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Finding Common Ground: Resolving Assumption and Assignment of Intellectual Property Licenses in Chapter 11 Bankruptcy Through Adoption of the Actual Test

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FINDING COMMON GROUND: RESOLVING ASSUMPTION AND ASSIGNMENT OF INTELLECTUAL PROPERTY LICENSES IN CHAPTER 11 BANKRUPTCY THROUGH ADOPTION OF THE ACTUAL TEST

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I. INTRODUCTION

In what is often described as the most economically depressed economy the United States has experienced since the Great Depression, personal and corporate bankruptcy filings are at near historic highs.[1] In 2008, Chapter 11 bankruptcy filings, a chapter generally tailored to business debtors,[2] grew sixty percent to 10,160 filings, up from 6,353 filings in 2007.[3] Such a dramatic increase in the rate of Chapter 11 filings has given rise to concern among creditors and others who have a business relationship with a debtor in Chapter 11 bankruptcy. Among those who have concerns are licensors of intellectual property. This Note will focus on a primary concern of these non-debtor licensors: how the court determines whether a debtor in Chapter 11 bankruptcy who holds an intellectual property license is permitted to assume that license as a debtor-in-possession, over the objections of the licensor.

Imagine, for example, that a corporation holds a license to market exercise related products and services bearing the TaeBo trademark, a mark associated with a particular type of physical fitness regimen and owned by a party other than the license holder.[4] When the licensee corporation files for Chapter 11 bankruptcy, it becomes a debtor-in-possession and proposes as part of its reorganization plan to assume the license it held (prior to filing for bankruptcy) to market these TaeBo-marked products. The owner of the mark refuses to give consent to the assumption of the license. Without the license, the debtor-in-possession faces an almost certain failed attempt at reorganization under Chapter 11.

At present, the outcome of such a situation may well depend upon the jurisdiction in which the bankruptcy case is filed. In determining whether a debtor-in-possession licensee may assume a license to intellectual property over the objections of the licensor, courts have looked to the language of 11 U.S.C. § 365(c),[5] a provision of the Bankruptcy Code addressing executory contracts.[6] There is division among the courts with regard to the interpretation of the

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[1] Press Release, Administrative Office of the United States Courts, Bankruptcy Filings Up In Calendar Year 2008 (Mar. 5, 2009), *available at* http://www.uscourts.gov/News/News View/09-03-05/Bankruptcy_Filings_up_in_Calendar_Year_2008.aspx.

[2] 7 COLLIER ON BANKRUPTCY ¶ 1100.01 (15th ed. 2004).

[3] Press Release, Administrative Office of the United States Courts, *supra* note 1.

[4] *See* N.C.P. Mktg. Group, Inc. v. BG Star Prods., Inc., 279 Fed. Appx. 561 (9th Cir.), *cert. denied*, 129 S. Ct. 1577 (2009).

[5] *See, e.g.*, John R. Knapp, Jr., *Treatment of Intellectual Property Licenses in Bankruptcy*, ADVOCATE, Aug.-Sept. 2007, at 29; Brett T. Cooke, *Intellectual Property Licenses and Assignments Under Chapter 11 of the Bankruptcy Code: A Brief Survey of the Nature of Property Rights Conferred and Implications Due to Reorganization*, 15 TEX. INTELL. PROP. L.J. 213, 218–27 (2007) (discussing property rights arising under executory contracts).

[6] 11 U.S.C. § 365(c)(2006).

ambiguous language of Section 365(c).[7] The division primarily concerns whether and under what conditions a debtor-licensee may assume or assign an intellectual property license.[8] Depending on the jurisdiction where the debtor has filed for bankruptcy protection, the court may administer one of two tests—the so-called "hypothetical test" or the "actual test."[9] The "hypothetical test" provides that a debtor-licensee may not assume an intellectual property license where applicable non-bankruptcy law would otherwise prohibit assignment without the consent of the licensor.[10] This holds true even when the debtor-in-possession indicates no interest in assigning the license. Under this test, if the debtor-licensee "lacks hypothetical authority to assign a contract, then it may not assume it—even if the debtor-in-possession has no *actual* intention of assigning the contract to another."[11] The "hypothetical test" has been adopted by the Third, Fourth, Ninth, and Eleventh Circuits.[12]

Alternatively, under the "actual test" approach, the court permits a debtor-licensee to assume an intellectual property license over the objections of the licensor where the debtor seeks only to assume the intellectual property license and has not contemplated assignment to a third party.[13] The "actual test" is used by the First and Fifth Circuits, as well as by lower courts in the Eighth and Tenth Circuits.[14]

This split of authority was recently left unresolved when the United States Supreme Court denied certiorari in *N.C.P. Marketing Group, Inc. v. BG Star Productions, Inc. (N.C.P. Marketing)*.[15] In this case, discussed in greater detail later in this Note, the United States District Court for the District of Nevada relied on the Ninth Circuit's prior interpretation of the language of 11 U.S.C. § 365(c)(1) in relation to copyrights and patents, and extended this interpretation to trademarks.[16] This interpretation provided that copyrights, patents, and now trademarks, "are personal and assignable only with the consent of the licensor and therefore unassumable under section 365(c)(1)."[17]

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[7] Neil S. Hirshman, Michael G. Fatall & Peter M. Spingola, *Is Silence Really Golden? Assumption and Assignment of Intellectual Property Licenses in Bankruptcy*, 3 HASTINGS BUS. L.J. 197, 212–15 (2007).

[8] Cooke, *supra* note 5, at 223; Hirshman, Fatall & Spingola, *supra* note 7, at 198.

[9] Knapp, *supra* note 5, at 29; Hirshman, Fatall & Spingola, *supra* note 7, at 213–14.

[10] Hirschman, Fatall & Spingola, *supra* note 7, at 213.

[11] N.C.P. Marketing Group, Inc. v. BG Star Prods., 279 Fed. Appx. 561 (9th Cir.), *cert. denied*, 129 S. Ct. 1577, 1577 (2009).

[12] *Supreme Court Leaves Circuits Split on Whether Intellectual Property Licenses Can Be Assumed in Bankruptcy*, CLIENT ALERT: INTELLECTUAL PROPERTY AND FINANCIAL RESTRUCTURING PRACTICE GROUPS (King & Spalding, Atlanta, GA) Apr. 1, 2009, at 1, *available at* http://www.kslaw.com/library/publication/ca040109.pdf [hereinafter King & Spalding].

[13] Hirshman, Fatall & Spingola, *supra* note 7, at 213–14.

[14] King & Spalding, *supra* note 12, at 2.

[15] 129 S. Ct. 1577 (2009).

[16] N.C.P. Mktg. Group v. Blanks (*In re* N.C.P. Mktg. Group), 337 B.R. 230, 235–37 (D. Nev. 2005).

[17] *Id.* at 235.

Under the "hypothetical test" adopted by the Ninth Circuit, a debtor-in-possession may assume an executory contract only if it might hypothetically, under applicable non-bankruptcy law, assign that contract to a third party.[18] The District Court held that trademark licenses are "personal and non-assignable without the consent of the licensor."[19] The court further held that the trademark license at issue was unassumable by the debtor-in-possession without the consent of the non-debtor licensor.[20] The Ninth Circuit Court of Appeals affirmed this decision.[21]

The United States Supreme Court subsequently denied certiorari in the case on March 23, 2009.[22] Justice Kennedy, with Justice Breyer joining, issued a statement regarding the denial of certiorari.[23] In this statement, Justice Kennedy noted that the "hypothetical test is not . . . without its detractors."[24] Describing a myriad of problems associated with both the "hypothetical" and "actual tests," Justice Kennedy concluded by noting that "[t]he division in the courts over the meaning of § 365(c)(1) is an important one to resolve"[25] and urged the Court to "[i]n a different case . . . consider granting certiorari on this significant question."[26]

N.C.P. Marketing may have fared differently in this case were it located in the First or Fifth Circuit, where the "actual test" provides that a debtor-licensee may assume an intellectual property license over the objections of the licensor when the debtor-licensee does not intend to assign the license to a third party.[27] As a result of this continuing circuit split, the disposition of cases involving the treatment of intellectual property licenses in bankruptcy is largely determined by the jurisdiction where the bankruptcy petition is filed.

This Note examines the split in authority regarding the treatment of intellectual property licenses by individuals and corporations seeking Chapter 11 bankruptcy protection. This examination centers largely on the underlying, often competing, policy considerations and principles of intellectual property law and bankruptcy law. This Note concludes that the "actual test" is the superior doctrinal test for the advancement and promotion of the underlying principles of both intellectual property and bankruptcy law. Part II provides a general overview of Chapter 11 bankruptcy, including relevant statutes, the purpose of the Chapter 11 protection, and the simple mechanics of a Chapter

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18 *Id.* at 234–35.

19 *Id.* at 237.

20 *Id.*

21 N.C.P. Mktg. Group v. BG Star Prods., 279 Fed. Appx. 561 (9th Cir. 2008), *cert. denied*, 129 S. Ct. 1577 (2009).

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.* at 1578.

26 *Id.* at 1577.

27 *See* Hirshman, Fatall & Spingola, *supra* note 7, at 213.

11 bankruptcy filing. Part III provides an analysis of the two tests employed by the courts to determine whether a debtor-in-possession may assume an intellectual property license over the objections of the non-debtor licensor. Included in this analysis are cases to illustrate the application of the tests, elements of the tests, and relevant interpretations of the statutory language to justify a particular approach. Shortcomings of both the "hypothetical" and the "actual" tests are highlighted. The pragmatic consequences of the circuit split are further detailed, including the potential for forum-shopping, differential protection, effects on lending and capital, and inefficiencies and related legal costs. Significant attention is given to the underlying policy considerations of both intellectual property law and bankruptcy law, demonstrating that principles of both areas of law may be best satisfied through uniform adoption of the "actual test" in the determination of intellectual property license assumption and assignment. Finally, Part IV summarizes the effect of the split of authority at this intersection of bankruptcy and intellectual property law and presents the reasons why the court should settle this question.

II. BACKGROUND

A. CHAPTER 11 BANKRUPTCY: AN OVERVIEW

The institution of bankruptcy protection has a long and rich history in the United States. Indeed, the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States" is one of the enumerated powers of Congress included in Article I, Section 8 of the Constitution of the United States.[28] On the inclusion of the bankruptcy clause in the Constitution, James Madison wrote:

> The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question.[29]

From its establishment, debtor protection through the formal institution of bankruptcy, codified under Title 11 of the United States Code and commonly known as the "Bankruptcy Code,"[30] has embodied the principle that commerce in general, from the perspective of not only the debtor but also creditors, is better served by permitting debtors occasional and regulated debt relief than by permitting individuals and businesses to fail.

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[28] U.S. CONST. art. I, § 8, cl. 2.

[29] JAMES MADISON, THE FEDERALIST NO. 42 (Ian Shapiro ed., 2009).

[30] 11 U.S.C. §§ 101–1532 (2006).

The Bankruptcy Code is organized into various chapters, including six chapters under which a debtor may file bankruptcy.[31] These chapters address the particular needs of certain classes of debtors and provide a range of statutory relief options. Chapter 11 of the United States Bankruptcy Code, the chapter this Note addresses, provides businesses, and some individuals, the opportunity to reorganize and restructure debts, or to engage in a process of managed liquidation of property.[32] Chapter 11 is grounded in the principle that business survival, that is, continued operation and productivity, through reorganization is generally preferable to the forced liquidation of a failed business' assets for the benefit of its creditors.[33] Chapter 11 provides wide debtor protection under the assumption that "greater value may be derived from the debtor's assets when coordinated as an operating synergistic business than would result from piecemeal liquidation."[34] Simply put, a creditor to a debtor in Chapter 11 bankruptcy should generally fare better by recovering more of that which is owed to them under the debtor's reorganization plan than they would have if the debtor had simply ceased operation of its business.

Toward this end of "synergistic business"[35] operation, an estate is automatically created under 11 U.S.C. § 541 upon the commencement of a bankruptcy case.[36] The purpose of this estate is to "allow for the effective management of the debtor's assets."[37] In a Chapter 11 bankruptcy, the estate is most often managed by the debtor as the debtor-in-possession, but may alternatively be managed by a trustee should the court find it necessary to appoint one.[38] The debtor-in-possession or trustee, as fiduciary, is charged with protecting the property of the estate.[39] Toward this end, the debtor-in-possession or trustee is empowered to sell or lease non-cash-collateral property,[40] and to assume or reject executory contracts.[41]

B. AUTOMATIC STAY

Upon commencement of a Chapter 11 bankruptcy case, an automatic stay is imposed on all actions by creditors to collect pre-petition claims from the debtor or to seize or otherwise interfere with property of the estate.[42] There are

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31 *Id.* § 103.
32 7 COLLIER ON BANKRUPTCY ¶ 1100.01 (15th ed. 2004).
33 7 *id.*
34 Cooke, *supra* note 5, at 217.
35 *See id.*
36 11 U.S.C. § 541 (2006).
37 Cooke, *supra* note 5, at 216.
38 11 U.S.C. § 1104 (2006).
39 *Id.* § 1107.
40 *Id.* § 363(b)–(c).
41 *Id.* § 365.
42 *Id.* § 362.

exceptions to the universe of actions covered by the automatic stay[43] and some creditors are, additionally, able to petition the court for relief from stay.[44] The court may grant relief from stay either "for cause, including the lack of adequate protection of an interest in property of such party in interest."[45] Relief may further be granted when the court determines that the debtor has no equity in the property at issue[46] or that the property is "not necessary to an effective reorganization."[47] There are additional grounds for granting relief from stay with regard to real property.[48] If the court does not grant relief from the automatic stay while the bankruptcy is pending, the stay generally continues until the property ceases to be property of the estate,[49] the case is closed,[50] the case is dismissed,[51] or discharge is either granted or denied.[52]

The automatic stay provisions and other protections of the Bankruptcy Code are provided to allow debtors the opportunity to formulate a plan for reorganization "that will enable the debtor to emerge from bankruptcy as a viable, profitable enterprise."[53] Once this plan for reorganization has been developed, it is submitted to creditors and equity holders of the debtor, who must vote to accept or reject the plan.[54] The plan is then forwarded to the court for confirmation[55] and, once and if confirmed, implemented by the debtor and any other entity organized for the purpose of carrying out the plan.[56]

C. INTELLECTUAL PROPERTY AND EXECUTORY CONTRACTS IN BANKRUPTCY

A central element of Chapter 11 bankruptcy is the presumptive right of the individual debtor to retain its pre-petition property.[57] Property of the bankruptcy estate may include property inherent in an object or thing, such as real property and patents, or property arising from executory contracts, such as licenses and leases.[58] Of particular relevance to this Note is property in the

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[43] *See id.* § 362(b).
[44] *Id.* § 362(d).
[45] *Id.* § 362(d)(1).
[46] *Id.* § 362(d)(2)(A).
[47] *Id.* § 362(d)(2)(B).
[48] *Id.* § 362(d)(3)–(4).
[49] *Id.* § 362(c)(1).
[50] *Id.* § 362(c)(2)(A).
[51] *Id.* § 362(c)(2)(B).
[52] *Id.* § 362(c)(2)(C).
[53] H.R. REP. NO. 95-595, at 340 (1977); 7 COLLIER ON BANKRUPTCY ¶ 1100.09 (15th ed. 2004).
[54] 11 U.S.C. § 1126 (2006).
[55] *Id.* § 1129.
[56] *Id.* § 1142.
[57] *Id.* § 541. *See also* 7 COLLIER ON BANKRUPTCY ¶ 1115.01 (15th ed. 2004) (noting the significant advantage the right to remain in possession of the property of the estate affords to a Chapter 11 individual debtor over the individual Chapter 7 debtor).
[58] Cooke, *supra* note 5, at 216.

form of intellectual property licenses held by the Chapter 11 debtor. Within the Bankruptcy Code, intellectual property is defined as follows:

> The term "intellectual property" means — (A) trade secret; (B) invention, process, design, or plant protected under title 35; (C) patent application; (D) plant variety; (E) work of authorship protected under title 17; or (F) mask work protected under chapter 9 of title 17; to the extent protected by applicable nonbankruptcy law.[59]

A debtor's intellectual property rights are generally treated like other property of the estate, subject, *inter alia*, to the use, sale, and lease provisions of 11 U.S.C. § 363 to the extent permitted under relevant nonbankruptcy law.[60] A more complicated issue arises when the debtor in Chapter 11 bankruptcy enters bankruptcy protection as a licensee of intellectual property.

D. LICENSES

Most courts have treated non-exclusive licenses of intellectual property as executory contracts.[61] Non-exclusive licenses grant personal, as opposed to property interests, and do not preclude the licensing of the same product or property to third parties.[62] In general, non-exclusive licenses of intellectual property are treated as executory contracts, but exclusive licenses of intellectual property are not.[63] Section 365 of the Bankruptcy Code governs the treatment of all executory contracts in bankruptcy.[64] Though "executory contract" is not defined in the Code, it is generally held to denote a contract that, "at the time of the filing of the bankruptcy petition is 'so far unperformed that the failure of either [party] to complete performance would constitute a material breach excusing the performance of the other.' "[65] Section 365 permits the debtor or trustee, "subject to the court's approval," to "assume or reject any executory contract or unexpired lease of the debtor."[66] The primary purpose of extending such power to the debtor is to "relieve the [debtor] of burdensome obligations while at the same time providing 'a means whereby a debtor can force others to continue to do business with it when the bankruptcy filing might otherwise

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[59] 11 U.S.C. § 101(35A) (2006).
[60] *Id.* § 363. *See also* Cooke, *supra* note 5, at 217–18.
[61] Hirshman, Fatall & Spingola, *supra* note 7, at 211.
[62] *In re* Golden Books Family Entm't, Inc., 269 B.R. 300, 309–10 (Bankr. D. Del. 2001).
[63] *Id.* at 310.
[64] 11 U.S.C. § 365 (2006).
[65] Cooke, *supra* note 5, at 218 (quoting Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 436, 460 (1973)).
[66] 11 U.S.C. § 365(a) (2006).

make them reluctant to do so."[67] That is, if the executory contract to which the debtor is a party provides revenue and reputation to the debtor, other parties are likely to feel greater confidence in a decision to conduct business with the debtor. This improved good will may well lead to the debtor's effective reorganization and continued survival, if not its eventual success.

If an executory contract is in default and a debtor-in-possession or trustee wishes to assume the contract, certain criteria must be met. The trustee must cure all defaults in the contract,[68] provide compensation or assurance of compensation for actual pecuniary loss resulting from any default,[69] and provide "adequate assurance of future performance under" the contract.[70] Assumption of the executory contract binds the debtor-in-possession to the terms of that contract as that debtor moves forward out of bankruptcy.[71] Alternatively, assignment of the executory contract absolves the debtor-in-possession of future obligations under the contract in the creation of a new contract between the non-debtor party and a third-party assignee.[72] A debtor-in-possession or trustee may assign an executory contract of the debtor if in the contract it is assumed in accordance with the requirements of Section 365(b)[73] and "adequate assurance of future performance by the assignee is provided."[74] Finally, the trustee may, subject to the court's approval, reject the executory contract all together.[75] "Rejection" is not specifically defined by the Bankruptcy Code, but is considered to simply mean "a bankruptcy estate's decision not to assume [the contract], because the contract or lease does not represent a favorable or appropriate investment of the estate's resources."[76]

E. ASSIGNMENT, ASSUMPTION, AND REJECTION OF INTELLECTUAL PROPERTY LICENSES

While Section 365 of the Bankruptcy Code generally furthers the debtor-friendly principles underlying Chapter 11 bankruptcy protection in permitting the debtor to absolve itself of burdensome contractual obligations and to assume those of value, subsections 365(c), 365(e), and 365(n) reflect a deference

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[67] Chateaugay Corp. v. LTV Steel Co. (*In re* Chateaugay Corp.), 10 F.3d 944 (2d Cir. 1993) (quoting Richmond Leasing Co. v. Capital Bank, N.A., 762 F.2d 1303, 1310 (5th Cir. 1985) (per curiam)).

[68] 11 U.S.C. § 365(b)(1)(A) (2006).

[69] *Id.* § 365(b)(1)(B).

[70] *Id.* § 365(b)(1)(C).

[71] Knapp, *supra* note 5, at 29.

[72] *Id.*

[73] 11 U.S.C. § 365(f)(2)(A) (2006).

[74] *Id.* § 365(f)(2)(B).

[75] *Id.* § 365(a).

[76] Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 59 U. COLO. L. REV. 845, 848 (1998).

to the principles that underlie intellectual property law.[77] Section 365(n), added to the Bankruptcy Code by the Intellectual Property Bankruptcy Protection Act of 1988,[78] provides a non-debtor licensee of intellectual property certain protections in the event that the trustee rejects an executory contract in which the debtor is the licensor of the intellectual property.[79]

In the alternative scenario, and the focus of this Note, in which the debtor is the *licensee* of intellectual property, Section 365(c) is controlling. Section 365(c) provides, in relevant part, the following:

> The trustee may not assume or assign any 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 (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (B) such party does not consent to such assumption or assignment . . . .[80]

It is the interpretation of this statutory language that has lead to the circuit split and the development of competing tests that are the focus of this Note.

Courts have employed two primary and competing tests to determine whether an intellectual property license, as an executory contract, may be assumed under the statutory language of Section 365(c): the so-called "hypothetical test" and the "actual test."[81] The "hypothetical test" is the majority test, employed most notably by the Third, Ninth, and Eleventh Circuit Courts of Appeals,[82] and to some extent by the Fourth Circuit.[83] The "actual

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[77] 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(c), 365(e), and 365(n) of the Bankruptcy Code*, 8 AM. BANKR. INST. L. REV. 307, 314 (2000).

[78] Pub. L. No. 100-506, 102 Stat. 2538 (1988) (codified as amended at 11 U.S.C. § 365(n)).

[79] 11 U.S.C. § 365(n) (2006).

[80] *Id.* § 365(c).

[81] Primoff & Weinberger, *supra* note 77, at 331–33; Hirshman, Fatall & Spingola, *supra* note 7, at 212.

[82] Primoff & Weinberger, *supra* note 77, at 331. *See, e.g.*, Perlman v. Catapult Entm't, Inc., 165 F.3d 747 (9th Cir. 1999); City of Jamestown v. James Cable Partners, L.P., 27 F.3d 534 (11th Cir. 1994); *In re* West Elecs., Inc., 852 F.2d 79 (3d Cir. 1988).

[83] *See, e.g.*, Breeden v. Catron (*In re* Catron), 158 B.R. 629 (E.D. Va. 1993), *aff'd per curiam*, 25 F.3d 1038 (4th Cir. 1994); RCI Tech. Corp. v. Sunterra Corp. (*In re* Sunterra Corp.), 361 F.3d 257 (4th Cir. 2004).

test" is the minority test, and is employed primarily by the United States District Court of Appeals for the First Circuit.[84]

F. "HYPOTHETICAL TEST"

1. *Elements of the Test.* The majority of courts interpret the ambiguous language of Section 365(c) to provide that a debtor-licensee may not assume an intellectual property license where applicable nonbankruptcy law, here copyright, patent, and trademark law, prohibits *assignment* of a license without the consent of the licensor, regardless of the intentions of the debtor to ever assign the license.[85] Under the "hypothetical test," the court creates a hypothetical third party for the purposes of the analysis.[86] If the licensor of the intellectual property could lawfully refuse assignment to this hypothetical third party under nonbankruptcy law, the debtor-licensee is not only barred from assigning the license without the licensor's consent, but is also prohibited from assuming (retaining) the license.[87] The contract is, thus, effectively terminated, even when the debtor-licensee has no intention of assigning the contract in question to a third party.

Beyond the general use or positive treatment of the "hypothetical test" by the Third, Ninth, and Eleventh Circuits, the Fourth Circuit has gone so far as to hold that a non-exclusive intellectual property license (copyright) that expressly permitted assignment under certain conditions was not assumable without the licensor's express consent.[88]

2. *Policy Considerations and Objectives.* Courts employing the "hypothetical test" interpret the statutory language of Section 365(c) by its "plain meaning."[89] In doing so, the subscribing courts:

> [D]isdain to construe the "or" to mean "and" in the phrase "assume or assign," and they apply the language "assume or assign" literally as it is written, reasoning that if the statute as written produces results which seem at odds with the basic objectives of the Bankruptcy Code, the remedy lies with Congress, not the courts.[90]

The "hypothetical test" approach thus embodies both a plain meaning statutory interpretation rule as well as deference to Congress.

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[84] Primoff & Weinberger, *supra* note 77, at 332; Hirshman, Fatall & Spingola, *supra* note 7, at 213. *See, e.g.*, Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489 (1st Cir. 1997).

[85] Hirshman, Fatall & Spingola, *supra* note 7, at 213.

[86] *Id.*

[87] Primoff & Weisenberger, *supra* note 77, at 331; Hirshman, Fatall & Spingola, *supra* note 7, at 213.

[88] *In re* Sunterra Corp., 361 F.3d 257 (4th Cir. 2004).

[89] *In re* Footstar, Inc., 323 B.R. 566, 570 (Bankr. S.D.N.Y. 2005).

[90] *Id.*

Beyond concern for the plain language of the Bankruptcy Code, courts using the hypothetical approach also emphasize intellectual property law values. These courts are particularly concerned that licensors of intellectual property maintain a significant level of control over their property, and that the system by which invention and creation are incentivized is not undermined by any threat to this control.[91]

3. Application: Harris v. Emus Records. In *Harris v. Emus Records Corp.*,[92] singer and songwriter Emmylou Harris (Harris) entered into an agreement with the Jay-Gee Record Company (Jay-Gee) in which she agreed to record songs for the company in exchange for certain royalties.[93] Under this agreement, Harris recorded six songs that were produced as an album entitled "Gliding Bird" and released by Jay-Gee in 1968.[94] Of the six songs on the album, five were written and composed by Harris and one, the title track, was composed by a third party, Tommy Slocum.[95] In 1971, Jay-Gee filed for bankruptcy.[96] A year later, the trustee in the Jay-Gee bankruptcy case sold assets of the debtor, including the master tape of the original songs included on the Gliding Bird album.[97] The songs were sold to Suellen Productions, Inc., which subsequently transferred its rights to produce and distribute the songs and album to Emus Recordings (Emus).[98] Emus re-released the Gliding Bird album in 1979, albeit with a different cover and serial number.[99]

Because Harris had never received royalties for the re-released Gliding Bird album, she demanded that Emus cease the manufacture and distribution of the songs. Harris also sued for copyright infringement. Harris prevailed on her infringement claim in district court and Emus was enjoined from further distribution of the Gliding Bird album.[100] In affirming this decision, the United States Court of Appeals in the Ninth Circuit held, as a matter of first impression, copyright licenses to be non-transferable as a matter of law.[101] Citing similar policy concerns as those later articulated in *In re* CFLC, Inc.,[102] the Court looked to the legislative history of the Copyright Act, concluding:

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[91] *See, e.g.*, Everex Systems, Inc. v. Cadtrak Corp. (*In re* CFLC, Inc.), 89 F.3d 673, 679 (9th Cir. 1996) (holding that the free assignability of nonexclusive patent licenses would "undermine the reward that encourages invention"); Harris v. Emus Records Corp., 734 F.2d 1329, 1334 (9th Cir. 1984) (noting the "awareness" in the legislative history of federal copyright law of "the necessity of preserving the rights of authors and composers in order to stimulate creativity").

[92] 734 F.2d 1329 (9th Cir. 1984).

[93] *Id.* at 1331.

[94] *Id.*

[95] *Id.*

[96] *Id.* at 1332.

[97] *Id.*

[98] *Id.*

[99] *Id*

[100] *Id.*

[101] *Id.* at 1333.

[102] Everex Systems, Inc. v. Cadtrak Corp. (*In re* CFLC, Inc.), 89 F.3d 673 (1996).

> The legislative history reveals an acute awareness of the need to delicately balance competing interests. On the one hand, there was a strong reluctance to allow a monopolization of works or compositions; at the same time, there was an awareness of the necessity of preserving the rights of authors and composers in order to stimulate creativity.[103]

The Court further concluded that, in assignment by a licensee rather than licensing by the copyright owner, the ability of the copyright owner to monitor use and collect royalties is undermined.[104]

4. *Application:* Everex Systems, Inc. v. Cadtrak Corp. In 1996, the United States Court of Appeals for the Ninth Circuit, in *Everex Systems, Inc. v. Cadtrak Corp.* (*In re* CFLC, Inc.), held that because Section 365(c) barred the debtor-licensee from assigning a patent license, the debtor-licensee was also barred from assuming the license in bankruptcy.[105] In this case, Cadtrak Corporation held a patent for a certain computer graphics technology. In 1986, and again in 1989 as a supplemental agreement, Cadtrak entered into a license agreement with CFLC (to become Everex Systems, Inc.), a personal computer company. CFLC received a royalty-free, worldwide, non-exclusive license related to the patent and, in exchange, Cadtrak received a one-time $290,000 payment.[106] The terms of the license agreement specifically provided that the license was non-transferable, that CFLC did not retain the right to sublicense the property, and that the license agreement could be terminated upon CFLC's bankruptcy.[107]

CFLC subsequently filed for bankruptcy under Chapter 11 in January 1993.[108] After liquidating most of its divisions, CFLC sold its remaining assets, including the opportunity, with court approval, to assume and assign certain executory contracts to Everex Systems, Inc. (Everex) in November 1993 for approximately $4 million.[109] Among these contracts was the license agreement with Cadtrak.[110] In January 1994, CFLC sought to assume and assign various executory contracts, including the Cadtrak license, prompting an objection by Cadtrak. The bankruptcy court denied the assumption and assignment. Everex and CFLC appealed to the district court, which affirmed the bankruptcy court's denial.[111]

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103 *Harris*, 734 F.2d at 1334 (citing H.R. REP. NO. 60-2222, at 7 (1909)).
104 *Id*
105 89 F.3d 673, 673 (1996).
106 *Id.* at 674.
107 *Id.* at 674–75.
108 *Id.* at 675.
109 *Id.*
110 *Id.*
111 *Id.*

On appeal the Court of Appeals held that a "nonexclusive patent license is personal and nondelegable"[112] under federal patent law, and that Section 365(c) specifically barred the assumption and assignment of the CFLC license.[113] The *In re CFLC, Inc.* decision is particularly notable in its conclusion that "federal law governs the assignability of patent licenses because of the conflict between federal patent policy and state laws . . . that would allow assignability."[114] Though the Bankruptcy Code generally allows for the assignment of an executory contract even when that contract contains a "no-assign" provision, as here, the non-bankruptcy law that would prevent such an assignment of a patent license is the "longstanding rule of federal common law [that] bars assignment unless the license says otherwise."[115]

The Court warned of the dangers of allowing states to permit the free assignability of non-exclusive patent licenses, stating that to do so "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."[116] The court warned that under such a scenario, the licensees of a patent license become competitors to the licensor, and that the licensor loses its ability to control the "*identity* of its licensees."[117]

G. "ACTUAL TEST"

1. *Elements of the Test.* Under the "actual test" employed by a minority of circuit courts, but by a majority of lower courts,[118] the relevant question when determining whether a license is assignable is not whether relevant nonbankruptcy law would prohibit the assignment of such a license to a hypothetical third party, as it is under the "hypothetical test," but whether an assignment would actually occur, causing the licensor to accept performance from a third party.[119] Under this actual approach, courts permit a debtor-licensee to assume an intellectual property license when that debtor does not contemplate assignment to a third party, even in those circumstances in which the licensor objects to such assumption.[120] In contrast to the "hypothetical

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112 *Id.* at 677.

113 *Id.* at 679–80.

114 *Id.* at 679.

115 Matt Siegel, *Why the Ninth Circuit Decided* Everex *as if Every Patent Licensee in America Were Destined for Bankruptcy*, 70 BROOK. L. REV. 423 (2005).

116 Everex Systems v. Cadtrak Corp. (*In re* CFLC, Inc.), 89 F.3d 673, 679 (1996) (emphasis in original).

117 *Id.*

118 *In re* Footstar, Inc., 323 B.R. 566, 569 (Bankr. S.D.N.Y. 2005) (citing various decisions demonstrating this divide).

119 *See* Primoff & Weinberger, *supra* note 77, at 332–33; Knapp, *supra* note 5, at 29; Hirshman, Fatall & Spingola, *supra* note 7, at 213–14.

120 Hirshman, Fatall & Spingola, *supra* note 7, at 213–14.

test," courts employing the "actual test" do not consider the hypothetical scenario of assignment when there is no intention of assignment at the time of assumption.[121]

2. *Policy Considerations and Objectives.* The "actual test" approach has been criticized as contrary to or a rejection of the plain language of Section 365(c) of the Bankruptcy Code.[122] Proponents of the "actual test" approach, however, laud its pragmatism.[123] Those courts employing the "actual test" stress not only this pragmatism and focus on the actual intentions of the debtor-licensee, but also emphasize traditional bankruptcy law values. These courts are specifically concerned with the survival of the debtor-business where such survival depends on the ability of the debtor-licensee to continue to use licensed intellectual property. These courts emphasize:

> [T]he fact that a literal interpretation of the disjunctive "or" is utterly incongruent with the objectives of the Bankruptcy Code and would lead to the anomalous result that a debtor in possession would be deprived of its valuable but unassignable contract solely by reason of having sought the protection of the Bankruptcy Court, even though it did not intend to assign it.[124]

3. *Application:* Institut Pasteur v. Cambridge Biotech Corp. In *Institut Pasteur v. Cambridge Biotech Corp.*, Cambridge Biotech Corporation (CBC) manufactured and sold diagnostic testing kits to detect the human immunodeficiency virus (HIV).[125] To accomplish this work CBC entered into various cross-license agreements in 1989 with Pasteur Sanofi Diagnostics (Pasteur), which held the exclusive right to use and sublicense patents of the Institut Pasteur, a nonprofit foundation engaged in AIDS-related research and development that held several patents for procedures to diagnose a particular type of the HIV virus, HIV-2.[126] Under these cross-licenses, CBC acquired the right to use these patented diagnostic procedures in diagnostic kits it developed and sold in several countries, including the United States.[127] In exchange, Pasteur acquired the right to use various technologies patented or licensed by CBC.[128] Though the cross-license agreements specifically barred either party from assigning or sublicensing these rights to third parties, both CBC and Pasteur retained the

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[121] *Id.* at 214.

[122] Knapp, *supra* note 5, at 29; Primoff & Weinberger, *supra* note 77, at 332–33. *See, e.g.*, Pearlman v. Catapult Entm't, Inc. (*In re* Catapult Entm't, Inc.), 165 F.3d 747, 754 (9th Cir. 1999) (asserting that an actual test approach amounts to a judicial revision of Section 365(c)).

[123] Knapp, *supra* note 5, at 29; Primoff & Weinberger, *supra* note 77, at 332–33.

[124] *In re* Footstar, Inc., 323 B.R. 566, 570 (Bankr. S.D.N.Y. 2005).

[125] 104 F.3d 489 (1st Cir. 1997).

[126] *Id.* at 490.

[127] *Id.*

[128] *Id.*

benefits of the license agreements to "affiliated companies," defined as "organization[s] which [control] or [are] controlled by a party or an organization which is under common control with a party."[129]

While still holding these cross-licenses, CBC filed for bankruptcy under Chapter 11 in 1994, and continued, as debtor-in-possession, to operate its business.[130] In the process of its reorganization, CBC sought to assume the cross-licenses it held with Pasteur and continue in the manufacturing and selling of retroviral tests.[131] CBC also proposed in its reorganization plan to sell all CBC stock to a subsidiary of bioMerieux, a competitor of Pasteur.[132] Pasteur objected to the reorganization plan, arguing that such assumption of the cross-licenses by CBC and *de facto* assignment to a third party, bioMerieux, would violate not only the explicit terms of the cross-licenses with respect to assignability, but also the presumption of nonassignability of patents in federal common law.[133] Pasteur asserted that it would not extend such a license, under the terms provided by CBC, to its direct competitor.[134]

The bankruptcy court, over the objections of Pasteur, permitted CBC to assume the cross-licenses as part of its reorganization plan, holding that such a sale to bioMerieux did not constitute an assignment, but rather an assumption of the license by the debtor-in-possession under new ownership, as permitted by Section 365(c).[135] The First Circuit Court of Appeals subsequently affirmed this decision of the bankruptcy court.[136]

Following its previous rejection of the "hypothetical test,"[137] the court employed the "actual test" (which it refers to as the "actual performance test"[138]) to determine whether Pasteur was actually being denied the full benefit of its bargain with the debtor-licensee. The Court articulated the test as follows:

> Where the particular transaction envisions that the debtor-in-possession would assume and continue to perform under an executory contract, the bankruptcy court cannot simply presume as a matter of the law that the debtor-in-possession is a legal entity *materially* distinct from the prepetition debtor with whom the nondebtor party . . . contracted. Rather, "sensitive to the rights of

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129 *Id.*
130 *Id.*
131 *Id.*
132 *Id.*
133 *Id.* at 490–91.
134 *Id.*
135 *Id.* at 491.
136 *Id.* at 489.
137 *Id.* at 493, referring to its decision in Summit Inv. & Dev. Corp. v. Leroux (*In re* Leroux), 69 F.3d 608 (1st Cir. 1995).
138 *Id.*

> the nondebtor party . . ." the bankruptcy court must focus on the performance actually to be rendered by the debtor-in-possession with a view to ensuring that the nondebtor party . . . will receive the "full benefit of [its] bargain."[139]

With its focus on the actual intentions of the debtor-licensee with respect to assignment, the court held that CBC was permitted to assume the cross-licenses at issue in bankruptcy, despite the objections of licensor Institut Pasteur.

4. *Application: In re* Footstar, Inc. In 2005, the United States Bankruptcy Court for the Southern District of New York, while not determining the fate of an intellectual property license in bankruptcy, articulated more fully the policy concerns underlying this issue of assumption and assignment of licenses as executory contracts in bankruptcy.[140] More importantly, the Court provided an alternative interpretation of the language of Section 365(c).[141] In *In re Footstar, Inc.*, the debtor operated both a discount and family footwear business, and an athletic apparel and footwear business.[142] After filing for bankruptcy under Chapter 11, the debtor-in-possession continued to operate its discount and family footwear division, known as Meldisco.[143] Almost all of the revenue received by Meldisco came from operation of footwear departments located inside Kmart retail stores.[144] An outside "Shoemart Corporation" operated shoe departments inside Kmart stores.[145] Footstar/Meldisco owned fifty-one percent of Shoemart Corporation, while Kmart owned the remaining forty-nine percent.[146] Under sub-agreements with Kmart, Shoemart Corporation, and thus Footstar/Meldisco, held the exclusive right to operate the shoe departments in over 1,500 Kmart stores.[147] In Chapter 11 bankruptcy, Footstar sought to assume these licenses.[148]

The Court permitted the debtor to assume the licenses in bankruptcy, asserting that "nothing in the Bankruptcy Code" would prohibit such an assumption.[149] Here, the Court declared its preference for the practical results of the application of the "actual test" as opposed to the "hypothetical test" in determining whether an executory contract may be assumed by a debtor,[150] and

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[139] *Id.* (quoting NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528, 612–13 (1984) (emphasis in original)).
[140] *In re* Footstar, Inc., 323 B.R. 566 (Bankr. S.D.N.Y. 2005).
[141] *Id.*
[142] *Id.*
[143] *Id.* at 568.
[144] *Id.* at 566.
[145] *Id.*
[146] *Id.*
[147] *Id.*
[148] *Id.* at 568.
[149] *Id.* at 570.
[150] *Id.*

also put forth a "somewhat different focus for analysis of Section 365."[151] The Court asserts that the plain language of Section 365(c) is intended to apply only to the trustee in a bankruptcy estate, should one be appointed, and not to the debtor-in-possession. To read the statute otherwise, according to the Court, would be to "defy the 'plain meaning' of the statute as written by Congress"[152] and would result in the same sort of "judicial legislation" feared by proponents of the hypothetical test.[153] The Court notes that Congress "has been quite careful" in discriminating between a trustee and a debtor-in-possession.[154] When this distinction is appreciated, the Court asserts that any concern that a licensor may be forced to accept performance from a third-party is not relevant where a debtor-in-possession assumes an executory contract.[155] When a trustee is appointed to a Chapter 11 estate, the debtor ceases to be a debtor-in-possession and the trustee assumes all the rights and property of the estate.[156] In this situation, then, the Court states that "it makes perfect sense to say that the trustee may not assume the contract, and also that the trustee may not assign it,"[157] for this would oblige the licensor to accept performance from a party with which it did not contract. When the debtor-in-possession, however, assumes the license, this does not force the licensor to accept performance from a third party.[158] The Court states, "the basic objective of Section 365(c)(1)—to protect the contract counterparty [licensor] from unlawful assignment of the contract—simply is not implicated when a debtor in possession itself seeks to assume, but not assign, the contract."[159]

In providing this analysis, the Court notes that the "hypothetical test" may yield the "perverse and anomalous consequence" of the debtor losing a non-assignable contract—a contract it was once a party to—in bankruptcy when that contract is critical to its survival.[160] Thus, in holding that Footstar/Meldisco was not prohibited from assuming its contract with Kmart as a debtor-in-possession, the Court not only rejects the "hypothetical test" for its consequences that are contrary to the purpose of the Bankruptcy Code,[161] but also seriously calls into question a reading of Section 365(c) that applies to both a trustee and a debtor-in-possession. In doing so, the decision in *In re Footstar*, subsequently followed in both the Second[162] and Tenth[163] Circuit

[151] *Id.*
[152] *Id.*
[153] *Id.* at 570–71.
[154] *Id.* at 571.
[155] *Id.* at 573.
[156] *Id.* at 571.
[157] *Id.* at 573.
[158] *Id.*
[159] *Id.* at 573–74.
[160] *Id.* at 574.
[161] *Id.*
[162] *In re* Adelphia Commc'ns Corp., 359 B.R. 65 (Bankr. S.D.N.Y. 2007).

Bankruptcy Courts, has ushered in some hope for resolution of the persistent question of whether a non-exclusive license may be assumed in bankruptcy by a debtor-licensee.[164]

H. *N.C.P. MARKETING GROUP, INC. V. BG STAR PRODUCTIONS*

In March 2009, the United States Supreme Court denied certiorari in *N.C.P. Marketing Group, Inc. v. BG Star Productions* (*NCP Marketing*)[165] to the disappointment of many engaged in both intellectual property and bankruptcy law.[166] In denying certiorari, the Court left unresolved the split among circuits regarding the treatment of non-exclusive intellectual property licenses in bankruptcy. Despite the Court's denial of certiorari, *N.C.P. Marketing* may well come to mark a significant point in the resolution of the circuit split. In "reluctantly" agreeing to deny certiorari, Justice Kennedy, together with Justice Breyer, submitted a statement urging the Court to consider granting certiorari in a different, future case in order to resolve the "significant question" of how courts are to interpret the meaning of Section 365(c)(1).[167]

N.C.P. Marketing Group, Inc. (NCP) held a non-exclusive license to advertise and sell fitness-related products and services containing the "TaeBo" trademark, owned by Billy and Gayle Blanks through BG Star Productions (BG).[168] The relationship between the parties was governed by a Settlement Agreement confirming the Blanks' ownership of the trademark, signed in October 2001, and a License Agreement, signed in June 2002, establishing the parameters for how N.C.P. was to use the trademark.[169] Shortly after the signing of these agreements, N.C.P. materially breached both agreements in its failure to pay the Blanks agreed-upon royalties.[170] In response to the breach, an arbitrator ordered that N.C.P. pay the Blanks $2.1 million in royalties.[171] N.C.P. failed to pay this amount and instead filed for Chapter 11 bankruptcy in April 2004.[172]

In the plan for reorganization filed by N.C.P. with respect to its Chapter 11 bankruptcy, the debtor sought to assume the TaeBo license agreement as an

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[163] *In re* Aerobox Composite Structures, 373 B.R. 135 (Bankr. D.N.M. 2007).

[164] *See, e.g.*, David R. Kuney, *Restructuring Dilemmas for the High Technology Licensee: Will "Plain Meaning" Bring Order to the Chaotic Bankruptcy Law for Assumption and Assignment of Technology Licenses?*, 44 GONZ. L. REV. 123 (2008–2009).

[165] 129 S. Ct. 1577 (2009).

[166] *See, e.g.*, King & Spalding, *supra* note 12.

[167] *N.C.P. Mktg. Group, Inc.*, 129 S. Ct. at 1578.

[168] N.C.P. Mktg. Group, Inc. v. Blanks (*In re* N.C.P. Mktg. Group), 337 B.R. 230, 232 (D. Nev. 2005).

[169] *Id.* at 232–33.

[170] *Id.* at 233.

[171] *Id.*

[172] *Id.*

executory contract under Section 365(c).[173] The Blanks resisted such an assumption, asserting first that the debtor no longer owned the license right, and thus had no right to assume the license as all controlling agreements had been terminated for breach of contract.[174] The Blanks further asserted that, even if the debtor did own such rights, the license was non-assumable under applicable federal trademark law.[175] In affirming the decision of the Bankruptcy Court, the United States District Court in the District of Nevada found this second argument particularly compelling. The court concluded that applicable federal trademark law provides that "trademarks are personal and non-assignable without the consent of the licensor"[176] and, under the "hypothetical test" adopted in the Ninth Circuit, a debtor-in-possession may not assume such an executory contract in the face of licensor objections if such applicable law would bar assignment of such a license to a third party, even if the debtor-licensor has no intention of such assignment.[177] The court thus held that N.C.P. could not assume the license in bankruptcy without the consent of the Blanks.[178] This decision was subsequently affirmed without argument by the Court of Appeals for the Ninth Circuit.[179]

Though the Supreme Court denied certiorari in this case, Justice Kennedy's statement urging the Court to consider granting certiorari in a different case indicates that the issue of interpreting Section 365(c) of the Bankruptcy Code is "an important one to resolve for Bankruptcy Courts and for businesses that seek reorganization"[180] to at least some members of the sitting Court. Justice Kennedy notes that such an effort to address this issue may first require the resolution of "antecedent questions under state law and trademark-protection principles," though he does not specifically articulate those underlying issues.[181]

III. DISCUSSION

A. CONSEQUENCES OF THE CIRCUIT SPLIT

With the Supreme Court's denial of certiorari in *N.C.P. Marketing Group, Inc. v. BG Star Productions*, the split among circuits regarding the interpretation of Section 365(c) of the Bankruptcy Code remains intact. In the majority of circuits, the "hypothetical test" has been adopted and intellectual property

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173 *Id.*
174 *Id.*
175 *Id.*
176 *Id.* at 237.
177 *Id.* at 234–35.
178 *Id.* at 238.
179 N.C.P. Mktg. Group v. BG Star Prods., Inc. (*In re* N.C.P. Mktg. Group, Inc.), 279 Fed. Appx. 561 (9th Cir. 2008).
180 N.C.P. Mktg. Group, Inc. v. BG Star Prods., 129 S. Ct. 1577, 1578 (2009).
181 *Id.*

licensors may generally expect to obtain the power to deny the efforts of a debtor-licensee in Chapter 11 bankruptcy to both assume and assign non-exclusive intellectual property licenses. In the minority of circuits where the "actual test" has been adopted, the licensor may, alternatively, expect a case-by-case analysis to determine the actual intention of the debtor-licensee with respect to assignment and for the debtor-in-possession to be permitted to assume an intellectual property license where that debtor does not intend to assign that license to a third party.

The jurisdiction where the bankruptcy is filed, thus, plays a central determinative role in the disposition of an intellectual property license in Chapter 11 bankruptcy. While this determinative power of jurisdiction is present in any circuit split scenario, this problem is especially exacerbated in the bankruptcy context, where the debtor has greater control over the jurisdiction in which its case is filed. A Chapter 11 bankruptcy case may be commenced by a business in the district court for the district that is either (1) the principal place of its business, (2) the principal location of its assets, or (3) the place of its incorporation.[182] For many businesses, this restricts venue options to one or two jurisdictions. For larger corporations, however, it is easy to imagine a scenario in which the corporation may have its place of incorporation in one jurisdiction, its principal place of business in another, and perhaps its principal assets located in still another.[183] This flexibility afforded to the debtor provides a convenient mechanism for strategic forum-shopping for the debtor-licensee who wishes to assume a non-exclusive intellectual property license and who has reason to believe that such an assumption would not be consented to by the licensor. With such opportunity available to many debtor-licensees, the licensor of intellectual property is disadvantaged in not being able to reliably predict how its license will be treated should the licensee enter bankruptcy. Inherent in such uncertainty are concerns about differential protection and rights for both the licensor and the debtor-licensee. Where a debtor-licensee enjoys the freedom to select from multiple venues and where one jurisdiction may be more advantageous in terms of assumption of a license agreement, the debtor is necessarily afforded greater protections than other debtors who are not similarly situated. In the converse, where the bankruptcy case is filed in a jurisdiction more favorable to the licensor in its use of the hypothetical test, the licensor enjoys more rights than other licensors of intellectual property.

Beyond these equity concerns, the uncertainty resulting from the circuit split may increase legal costs to both the licensor and the licensee. In anticipating the potential of bankruptcy and guarding against the effects of the circuit split, contracts may require more time to develop and execute between parties. If an

[182] 28 U.S.C. § 1408 (2006).

[183] *See* BANKRUPTCY: THE NEXT TWENTY YEARS, NATIONAL BANKRUPTCY REVIEW COMMISSION FINAL REPORT § 3.1.5 (2009).

issue does arise with respect to a license agreement in bankruptcy, the legal costs associated with navigating the uncertain waters and pursuing the case appropriately may also increase costs to the parties.

Finally, the circuit split may make investors more wary of investing in a business whose success largely depends on holding certain intellectual property licenses if there is a possibility that such licenses may not be assumed in reorganization should the licensee file Chapter 11 bankruptcy. The uncertainty of the disposition of the licenses may not only discourage investment generally, but, where the risk is taken by the investor, may yield an investment which is less favorable to the licensee than would have occurred if the investor had not had to guard against the risk of such uncertainty.

B. POLICY CONSIDERATIONS

1. *Bankruptcy Law.* Bankruptcy protection is available to individuals and businesses in the United States in the spirit of providing a second chance to realize financial stability and success.[184] Chapter 11 bankruptcy, in particular, is designed deliberately with the intention of providing a debtor business the opportunity to reorganize itself to achieve economic stability both at the organizational level and, more broadly, as an actor in the overall commercial activities of the larger economy.[185] Significant tools toward this end include the automatic stay provisions[186] and the ability, as debtor in possession, to assume or reject executor contracts and unexpired leases of the debtor.[187]

Bankruptcy law is not, by any means, concerned only with the rights of the debtor. To the contrary, bankruptcy law embodies an attempt to balance the interests of the debtor with those of the creator.[188] Toward this end, creators, among other things, vote to confirm a debtor's Chapter 11 reorganization plan,[189] may be able to dismiss a plan filed in bad faith or a plan that is not feasible,[190] and may seek relief from the automatic stay when their interests are not adequately protected.[191]

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[184] *See* Local Loan Co. v. Hunt, 292 U.S. 234 (1934) (articulating that the purpose of the bankruptcy act is to give "the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort").

[185] Johns-Manville Corp. v. Chubb Indem. Ins. Co. (*In re* Johns-Manville), 517 F.3d 52 (2d Cir. 2008) (noting that the purpose of Chapter 11 bankruptcy is achieved in "facilitating the reorganization and rehabilitation of the debtor as an economically viable entity"); NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984) (finding "the fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources").

[186] 11 U.S.C. § 362 (2006).

[187] *Id.* § 365.

[188] 7 COLLIER ON BANKRUPTCY ¶ 1100.01 (15th ed. 2004).

[189] 11 U.S.C. § 1129 (2006).

[190] *Id.* § 1112(b).

[191] *Id.* § 362(d).

2. *Intellectual Property Law.* Intellectual property law, too, is concerned with economic success, particularly as realized through the provision of—or, at a minimum, the protection of—incentives for creation and invention.[192] Toward this end, intellectual property licensors retain significant rights to protect their property in the manner in which it is used, and from assignment to third parties. In a broader sense, this concern for incentivizing creation and invention is, like those principles underlying bankruptcy law, a concern for greater economic stability, not only for the intellectual property license-holder, but also for the broader commercial environment.

C. COMMON GROUND AS REALIZED THROUGH THE APPLICATION OF THE ACTUAL TEST

Bankruptcy law and intellectual property law share more common policy objectives than they do competing objectives. Most notably, both bodies of law are distinctly concerned with maximizing individual potential for economic success. Where intellectual property law allows for the commercialization and protection of the tangible expressions of our ideas and our creativity, bankruptcy law provides us the opportunity to reorganize the business surrounding that commercialization should the need arise. The common ground underlying both intellectual property law and bankruptcy law is this value of protecting and expanding commercial opportunities. Where intellectual property law addresses this concern for opportunity in its effort to diminish unfair competition,[193] bankruptcy law addresses the same concern in its effort to provide a fresh start.[194] Both of these efforts recognize that "the good will and other property of a business should be protected."[195] Far from undermining this common ground, use of the "actual test" to determine whether a debtor-licensee of intellectual property may, in Chapter 11 bankruptcy, assume a license it held pre-petition affirms this common interest in opportunity for commercial success.

It is readily apparent how permitting a debtor-licensee to assume such an intellectual property license in bankruptcy when the debtor has not contemplated the assignment of the license comports with the underlying purpose and principles of bankruptcy law. When a debtor-licensee relies on such a license for the survival of its business, to deny such assumption would be to frustrate the reorganization and opportunity for economic success of the debtor-in-possession.

Arguably, the benefit of such a scheme to the non-consenting licensor is a harder sell. Despite the licensor's reasonable frustrations related to being in a

[192] *See supra* note 91 and accompanying text.
[193] 1-1 GILSON ON TRADEMARK ¶ 1.04.
[194] *See supra* note 32 and accompanying text.
[195] 1-1 GILSON ON TRADEMARK ¶ 1.04[2].

licensing relationship with an insolvent licensee, however, it is important to realize that this issue of assumption does not unfairly disadvantage the non-debtor licensor. That is, while it may not be preferable to the licensor, this assumption does not take any right from the licensor that it would have otherwise enjoyed had the licensee not filed for bankruptcy protection. From the licensor's perspective, the assumption of an intellectual property license by a debtor-licensee in bankruptcy does not change the bargain that the parties agreed to, nor the terms they were bound by pre-petition. With assumption, both the licensor and the licensee continue to receive the benefit of their pre-petition bargain. In so doing, intellectual property law's interest in the protection and expansion of economic opportunity—the "common ground"—is only furthered.

The true risk of the "hypothetical test" lies in barring the assumption of the license, bestowing upon the licensor rights that it would not otherwise have had. The ironic and tragic consequence of such a bar would be that the debtor that sought protection in bankruptcy was instead denied a right it held pre-petition (the right to its non-assignable license, a right necessary to its survival), while the licensor's rights were expanded beyond what they were pre-petition.

The potential that filing for bankruptcy harms the debtor, while the licensor receives a virtual boon of rights, undermines the purpose of and policies underlying bankruptcy law to an intolerable extent. In contrast, what is asked of the non-debtor licensor is little more than what it bargained for pre-petition. While the position of the non-debtor licensor is not an enviable one, it should not be an unanticipated one, particularly in the current economic climate. Pragmatically, the non-debtor licensor may find that it, in fact, prefers to deal with a licensee who is working through a monitored and highly-structured plan for reorganization through the bankruptcy system than it would an insolvent and floundering licensee. For these reasons, the "actual test" to determine whether an intellectual property license may be assumed in Chapter 11 bankruptcy, unlike the "hypothetical test," furthers, or at the very least does not undermine, the policy concerns underlying both bankruptcy and intellectual property law.

IV. CONCLUSION

The "actual test" for determining whether an intellectual property license may be assumed in Chapter 11 bankruptcy, even when the licensor does not offer its consent for assumption, offers a pragmatic, reasoned approach to this issue that not only comports with the plain meaning of Section 365(c) of the Bankruptcy Code, but also does not undermine the underlying policy concerns of either bankruptcy or intellectual property law. Indeed, what does frustrate the underlying policies of both bankruptcy and intellectual property law is the confusion, inconsistency, inequity, and resulting increased costs resulting from the circuit split on this issue. For this reason, the United States Supreme Court should grant certiorari when the proper case arises, per Justice Kennedy and Justice Breyer, to resolve this issue and should do so by adopting the "actual test" to determine, on a case-by-case basis, whether an intellectual property license may be assumed in Chapter 11 bankruptcy by a debtor-licensee, even over the objections of the non-debtor licensor.