaming network. The debtor entered into a merger agreement that proposed to leave the debtor as the surviving entity. This agreement also contemplated the filing of a bankruptcy petition, followed by a reorganization via a reverse triangular merger. As part of the plan, the debtor filed a motion seeking to assume 140 executory contracts and leases, including the Perlman licenses. It was clear that assumption of these licenses was critical to the success of the debtor's plan. The bankruptcy court approved the assumption over Perlman's objections, and subsequently confirmed the plan that had been accepted by the requisite majority of creditors and equity holders required under the Code. On appeal, the U.S. District Court for the Northern District of California affirmed the decision of the bankruptcy court. Perlman thereafter appealed and the Ninth Circuit Court of Appeals reversed the two courts below.

The Ninth Circuit began its analysis with section 365(c)(1) and by explaining the "hy-

pothetical" and "actual" tests, the two primary approaches utilized by the courts in interpreting the rights and obligations of the parties under section 365(c)(1). The hypothetical test is derived from a plain statutory language approach and provides:

The plain language of § 365(c)(1) "link[s] nonassignability under 'applicable law' together with a prohibition on assumption. . . ." In other words, the statute by its terms bars a debtor in possession from assuming an executory contract without the nondebtor's consent where applicable law precludes assignment of the contract to a third party. The literal language of § 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 has no intention of assigning the contract in question to any such third party.<sup>28</sup>

The actual test is premised on reasoning that Congress did not intend to bar debtors in possession from assuming their contracts when no assignment is contemplated.

[T]he statute bars assumption by the debtor in possession only where the reorganization in question results in the nondebtor actually having to accept performance from a third party. Under this reading of §365(c), the debtor in possession would be permitted to assume any executory contract, so long as no assignment was contemplated.<sup>29</sup>

The debtor urged the Ninth Circuit to adopt the actual test because (1) a literal reading of section 365(c)(1) creates inconsistencies within section 365(c) as adoption of the hypothetical test would render section 365(c)(2), prohibiting assignment of contracts to make loans or extend other debt financing or financial accommodations to or for the benefit of the debtor, unnecessary and superfluous; (2) a literal reading is inconsistent with the legislative history; and (3) a literal reading flies in the face of sound bankruptcy policy. The court, however, rejected each of these arguments in favor of a plain reading of the statute.

The court first concluded that the various subsections of section 365 could be "credibly

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reconciled” because “each subsection recognizes an ‘applicable law’ of markedly different scope.”<sup>30</sup> Section 365(f)(1), which permits the assignment of executory contracts, delineates a broad rule rather than a carefully crafted exception. If applicable law does not contain a general ban on assignment, but specifically excuses a party from accepting performance from an entity different from the one with whom the party originally contracted, the applicable law prevails and the proposed assignment may be vetoed by the nondebtor party.

The Ninth Circuit rejected the suggestion that adoption of the hypothetical test created inconsistencies within the statute by articulating distinctions between the two subparts of section 365(c). Subsection 365(c)(2) has been rendered superfluous by national uniformity of applicable state laws, not by the court’s interpretation of subsection (c)(1). Moreover, the court reasoned that the debtor could avoid the prohibition of subsection (c)(1) by obtaining the consent of the nondebtor party, whereas consent of the nondebtor party could never alter or waive the prohibition in subsection (c)(2).

Because the court believed that a plain reading of the statute was clear and unambiguous, the legislative history of 11 USC 365(c)(1) need not have been consulted. Nevertheless, the court reviewed the legislative history and found that no contemporaneous legislative history regarding the current formulation of section 365(c)(1) existed. The legislative history from a 1980 House proposal proffered by the debtor was rejected by the court as not constituting authoritative support for the language subsequently adopted as part of the 1984 amendment to section 365(c)(1)—too much time had elapsed between the earlier proposal and the 1984 amendments without evidence of any clear connection between the two legislative proposals.

The court also rejected policy arguments advanced by the debtor because “[p]olicy arguments cannot displace the plain language of the statute; that the plain language of § 365(c)(1) may be bad policy does not justify a judicial rewrite.”<sup>31</sup> Ultimately, if the language creates a “bad result,” it is incumbent on Congress, not the courts, to rewrite the statute.

Since the Ninth Circuit decided *Catapult*, it has been cited with approval or followed by a number of other courts.<sup>32</sup>

## Protecting the Secured Party’s Interest in Intellectual Property

### *The Role of Secured Creditors’ Counsel*

Creditors claiming security interests in intellectual property owned by a Chapter 11 debtor should retain bankruptcy counsel to represent their interests in the bankruptcy case. One of counsel’s first actions taken after retention should be to review all of the creditor’s files relating to the debtor and the secured loans extended to it and interview the creditor’s personnel responsible for the administration and collection of those loans. To determine whether a creditor’s liens and interests are perfected under applicable non-bankruptcy law, counsel should order Uniform Commercial Code (UCC) searches in the appropriate jurisdictions and, in situations where the creditor asserts a security interest in a copyright, order lien searches from the U.S. Copyright Office in Washington, D.C. In the event that the creditor’s liens and security interests have not been perfected as of the Chapter 11 filing date, the debtor (or a properly authorized creditors committee) may request the bankruptcy court to avoid those liens and interests under the “strong-arm powers” granted to a trustee or debtor in possession by 11 USC 544(a).

### *Determining Perfection of Security Interests and Liens in Intellectual Property*

**In General.** This section contains a brief overview of how security interests in trademarks, patents, and copyrights may be perfected under Revised Article 9 and applicable federal law. If a federal statute or regulation creates an alternative method of perfection, that statute or regulation will preempt Revised Article 9.<sup>33</sup> As discussed in more detail below, the existing case law holds that only the Federal Copyright Act, 17 USC 101 et seq., preempts Revised Article 9. Consequently, perfection of security interests in trademarks and patents may be accomplished by filing a financing statement in accordance with the applicable provisions of Revised Article 9.

**Trademarks.** The reported case law holds that a security interest in a common law or federally registered trademark may be perfected by filing a financing statement in the proper state filing office.<sup>34</sup> Because a trademark is properly classified as a “general intangible” under MCL 440.9102(1)(pp), the secured party must file a financing state-

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ment with the filing office in the debtor's "location." However, when a federally registered trademark serves as collateral, the secured party should, in an abundance of caution, record its security agreement with the PTO.

**Patents.** Reported case law holds that a security interest in a patent may be perfected by the filing of a financing statement in the proper state filing office.<sup>35</sup> Like trademarks, patents are "general intangibles" and a financing statement should be filed with the proper filing office in the state where the debtor is located. Again, it is advisable, but not required, to record the security agreement with the PTO.

**Copyrights.** To perfect a security interest in a federally registered copyright, a secured party must record its security agreement or copyright mortgage in the U.S. Copyright Office.<sup>36</sup> This federal system is designed to give all persons constructive notice of the facts contained in the recorded document and, therefore, preempts Revised Article 9.<sup>37</sup> The failure to so record a security agreement or copyright mortgage will render the security interest unperfected.<sup>38</sup> In an abundance of caution, secured parties should also file financing statements listing the copyright as collateral with the proper filing office in the state where the debtor is located.

There is a split of decisional authority on how to perfect a security interest in an unregistered copyright. In the case *In re AEG Acquisition Corp.*, 127 BR 34 (Bankr CD Cal 1991), the bankruptcy court held that unregistered copyrights must be registered with the U.S. Copyright Office to perfect a security interest in that property. *In re Avalon Software*, 209 BR 517 (Bankr D Ariz 1997), held that a security interest in an unregistered copyright may be perfected only by both registering the copyright and recording the security agreement with the U.S. Copyright Office. Nevertheless, at least one court has disagreed with *AEG Acquisition* and *Avalon Software* by holding that a security interest in an unregistered copyright may be perfected by the filing of a financing statement in the proper filing office dictated by Article 9 of the UCC.<sup>39</sup> In light of this disagreement in the case law, a secured party should require the owner to record the copyright with the U.S. Copyright Office, record the security agreement or copyright mortgage there, and then file a financing statement with the proper filing office in the state where the debtor is located.

### **Valuation Issues**

As discussed in the section "Valuation of Intellectual Property Assets," creditors holding security interests and liens in a Chapter 11 debtor's intellectual property, as well as counsel to these creditors, should be extremely sensitive to the value of these intangible assets. The value assigned to this property by the bankruptcy court will determine the amount of the creditor's secured claims, at least for the purposes of that particular hearing.<sup>40</sup>

**Adequate Protection Disputes.** At the outset of a Chapter 11 case, valuation of a secured creditor's collateral will be important for purposes of adequate protection. Under 11 USC 363(e), a debtor may not use a secured creditor's collateral without that creditor's consent unless the bankruptcy court finds that the creditor's liens and security interests in the collateral are "adequately protected." The court will normally conclude that adequate protection exists when the secured creditor is or will be compensated for any deterioration in the value of those interests and liens caused by the debtor's use of collateral during the pendency of the Chapter 11 case.<sup>41</sup> For these purposes, a debtor that desires to use intellectual property over the secured creditor's objection should be prepared to introduce evidence at the hearing<sup>42</sup> that the value of these assets will not depreciate through their use during the Chapter 11 case or, if such depreciation does occur, the creditor will be protected against any loss, either through periodic cash payments made to the creditor or replacement liens on other property granted to the creditor.<sup>43</sup> The debtor may also argue that the value of the intellectual property assets far exceeds the amount of the creditor's liens and interests in that property and, consequently, this "equity cushion" provides the secured creditor with the necessary adequate protection.

In opposing the debtor's request for use of collateral under 11 USC 363(e) or in requesting relief from the automatic stay under 11 USC 362(d) to recover and dispose of collateral, the secured creditor should be prepared to introduce expert testimony of a qualified appraiser of intellectual property to establish the amount and rate of depreciation in value of the collateral caused by the debtor's anticipated use. In addition, the secured creditor should be ready to prove at the hearing that the debtor's adequate protection offers are inadequate to compensate for the depreciation in value of the creditor's lien. For example, the creditor may intro-

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duce evidence that the proposed cash payments are insufficient to compensate for the decrease in value of the creditor's lien and/or that no equity cushion exists in the particular intellectual property to protect that lien.

**Objections to Confirmation.** In a proposed Chapter 11 plan, the debtor may provide that the value of the secured creditor's lien in intellectual property is less than the amount of the debt owed to that creditor. In these circumstances, the creditor would hold two claims: one claim for the value of the lien as its secured claim and the other claim, which would be unsecured, for the projected deficiency. The debtor would then be required to pay the "present value" of that secured claim in the plan by installment payments bearing a market rate of interest to overcome a "cram down" objection by that creditor under 11 USC 1129(b)(1).<sup>44</sup> If the secured creditor objects to confirmation of the plan on the basis that the debtor failed to satisfy the cram down standards of 11 USC 1129(b)(1), the secured creditor should be prepared to introduce expert testimony of a qualified appraiser of intellectual property to support the creditor's assertion of value. The debtor, in turn, will normally be prepared to introduce evidence supporting its own asset valuation.

## NOTES

1. "The dotcom crash, it turns out, was merely the warm-up. The telecoms crash is many times bigger. Michael Powell [Chairman of the FCC] surprised nobody when he declared this week that the industry is facing 'utter crisis.' The situation is being likened to the Dark Ages. The old empires have fallen and a prolonged period of uncertainty looms." *Special Report: The Telecoms Crisis*, *The Economist*, July 20, 2002, at 59.

2. The use of the word *means* in this statute indicates that this is an exclusive list of intellectual property. The rules of statutory construction of the Federal Bankruptcy Code are contained in 11 USC 102, which states that the terms *include* and *including* are not limiting. 11 USC 102(3).

3. The Semiconductor Chip Protection Act of 1984, Pub L No 98-620. *Mask works* are defined in this statute as "a series of related images, however fixed and encoded, (A) having or representing the predetermined, three-dimensional pattern of metallic, insulating, or semiconductor material present or removed from the layers of a semiconductor chip product; and (B) in which series the relation of the images to one another is that each image has the pattern of the surface of one form of the semiconductor chip product." Production under the Federal Copyright Act extends only to the layout or topography of the chip—it does not protect any idea or concept associated with the mask work.

4. Trademarks and trade names were excepted from the scope of 11 USC 101(35A) because of concerns about the licensee's ability (or desire) to maintain quality control in the circumstance where a trademark license agreement is rejected by the debtor/licensor. See, e.g., *Licensing by Paolo, Inc v Sinatra (In re Gucci, Inc)*, 126 F3d 380, 394 (2d Cir 1997); S Rep No 100-505, at 5 (1988),

reprinted in 1988 USCCAN 3200, 3203-3204.

5. S Rep No 100-505, at 7-8 (1988), reprinted in 1988 USCCAN 3200, 3204-3205.

6. See generally *Leigh v Warner Bros, Inc*, 212 F3d 1210 (11th Cir 2000); *CPC Int'l, Inc v Skippy, Inc*, 214 F3d 456 (4th Cir 2000).

7. 15 USC 1051 et seq.

8. See, e.g., *Roulo v Russ Berrie & Co, Inc*, 886 F2d 931 (7th Cir 1989), *cert denied*, 493 US 1075 (1990), and the cases cited and discussed therein.

9. See, e.g., *Wynn Oil Co v American Way Serv Corp*, 943 F2d 595 (6th Cir 1991); *Two Men & a Truck/Int'l, Inc v Two Men & a Truck/Kalamazoo, Inc*, 949 F Supp 500 (WD Mich 1996).

10. 35 USC 101 et seq.

11. See, e.g., *Wickham v Knoxville Int'l Energy Exposition, Inc*, 739 F2d 1094 (6th Cir 1984); *Ahn v Midway Mfg Co*, 965 F Supp 1134 (ND Ill 1997).

12. 17 USC 102(a).

13. 17 USC 106. See also *Stewart v Abend*, 495 US 207 (1990).

14. See generally *Arco Indus Corp v Chemcast Corp*, 633 F2d 435 (6th Cir 1980); *McAlpine v AAMCO Automatic Transmissions, Inc*, 461 F Supp 1232 (ED Mich 1978).

15. See, e.g., *In re United Equip Sales Co*, 47 BR 818 (Bankr WD Mich 1985).

16. See, e.g., *Steinberg v Kendig (In re Ben Franklin Retail Stores)*, 225 BR 646 (Bankr ND Ill 1998).

17. 18 USC 152 and 18 USC 3571 permit federal courts to fine a person up to \$500,000 and/or to imprison him or her for up to five years for making false statements or concealing property in a bankruptcy case.

18. See also Weston Anson and Rick Schioldager, *Identifying Valuable Intellectual Property in Bankruptcy: Parts I and II*, 21 Am Bankr Inst LJ (May and June 2002 issues).

19. See, e.g., *Everex Sys v Cadtrak Corp (In re CLFC, Inc)*, 89 F3d 673 (9th Cir 1996) (patent license); *In re Superior Toy & Mfg Co*, 78 F3d 1169 (7th Cir 1996) (trademark license); *In re Patient Educ Media, Inc*, 210 BR 237 (Bankr SD NY 1997) (copyright license). But see *Microsoft Corp v DAK Indus, Inc (In re DAK Indus)*, 66 F3d 1091 (9th Cir 1995) (license reclassified as a sale).

20. S Rep No 100-505 (1988), at 2, reprinted in 1988 USCCAN 3200, 3201.

21. *Id.* at 4-5, reprinted in 1988 USCCAN 3200, 3203.

22. See generally *Encino Bus Mgmt v Prize Frize (In re Prize Frize)*, 32 F3d 426 (9th Cir 1994), which expresses the opinion that section 365(n) "has struck a fair balance between the interests of the bankrupt and the interests of a licensee of the bankrupt's intellectual property." *Id.* at 428.

23. See *In re Magness*, 972 F2d 689 (6th Cir 1992) (debtor's country club membership held nonassumable and nonassignable).

24. See, e.g., *PPG Indus, Inc v Guardian Indus Corp*, 597 F2d 1090 (6th Cir 1979); *In re Patient Educ Media, Inc*, 210 BR 237 (Bankr SD NY 1997). It is still an open question whether 11 USC 365(c)(1) would prohibit a debtor/licensee from assuming and assigning a nonexclusive trademark license in the absence of an express contractual prohibition against such assignment. Some courts have permitted a debtor/trademark licensee to assume and assign a trademark license. See, e.g., *In re Superior Toy & Mfg Co*, 78 F3d 1169 (7th Cir 1996); *In re Rooster, Inc*, 100 BR 228 (Bankr ED Pa 1989).

25. *Periman v Catapult Entertainment (In re Catapult Entertainment)*, 165 F3d 747 (9th Cir 1999), *cert filed*, 67 USWL 3749 (May 28, 1999) (No 98-1915), *cert dismissed pursuant to Rule 46.1*, 67 USWL 3749 (Oct 12, 1999).

26. 11 USC 365(c)(1).

27. See, e.g., *In re West Electronics, Inc*, 852 F2d 79 (3rd Cir 1988); *Breeden v Catron (In re Catron)*, 158 BR 629 (ED Va 1993), *aff'd without op*, 25 F3d 1038 (4th Cir 1994); *City of Jamestown v James Cable Partners, LP (In re James Cable*

*Partners, LP*, 27 F3d 534 (11th Cir 1994). *Contra Institut Pasteur v Cambridge Biotech Corp.*, 104 F3d 489 (1st Cir 1996), *cert denied*, 521 US 1120 (1997).

28. *Pelzman v Catapult Entertainment*, *supra* note 25, at 750.

29. *Id.* at 751.

30. *Id.* at 752, citing *In re Magness*, 972 F2d 689 (6th Cir 1992).

31. *Id.* at 754.

32. See *United States v Techdyn Sys Corp (In re Techdyn Sys Corp)*, 235 BR 857 (Bankr ED Va 1999) (involving government contract for telecommunications services); *In re Schick*, 235 BR 318 (Bankr SD NY 1999) (rights in partnership); *In re Access Beyond Techs*, 237 BR 32 (Bankr D Del 1999) (license that could not be assigned under applicable could not be assumed).

33. MCL 440.9109(3)(a); Official Comment 8 to Revised § 9-109.

34. See, e.g., *In re Roman Cleanser Co.*, 43 BR 940 (Bankr ED Mich 1984), *aff'd*, 802 F2d 207 (6th Cir 1986); *In re Chattanooga ChooChoo Co.*, 98 BR 792 (Bankr ED Tenn 1989); *In re Together Dev Corp*, 227 BR 439 (Bankr D Mass 1998), *aff'd*, *appeal dismissed*, *Trimarchi & Personal Dating Servs v Together Dev Corp*, 255 BR 606 (D Mass 2000).

35. See, e.g., *Moldo v Matsco, Inc (In re Cybernetic Servs)*, 239 BR 917 (BAP 1999), *aff'd*, 252 F3d 1039 (9th Cir 2001); *In re Transportation Design & Tech, Inc*, 48 BR 635 (Bankr SD Cal 1985).

36. 17 USC 205(a).

37. MCL 440.9109(3)(a).

38. See, e.g., *In re Peregrine Entertainment, Ltd.*, 116 BR 194 (CD Cal 1990); see also *Note, Transfers of Copyright for Security Under the New Copyright Act*, 88 Yale LJ 125 (1978); Steven Weinberger, *Note, Perfection of Security Interests in Copyrights: The Peregrine Effect on the Orion Pictures Plan of Reorganization*, 11 Cardozo Arts & Ent LJ 959 (1993).

39. See *Aerncon Engineering, Inv v Silicon Valley Bank (In re World Auxiliary Power Co)*, 244 BR 149 (Bankr ND Cal 1999).

40. 11 USC 506(a). The last sentence of 11 USC 506(a) provides that the value of a secured creditor's collateral "shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's

interest." Thus, a valuation for adequate protection purposes will not act as *res judicata* for confirmation purposes. See, e.g., *In re Woolley's Parkway Ctr, Inc*, 147 BR 996 (Bankr MD Fla 1992).

41. See, e.g., *In re Holly's, Inc*, 140 BR 643 (Bankr WD Mich 1992).

42. This evidentiary hearing could be held either on the debtor's motion to provide adequate protection to the secured creditor or on that creditor's motion for relief from the automatic stay provisions of the Bankruptcy Code.

43. 11 USC 361.

44. See, e.g., *In re Trevarrow Lanes*, 183 BR 475 (Bankr ED Mich 1995); *In re Eastland Partners Ltd P'ship*, 149 BR 105 (Bankr ED Mich 1992); *In re Kain*, 86 BR 506 (Bankr WD Mich 1988).



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**Exhibit A****Section 365(n) of the Bankruptcy Code**

- (1) If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—
  - (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or
  - (B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for—
    - (i) the duration of such contract; and
    - (ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.
- (2) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, under such contract—
  - (A) the trustee shall allow the licensee to exercise such rights;
  - (B) the licensee shall make all royalty payments due under such contract for the duration of such contract and for any period described in paragraph (1)(B) of this subsection for which the licensee extends such contract; and
  - (C) the licensee shall be deemed to waive—
    - (i) any right of setoff it may have with respect to such contract under this title or applicable nonbankruptcy law; and
    - (ii) any claim allowable under section 503(b) of this title arising from the performance of such contract.
- (3) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, then on the written request of the licensee the trustee shall—
  - (A) to the extent provided in such contract, or any agreement supplementary to such contract, provide to the licensee any intellectual property (including such embodiment) held by the trustee; and
  - (B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment) including any right to obtain such intellectual property (or such embodiment) from another entity.
- (4) Unless and until the trustee rejects such contract, on the written request of the licensee the trustee shall—
  - (A) to the extent provided in such contract or any agreement supplementary to such contract
    - (i) perform such contract; or
    - (ii) provide to the licensee such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law) held by the trustee; and
  - (B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including any embodiment), including any right to obtain such intellectual property (or such embodiment) from another entity.