CONFIDENTIAL DRAFT

VIA E-MAIL

M E M O R A N D U M

To	National Bankruptcy Conference Executive Committee
CC	Sally Schultz Neely Alan N. Resnick
From	International Aspects Committee
Re	Proposed Amendment to Section 1520 Section 6(d) of Innovation Act, H.R. 3309
Date	November 12, 2013

The Innovation Act, which is primarily focused on patent litigation reform, contains an amendment to section 1520 of chapter 15 of the Bankruptcy Code that we believe is inappropriate and that we recommend the Conference strongly oppose in its present form. The proposed amendment appears in **SEC. 6. PROCEDURES AND PRACTICES TO IMPLEMENT AND RECOMMENDATIONS TO THE JUDICIAL CONFERENCE** and provides as follows:

> (d) PROTECTION OF INTELLECTUAL-PROPERTY LICENSES IN BANKRUPTCY.—
> (1) IN GENERAL.—Section 1520(a) of title 11, United States Code, is amended—
> (A) in paragraph (3), by striking ''; and'' and inserting a semicolon;
> (B) in paragraph (4), by striking the period at the end and inserting ''; and''; and
> (C) by inserting at the end the following new paragraph:
> '(5) section 365(n) applies to intellectual property of which the debtor is a licensor or which the debtor has transferred.''.
> (2) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on the date of the enactment of this Act and shall apply to any action for which a complaint is pending on, or filed on or after, such date of enactment.

Chapter 15 of the Bankruptcy Code, included in the 2005 amendments to the Code with large bipartisan majorities, is designed to achieve worldwide cooperation in the liquidation or reorganization of a multinational company in order to preserve value for creditors and other stakeholders, especially employees. Its fundamental structure is "universalist" in that it requires that each country recognize a foreign *main* proceeding in the debtor's home country as the leader in the worldwide effort and that it cooperate with that jurisdiction to achieve the best results for all concerned. Among other advantages, this approach permits the sale of whole divisions with assets and operations in several nations as a single piece, which almost always will yield a higher price. It is also essential to reorganization of a global business.

Chapter 15 incorporated the UNCITRAL Model Law on Cross-Border Insolvency "to encourage cooperation between the United States and foreign countries with respect to transnational insolvency cases."[1] While the Model Law required modifications to fit into the existing judicial and legislative scheme, chapter 15 followed the exhortation of UNCITRAL: "Therefore, in order to achieve a satisfactory degree of harmonization and certainty, it is recommended that States [countries] make as few changes as possible in incorporating the model law into their legal systems."[2] The proposed amendment to section 1520 violates the purpose of chapter 15 to further international cooperation and, to that end, the guidance of UNCITRAL to minimize modifications to the Model Law.

Adding a provision to chapter 15 that deals with a special situation violates the principle of uniformity that makes the Model Law a valuable mechanism for greater legal certainty for

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[1] H.R.Rep. No. 109–31, pt. 1, 109th Cong., 1st Sess. 105 (2005) ("House Report" or "H.R. Rep.").

[2] ***UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*** *adopted on May 30, 1997 (the "Model Law," the "Guide.").* The Guide repeats this admonition in ¶ 50: "In enacting the Model Law, it is advisable to adhere as much as possible to the uniform text in order to make the national law as transparent as possible for foreign users of the national law (see also paragraphs 11-12 and 21 above)."

trade and investment. This is true even if one believes that, as a matter of public policy, the special situation should always be decided applying U.S. law. By such a unilateral, non-uniform amendment, the United States invites other countries to modify their versions of the Model Law in ways that may be detrimental to United States parties in foreign proceedings. The situation addressed by the proposed amendment is already before the courts and the tools to address the situation are already within chapter 15. The courts can deal with the issue appropriately and predictably without opening the door to other countries to reciprocate with their own deviations from the Model Law.

Section 1520, *Effects of recognition of a foreign main proceeding*, provides automatic relief on recognition of a foreign main proceeding.[3] It implements Article 20 of the Model Law by incorporating sections of the Bankruptcy Code that are consistent with the purpose of Article 20.[4] Both Article 20 and section 1520 operate automatically upon recognition of a foreign main proceeding and impose "effects" that "are necessary to allow steps to be taken to organize an orderly and fair cross-border insolvency proceeding...." [5] The fundamental effects necessary for an orderly and fair cross-border insolvency are (a) a stay of actions against or concerning the debtor or its assets, rights, obligations or liabilities, including a stay of execution against the

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[3] Section 1520 provides, in pertinent part, as follows:

(a)Upon recognition of a foreign proceeding that is a foreign main proceeding—
(1)sections 361 and 362 apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States;
(2)sections 363, 549, and 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that the sections would apply to property of an estate;
(3)unless the court orders otherwise, the foreign representative may operate the debtor's business and may exercise the rights and powers of a trustee under and to the extent provided by sections 363 and 552; and
(4)section 552 applies to property of the debtor that is within the territorial jurisdiction of the United States.

[4] H.R.Rep. 114-115 (2005).
[5] Guide at ¶ 143. Reference to the Model Law and the Guide for interpretation of chapter 15 are encouraged by section 1508. See, also, H.R. Rep. 109-110.

debtor's assets and (b) a stay of the debtor's transfer, encumbrance or disposition of assets.[6] Section 1520 imposes the stay by incorporating the automatic stay of section 362 (but limited to the debtor and its assets within the territorial jurisdiction of the United States) and the transfer restrictions of sections 549, 363 and 552.[7]

The Innovation Act would introduce into section 1520 a section of the Bankruptcy Code, section 365(n), that has nothing to do with allowing "steps to be taken to organize an orderly and fair cross-border insolvency proceeding". This would be a blow to the goals of uniformity and harmonization embodied in the Model law and chapter 15. Instead of a provision that affects all parties with an interest in a foreign proceeding, that effectively preserves the status quo and (potentially) going concern value and that does not intrude on the foreign proceeding, section 365(n) is not concerned with preservation of the status quo and affects the rights of a subset of licensees of intellectual property in the event that their license agreement is rejected or otherwise subjected to nonperformance in a foreign main bankruptcy case of a debtor who is their licensor. It effectively imposes U.S. law on the foreign proceeding whether or not U.S. law should apply to a particular license. If the legislation is adopted, it should, at the very least, be limited to licenses that are within the territorial jurisdiction of the United States.[8]

Automatically applying this section upon recognition of a foreign main proceeding would ignore the territorial limits of chapter 15 to property within the

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[6] Model Law § 20(1)(a).
[7] H.R. Rep. 114-115.
[8] Section 15102(8) provides that "within the territorial jurisdiction of the United States", when used with reference to property of a debtor, refers to tangible property located within the territory of the United States and intangible property deemed under applicable nonbankruptcy law to be located within that territory, including any property subject to attachment or garnishment that may properly be seized or garnished by an action in a Federal or State court in the United States."

territorial jurisdiction of the United States, since license grants by the foreign debtor may not be governed by U.S. law or may not even involve U.S. intellectual property. There should be a choice of law analysis performed before section 365(n) is applied in a chapter 15 case.[9] Section 365(n) could be applied in an appropriate situation on an appropriate showing under section 1522(a) and (b)).[10] Applying it automatically, without considering whether U.S. law should apply to the license in question and without the safeguards of sections 1521 and 1522 would be detrimental to the goals of the Model Law and chapter 15.[11] Rather than enhancing a cross-border insolvency proceeding, automatic application of section 365(n) would likely deter foreign representatives from seeking recognition to obtain necessary assistance for the foreign proceeding if a condition to recognition were entanglement in the possible briar patch of licensee rights under U.S. bankruptcy law.

The genesis of section 6(d) of the Innovation Act is likely the case of In re Qimonda AG, 462 B.R. 165 (Bankr. E.D. Va. 2011) which considered, on remand, the request of the foreign representative of a German liquidation proceeding, recognized as a foreign main proceeding, to modify a prior order that applied § 365 (and a laundry list of other sections of the Bankruptcy Code) in the chapter 15 case. On the petition of the administrator appointed in Qimonda's

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[9] *In re Maxwell Comm. Corp. plc* 93 F.3d 1036 (2d Cir. 1996) (dealing with choice of law in an avoidance action brought in connection with a proceeding under former section 304, the predecessor to chapter 15).

[10] Section 1522(a) and (b) provide: "**(a)**The court may grant relief under section 1519 or 1521, or may modify or terminate relief under subsection (c), only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected. **(b)**The court may subject relief granted under section 1519 or 1521, or the operation of the debtor's business under section 1520(a)(3), to conditions it considers appropriate, including the giving of security or the filing of a bond."

[11] Relief under § 1521 must be "necessary to effectuate the purpose of this chapter and to protect the assets of the debtor or the interests of the creditors..."

German main proceeding, the bankruptcy court entered an order recognizing the foreign main proceeding and, on the same date, entered a Supplemental Order under section 1521 that applied several sections of the Bankruptcy Code, including section 365 to the chapter 15 case. Upon realizing that section 365(n) interfered with his rights under the German insolvency code to "elect non-performance" of contracts, the administrator sought modification of the Supplemental Order. Licensees of U.S. patents, who would lose the protection of § 365(n) if § 365 no longer applied, objected. The Bankruptcy Court, on remand from the district court, found that there was a fundamental U.S. policy favoring innovation and that eliminating § 365(n) protection would be manifestly contrary to that policy. The court also ruled that the requested relief should be denied on the alternative section 1522 ground that the interests of the licensees would not be "sufficiently protected" if the requested relief were granted. The *Qimonda* decision was certified for direct appeal to the Fourth Circuit.[12] The Fourth Circuit heard argument on September 17, 2013 but has not ruled.[13]

Rather than passing legislation that would pre-empt the ruling of the Fourth Circuit and conflict with the purpose of the Model Law and chapter 15, Congress should reject this amendment. As noted, relief is already available to licensees in appropriate circumstances under section 1522 if a foreign representative seeks to deprive them of their rights under U.S. law. Applying section 365(n) to all foreign main proceedings would implicate licenses that are not within the territorial jurisdiction of the United States and would be

[12] In re Qimonda AG, 470 B.R. 374 (E.D. Vir. 2012).
[13] Case No. 12-1802.

inconsistent with the ancillary nature of a chapter 15 case, to provide assistance to the main case in another country where the debtor has the center of its main interests.

If the debtor's property is sliced into national bits, the cooperative approach of chapter 15 and the Model Law is seriously handicapped. The proposed amendment does just that as to intellectual property. IP is itself subject to a worldwide system of recognition and enforcement, which will be shattered for companies emerging from reorganization, creating a host of difficult questions and serious uncertainty about these crucial property rights. The United States makes a serious error by going it alone and by failing to let the courts develop the key issues under the existing statute. In short, those pushing this amendment might regret getting what they wished for.