GS&C/OLS Form (Rev. 10/86)

CONGRESSIONAL RECORD
PROCEEDINGS AND DEBATES OF THE 100TH CONGRESS

HOUSE

BILL	DATE	PAGE(S)
H.R.5348	Oct 3, 1988 138	H9302-04

ACTION: SUSPENSION OF RULES - VOTE POSTPONED

AMENDING THE BANKRUPTCY LAWS WITH RESPECT TO THE REJECTION OF INTELLECTUAL PROPERTY LICENSES

Mr. EDWARDS of California. Mr. Speaker, I move to suspend the rules and pass the bill (H.R. 5348) to amend title 11 of the United States Code with respect to the rejection of executory contracts licensing rights to intellectual property.

The Clerk read as follows:

H.R. 5348

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. AMENDMENTS TO TITLE 11 OF THE UNITED STATES CODE

(a) DEFINITIONS.—Section 101 of title 11, United States Code, is amended—

(1) by redesignating paragraphs (34) through (51) as paragraphs (36) through (53), respectively,

(2) by inserting after paragraph (33) the following:

"(35) 'mask work' has the meaning given it in section 901(a)(2) of title 17;",

(3) by redesignating paragraphs (32) and (33) as paragraphs (33) and (34), respectively, and

(4) by inserting after paragraph (31) the following:

"(32) '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;".

(b) EXECUTORY CONTRACTS LICENSING RIGHTS TO INTELLECTUAL PROPERTY.—Section 365 of title 11, United States Code, is amended by adding at the end the following:

"(n)(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 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 for 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 such embodiment), including any right to obtain such intellectual property (or such embodiment) from another entity.".

SEC. 2. EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

(a) EFFECTIVE DATE.—Except as provided in subsection (b), this Act and the amendments made by this Act shall take effect on the date of the enactment of this Act.

(b) APPLICATION OF AMENDMENTS.—The amendments made by this Act shall not apply with respect to any case commenced under title 11 of the United States Code before the date of the enactment of this Act.

The SPEAKER pro tempore. Pursuant to the rule, a second is not required on this motion.

The gentleman from California [Mr. EDWARDS] will be recognized for 20 minutes and the gentleman from New York [Mr. FISH] will be recognized for 20 minutes.

The Chair recognizes the gentleman from California [Mr. EDWARDS].

Mr. EDWARDS of California. Mr. Speaker, I yield myself such time as I may consume.

Mr. Speaker, H.R. 5348 is legislation introduced by me and the gentleman from California [Mr. MOORHEAD] relating to the treatment of intellectual property licenses by the bankruptcy laws. It was favorably reported to the House by the Committee on the Judiciary by unanimous voice vote on September 27, 1988.

Interest in this issue was in large measure sparked by the decision in the Lubrizol case,[1] in which the U.S. Court of Appeals for the Fourth Circuit upheld the bankrupt debtor's rejection of an executory license agreement involving intellectual property, terminating the licensee's use of the technology, without regard to the effect that rejection would have on the licensee or the estate.

At the June 3, 1988, hearing held by the Subcommittee on Monopolies and Commercial Law on this issue, it was made clear by industries that rely heavily on licensing arrangements—particularly high technology companies whose products are vital to our economy—that the Lubrizol case may have a chilling effect on transactions involving the licensing of intellectual property, and, correspondingly, on the development of new technology. H.R. 5348, which applies only to executory contracts under which the debtor is a licensor of a right to intellectual property, eliminates this possibility.

If an executory contract under which the debtor is a licensor of a right to intellectual property is rejected, the bill permits a licensee to continue to use the licensed technology. However, the debtor is relieved from the burdens of performing this contract, other than having to comply with any exclusivity provision as might be included in the contract.

On behalf of Chairman RODINO and the Judiciary Committee, I can state that although the committee is always very reluctant to create any exception to the general treatment of executory contracts by section 365 of the bankruptcy laws, the committee believes the importance of licensing transactions and the development of new technology to our economy justifies granting the exception in H.R. 5348 now.

Mr. Speaker, I urge my colleagues to support this legislation.

Mr. FISH. Mr. Speaker, I yield myself such time as I may consume.

Mr. Speaker, H.R. 5348 is important legislation designed to protect intellectual property licenses in bankruptcy cases. The bill is needed to safeguard the licensing process itself, a process that is essential to the development of new technologies and to the promotion of U.S. competitiveness in international markets. Congressional testimony on behalf of Intellectual Property Owners, Inc. emphasizes that "[l]icensing is important to every type of industry which relies on intellectual property, including chemicals, computers and software, electronics, entertainment, pharmaceuticals, and many others."

Licensing may be advantageous for a number of reasons:

First, licensing encourages inventors to devote enormous time and effort to creative endeavors—allowing them to share in the profits.

Second, licensing permits companies to utilize new ideas without the enormous expense associated with outright purchases.

Third, licensing facilitates the application of inventions to a range of products that may be manufactured by a number of different companies.

Under current law, a licensee may lose the use of intellectual property as a result of rejection of the licensing contract in bankruptcy. Concern about the severe consequences of rejection may discourage reliance on licensing arrangements—which can have very serious economic repercussions.

Bankruptcy Code section 365 generally permits assumption or rejection of executory contracts subject to approval of the bankruptcy court. The Court of Appeals for the Fourth Circuit, in *Lubrizol Enterprises* v. *Richmond Metal Finishers*, 756 F.2d 1043 (4th Cir. 1985), concluded that a specific licensing agreement was executory by applying Professor Vern Countryman's test of whether the "obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the others." Id. at 1045.

A debtor-licensor can reject an executory licensing contract. The business judgment standard for judicial approval or rejection, articulated by the Lubrizol court, accords great deference to the licensor's decision. The opinion states: "the issued * * * presented for * * * judicial determination by the

[1] *Lubrizol Enterprises, Inc.* v. *Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), *cert. denied*, 106 S. Ct. 1285 (1986).

bankruptcy court is whether the decision of the debtor that rejection will be advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith or whim or caprice." Id. at 1047. Rejection, under the Lubrizol decision, terminates the licensee's right to use the licensed property and relegates the licensee to a claim for damages.

The unfortunate consequences of the Lubrizol decision justify a congressional response. New York lawyer George Hahn, in a statement presented to the Subcomittee on Monopolies and Commercial Law on behalf of the National Bankruptcy Conference, refers to Lubrizol as creating "a general chilling effect upon the system of licensing rights in intellectual property."

The termination of a licensee's right to use intellectual property may destroy the licensee's business. The intellectual property may be unique—negating the possibility of obtaining an adequate replacement. Intellectual property licensees have special needs that our bankruptcy law must not ignore.

The licensee's right to use intellectual property merits legal protection. It is unfair to strip licensees of rights to use that already have been conveyed to them. Debtor-licensors can be relieved of such future affirmative obligations as servicing the contract or providing training—obligations that may impede reorganization—without disregarding the legitimate interests of licensees in having continued access to intellectual property.

What legislative options are available for correcting the deficiencies of current law?

A comprehensive redrafting of Bankruptcy Code section 365—which covers rejection of a wide range of contracts and contains a number of exceptions—may be an appropriate long-range goal. This cannot, however, be accomplished quickly. The impact of current law on intellectual property requires expeditious action.

Legislation articulating a more balanced standard for court review of contract rejections—in place of the business judgment test of the Lubrizol case—is another possibility. The Judiciary Committee, however, has not had an opportunity to consider the advantages and disadvantages of various standards or the implications of particular formulations for the many different kinds of contracts. In addition, the desirability of replacing the business judgment test by legislation rather than awaiting judicial developments—which may offer greater flexibility—is subject to question. Legislation replacing the standard for approving rejections, in any event, does not address—and, therefore, cannot ameliorate—the potentially disastrious consequences of rejection.

H.R. 5348 incorporates language specifically focusing on a rejection's consequences. The bill is tailored to safeguard a licensee's right to use intellectual property. The licensee, in return, must pay for that use-waiving setoffs and claims for administrative expenses that can interfere with the cash flow needed for reorganization. The licensor is relieved of requirements to perform future services—requirements that may prove inconsistent with effectuating the goal of reorganization.

Mr. Speaker, H.R. 5348 fairly reconciles the interests of the participants in licensing arrangements. I urge my colleagues to support it.

□ 1445

Again, I congratulate my friend and colleague, the gentleman from California [Mr. EDWARDS], for bringing this measure before us.

Mr. EDWARDS of California. Mr. Speaker, I have no further requests for time, and I yield back the balance of my time.

Mr. FISH. Mr. Speaker, I yield such time as he may consume to the gentleman from California [Mr. MOORHEAD].

Mr. MOORHEAD. Mr. Speaker, I welcome the opportunity to speak in support of H.R. 5348.

Our bankrupcty law, as interpreted in Lubrizol Enterprises versus Richmond Metal Finishers, discourages intellectual property licensing. This can have unfortunate consequences for the development of American technology—consequences that our Nation cannot afford. Testimony by James Burger of Apple Computer, Inc. describes licensing as "key to the way our [information technology] industry functions."

Remedial legislation is needed to remove the cloud that now hangs over the licensing process. George Hahn, a bankruptcy lawyer appearing on behalf of the National Bankruptcy Conference before the Subcommittee on Monopolies and Commercial Law, explains that "the Lubrizol court wrongly permitted rejection to strip Lubrizol of rights to the use of technology which the debtor, prior to bankruptcy, had conveyed to it."

The bill we are considering today will protect a licensee's use of intellectual property in bankruptcy cases—and at the same time recognize the needs of a debtor-licensor for continued payments. The Senate recently passed similar legislation.

I am delighted to be a cosponsor of H.R. 5348. The bill is meritorious and should be enacted into law.

Mr. FISH. Mr. Speaker, I have no further requests for time, and I yield back the balance of my time.

The SPEAKER pro tempore (Mr. BENNETT). The question is on the motion offered by the gentleman from California [Mr. EDWARDS] that the House suspend the rules and pass the bill, H.R. 5348.

The question was taken.

Mr. WALKER. Mr. Speaker, on that I demand the yeas and nays.

The yeas and nays were ordered.

The SPEAKER pro tempore. Pursuant to clause 5 of rule I and the Chair's prior announcement, further proceedings on this motion will be postponed.