ab E 9/28/88

Calendar No. 929

100TH CONGRESS 2d Session | SENATE | REPORT 100-505

INTELLECTUAL PROPERTY BANKRUPTCY PROTECTION ACT

SEPTEMBER 14 (legislative day, SEPTEMBER 7), 1988.—Ordered to be printed

Mr. BIDEN, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 1626]

The Committee on the Judiciary, to which was referred the bill (S. 1626) to amend title 11, United States Code, the Bankruptcy Code, regarding protection of certain intellectual property rights in bankruptcy, having considered the same, reports favorably thereon with an amendment in the nature of a substitute, and recommends that the bill, as amended, do pass.

CONTENTS

I. PURPOSE

The purpose of the bill is to amend Section 365 of the Bankruptcy Code to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to Section 365 in the event of the licensor's bankruptcy. Certain recent court decisions interpreting Section 365 have imposed a burden on American technological development that was never intended by Congress in enacting Section 365. The adoption of this bill will immediately remove that burden and its attendant threat to the development of American Technology and will further clarify that Congress never intended for Section 365 to be so applied.

II. Legislative History

On August 7, 1987, Senators DeConcini and Heflin introduced S. 1626, the Intellectual Property Bankruptcy Act. The bill's introduction focused attention on recent court decisions addressing Section 365 of the bankruptcy code which have stripped intellectual property licensees of their right to continue to use the licensed property. Numerous meetings were held within the intellectual property and bankruptcy communities to discuss the problems and the possible solutions.

On June 10, 1988, Senator Heflin convened a hearing of the Subcommittee on Courts and Administrative Practice, and received testimony from the following witnesses: John L. Pickitt, president of Computer and Business Equipment Manufacturers Association; Steven C. Mendell, chairman and CEO of XOMA Corp.; John P. McLaughln, vice president of Genetech Inc.; George Hahn, chairman of the Executory Contracts Committee, National Bankruptcy Conference; and Jeffrey Tarkenton of the American Bankruptcy Institute.

A substitute amendment was drafted to incorporate the recommendations that evolved from the meetings and the hearings. On August 9, 1988, the Subcommittee on Courts and Administrative Practice unanimously approved the substitute amendment and on August 10, 1988, the Committee on the Judiciary unanimously reported the bill.

III. Discussion

A. BACKGROUND: RECENT COURT DECISIONS

Several recent court decisions, including *Lubrizol Enterprises, Inc.* v. *Richmond Metal Finishers, Inc.*, 765 F.2d 1043 (4th Cir. 1985), *cert. denied* 106 S.Ct. 1285 (1986), have interpreted Section 365 of the Bankruptcy Code (the "Code") as providing a basis for permitting a licensor of intellectual property to strip its licensee of any continuing right to use the licensed intellectual property under the auspices of rejecting the license as an executory contract. Under the Code, a trustee or debtor in possession may be permitted to reject—that is, to breach—an executory contract when, in its business judgment as reviewed by the court, it concludes that affirmative ongoing performance of the contract would not be beneficial to the estate. These cases, however, have relieved the debtor not simply of its ongoing affirmative performance obligations under the executory license agreement, but also of its passive obligation to permit the licensee to use the intellectual property as provided in the license. Under this view, since rejection results in valuable rights apparently reverting to the bankruptcy estate—rights which the bankruptcy estate otherwise would have to share with the licensee—rejection will nearly always be arguably beneficial to the bankruptcy estate and any exercise of business judgment, however reviewed by the court, will lead to rejection.

This view, which several courts have not modified under their powers in equity, leaves licensees in a precarious position and thus threaten the very flexible and beneficial system of intellectual property licensing which has developed in the United States. Congress never anticipated that the presence of executory obligations in an intellectual property license would subject the licensee to the risk that, upon bankruptcy of the licensor, the licensee would lose not only any future affirmative performance required of the licensor under the license, but also any right of the licensee to continue to use the intellectual property as originally agreed in the license agreement.

The court decisions on Section 365 that have stripped intellectual property licensees of their right to continue to use the licensed property have gained wide notice. They threaten an end to the system of licensing of intellectual property (discussed below) that has evolved over many years to the mutual benefit of both the licensor and the licensee and to the country's indirect benefits. Because of the instability that Section 365 has introduced into the licensing relations, parties who would have formerly accepted licenses—the right to use another's intellectual property—are now forced to demand assignments—outright transfer of ownership of the intellectual property. This change in basic format is wasteful and cumbersome and is especially chilling to small business technologists. It is not an overstatement to say that the change is a fundamental threat to the creative process that has nurtured innovation in the United States.

B. BACKGROUND: THE ROLE OF LICENSING

Licensing of technology, which the bill is intended to protect and to facilitate, plays a substantial role in the process of technological development and innovation. That process begins with an inventive concept and must proceed through an expensive and risky series of steps including research, development, manufacturing and marketing. At each step, both money and additional refinement of the idea are required. Often, the financing and additional refinement are only available through the participation of persons other than the original innovator.

Licensing provides the mechanism by which the original innovator can retain sufficient ownership of his innovation so that he shares in the ultimate economic reward, while sharing that reward as remuneration to those who would provide the financing and refinement necessary to achieve economic success. Licensing also provides a mechanism whereby the innovator who has identified more than one domain in which his invention may have application can seek partners for each field of use without risking the probability that one developer's narrow focus will deny him the rewards of development in another area.

The alternative to licensing is outright sale. If the innovator sells his innovation at its genesis, he passes the entire risk of development onto the purchaser. If the legal environment forces reliance on sale rather than licensing, the number of parties who can participate in new technological development is sharply curtailed.

When intellectual property is assigned rather than licensed, the original creator loses his personal stake. The licensee or assignee frequently is interested in the intellectual property for a specific application or geographic market. In order to assure the continued availability of the intellectual property against the contingency of the creator's bankruptcy, however, the party seeking the intellectual property for limited use must demand assignment of the property, notwithstanding that a license would otherwise serve his purpose. The creator then is either totally alienated from his creation or, at best, given a license by the assignee. Such circumstances create obvious disincentives to the full development of intellectual property. If the creator is unwilling to assign, in some instances, transactions simply are not completed. In others, the licensee discounts what he will pay to account for the risk now seen as inherent in Section 365. In short, Section 365 is resulting in undercompensation of U.S. inventors. Ironically, the present law, as it is now being interpreted by courts, can result in increased financial distress for the inventor, causing him to be shortchanged to adjust for a risk which under present law cannot be contractually removed if a license format is selected.

C. OVERVIEW OF BILL

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

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

D. OTHER MATTERS

As discussed above, the bill is intended to respond to a particular problem arising out of recent court decisions under Section 365. As such, it is not in any way intended to address broader matters under Section 365 or the Bankruptcy Code in general. The bill does not affect the test of when a contract is an executory contract or the exercise of business judgment in rejecting an executory contract. Nor does the bill address or intend any inference to be drawn concerning the treatment of executory contracts which are unrelated to intellectual property. In addition, the bill does not treat certain issues related to intellectual property that are already dealt with elsewhere in the Code: Maintaining the confidentiality of trade secrets is adequately provided for in Section 107(b)(2); determinations of whether intellectual property licenses are assumable or assignable can be made in accordance with sections 365 (c) and (f). The bill does not deal with debtor licensees.

Finally, the bill does not address the rejection of executory trademark, trade name or service mark licenses by debtor-licensors. While such rejection is of concern because of the interpretation of section 365 by the *Lubrizol* court and others, *see, e.g., In re Chipwich, Inc.*, 54 Bankr. Rep 427 (Bankr. S.D.N.Y. 1985), such contracts raise issues beyond the scope of this legislation. In particular, trademark, trade name and service mark licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee. Since these matters could not be addressed without more extensive study, it was determined to postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts.

IV. Vote of Committee

On August 10, 1988, with a quorum present, by unanimous consent, the Committee on the Judiciary, ordered the bill, as amended, reported.

V. Test of S. 1626

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

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

(1) in paragraph (50) by striking "and" at the end,

(2) in paragraph (51) by striking the period at the end and inserting in lieu thereof a semicolon, and

(3) by adding at the end the following:

"(52) 'intellectual property' means—

"(A) trade secret;

"(B) invention, process, design, plant, or plant variety, including patents or patent applications thereon;

"(C) confidential research or development information;

"(D) work of authorship, including copyrights therefor; or

"(E) mask work;

to the extent protected by applicable nonbankruptcy law; and

"(53) 'mask work' has the meaning given it in section 901(a)(2) of title 17.".

(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 (other than a right under applicable nonbankruptcy law to specific performance of the future affirmative obligations under such contract, except those affirmative obligations retained in paragraphs (2) and (3) 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 payments with respect to such rights due under such contract with respect to the rights retained for the duration of such contract and for any period described in paragraph (1)(B) of this subsection for which the licensee extends such contract; and

"(C) the licensee shall be deemed to waive—

"(i) any right of setoff it may have with respect to such contract under this title or applicable nonbankruptcy law; and

"(ii) any claim allowable under section 503(b) of this title arising from the performance of such contract.

"(3) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, then on the written request of the licensee the trustee shall—

"(A) to the extent provided in such contract, or any agreement supplementary to such contract, provide to the licensee any intellectual property (including such embodiment) held by the trustee; and

"(B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment) including any right to obtain such intellectual property (or such embodiment) from another entity.

"(4) Unless and until the trustee rejects such contract, on the written request of the licensee the trustee shall—

"(A) to the extent provided in such contract or any agreement supplementary to such contract—

"(i) perform such contract; or

"(ii) provide to the licensee such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law) held by the trustee; and

"(B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment), including any right to obtain such intellectual property (or such embodiment) from a third entity.".

SEC. 2. EFFECTIVE DATES; 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.

VI. SECTION-BY-SECTION ANALYSIS

Section 1(a) amends Section 101 of the Bankruptcy Code, which sets forth definitions used in the Bankruptcy Code.

A. NEW SECTION 101(52) OF TITLE 11, UNITED STATES CODE

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

The definition of "intellectual property" is unusual for a federal statute because of its inculsion of trade secret, normally a concept reserved for development by the states. Because bankruptcy processes can alter rights created by state law, this inclusion is appropriate. Also included as a separate category is confidential research or development information. This was done because some states narrowly define trade secret, but accord protection to the developer of confidential technical information falling outside those definitions. The definition is broad and is to be interpreted liberally to carry out the intent of Congress to remove the cloud cast by that recent interpretation of the Bankruptcy Code upon the intellectual property licensing system.

B. NEW SECTION 101(53) OF TITLE 11, UNITED STATES CODE

The second new defined term is "mask work," a term included within the definition of "intellectual property." The term is used in recently adopted legislation and is to have the same meaning in title 11 as in section 901(a)(2) of title 17.

C. NEW SUBSECTION 365(N) OF TITLE 11, UNITED STATES CODE

Section (1)(b) adds a new subsection to Section 365 of title 11, United States Code, consisting of four paragraphs.

1. New paragraph (n)(1) of subsection 365(n)

The first paragraph of the new Section provides that, in the event an executory contract under which the debtor is a licensor of rights to intellectual property is rejected in the licensor's bankruptcy, the licensee may elect one of two sets of consequences to attach to that rejection. The licensee may treat the rejection as terminating the license, leaving the licensee with its various rights as a contract creditor under the Code. This course of action would be available to the licensee without this bill.

The second alternative which the bill explicitly makes available to the licensee is to elect to retain its rights under the license, as such rights existed immediately before the case commenced. The bill recognizes that continued affirmative performance of an intellectual property license may be impractical; for instance, a trustee will generally be unable to perform covenants calling for continued research to improve licensed intellectual property. However, performance of covenants requiring no action by the trustee impose no burden on the estate and result in equity to the nonbreaching party and certainty to the economy as a whole. When a bankruptcy court finds rejection of an intellectual property license to be appropriate, if the licensee so elects, the bill protects the licensee's right to the intellectual property as it existed at the time of the filing. If the licensee elects to retain such rights, he is required to continue making all royalty payments due under the rejected license, as more fully described below.

It is important to note that the amendment, when referring to retention of rights under "such contract," deliberately omits the phrase "the term of which has commenced" appearing in the somewhat parallel subsection 365(h) in connection with leases and time share plans. Frequently, the term of the license agreement is contingent upon the occurrence of a future event, such as FDA approval or issuance of the patent. The benefits of the bill are intended to extend to such license agreements, consistent with the limitation that the licensee's rights are only in the underlying intellectual property as it existed at the time of the filing.

For the term of the rejected license and any period for which such license could have been extended, the licensee under the rejected license

(1) is entitled to use the underlying intellectual property in the state that it existed on the day of the bankruptcy filing as provided in the license and

(2) is entitled to any judicial relief necessary to enforce that set of rights.

For instance, if the contract granted exclusive use to the licensee, such exclusivity would be preserved to the licensee. To this extent, the licensee is given the right to compel specific performance, i.e., to enjoin the licensing to another of the rights granted by the contract to the licensee. Retention of contractual rights, both in extent and quality, is a central aim of the bill. If the trustee has chosen to reject the license, the licensee, although entitled to elect to retain the use of the existing intellectual property without interference, cannot otherwise compel affirmative post-petition performance under the license. For instance, the licensee could not compel the licensor to defend the licensor's patent against an infringement claim. If the license provided the licensee a right to defend such a claim, however, that is one of the rights which this bill would protect.

Intellectual property licensing arrangements are not generally standardized. Rather, the particular transaction is the product of the circumstances of the licensor, the licensee and other interested parties. It is not unusual for the licensing arrangements to involve parties other than the licensor and licensee. It is also not unusual for the license agreement to be one of several agreements governing the working relationship between the licensor and licensee. For instance, the licensor may have contracted to supply the licensee with a product incorporating the licensed intellectual property and may have agreed that the licensee would only have access to information necessary to produce the licensed intellectual property in the event of the licensor's inability or unwillingness to supply the licensee. To assure the licensee of access to such secret information at the defined time, the licensor may have agreed to turn over such information to a third party to be held in escrow until the triggering event. The third-party escrow agent would be a party to such an agreement, and the agreement would be set forth in a document separate from the basic license. Section 365(n)(1)(B), thus, speaks of the retention by the licensee of rights to the intellectual property under "any agreement supplementary to such contract." The licensee retains both the rights set forth in the rejected license itself and any agreement supplementary thereto, whether the supplementary agreement was itself the subject of a rejection by the trustee. This bill is intended to restore confidence in the system of intellectual property licensing, and courts interpreting it should be sensitive to the reasonable practices that have and will evolve among parties seeking to add to the technological and creative wealth of America.

Among the rights retained by the licensee electing under new Section 365(n)(1)(B) is the right to any embodiment of the intellectual property to which the parties' contracts entitle the licensee. For instance, the parties might have agreed that the licensor would prepare a prototype incorporating the licensed intellectual property. If such a prototype was prepared prior to the filing of the petition for relief, but had not been delivered to the licensee at that time, then the licensee can compel the delivery of the prototype in accordance with the terms of the rejected license. Other examples of embodiments include genetic material needed to produce certain biotechnological products and computer program source codes. There are many other possible examples of embodiments, but critical to any right of the licensee to obtain such embodiments under this bill is the prepetition agreement of the parties that the licensee have access to such material and the physical existence of such material on the day of the bankruptcy filing.

2. New paragraph (n)(2) of subsection 365(n)

Section 365(n)(2) modifies the rights that a retaining licensee would ordinarily have as the nondebtor party to a contract rejected under section 365. So long as the trustee and its successors in interest allow the licensee to exercise the retention rights set forth in section 365, the licensee

(1) is to make all royalty payments due under the rejected license and any available extension which the licensee elects to exercise and

(2) waives any right to set off damages which it incurred as a result of the trustee's rejection and any claim which it might otherwise be allowed under Section 503(b) of title 11 arising from its performance of the rejected contract.

This represents a careful compromise between the needs of the debtor and the licensee. The licensee requires retention of its rights, even exclusive rights. No longer can the debtor expect to sell these rights through rejection. The debtor's ability to reorganize may depend upon preservation of the royalty payments called for under the contract, free of offset or administrative claims which could similarly defeat the right to royalty payments. The bill accomplishes this, but leaves unaffected the licensee's rights under Section 365(g), so that a general claim for damages, if any, from rejection can be asserted by the licensee.

3. New paragraphs (n)(3) and (n)(4) of subsection 365(n)

Prior to rejection by the debtor licensor but upon nonperformance by the trustee ((n)(4)), as well as upon rejection by the debtor licensor combined with the licensee's election to retain rights in intellectual property ((n)(3)), the trustee, upon written request by the licensee, as provided in the parties' agreements, shall turn over to the licensee intellectual property held by the trustee and shall not interfere with the licensee's contractual rights to use the intellectual property or to obtain it from a third party. The intellectual property referred to is only that which is in existance at the time of petition filing and not anything which first comes into being post-petition. New paragraphs (n)(3) and (n)(4) do not compel future affirmative performance by the trustee, as distinguished from providing the licensee with access to the existing intellectual property, including the delivery or turnover of any existing items specifically required by the contract, and not interfering with the licensee's rights thereto. It is contemplated that the trustee's undertaking will be essentially ministerial. Reference to noninterference by the trustee is not intended to imply that the rights of the licensee enjoy any protection from the trustee's avoiding powers under Sections 544 to 549 of the Code.

VII. Agency Views

General Counsel of the
United States Department of Commerce,
Washington, DC.

Hon. Joseph R. Biden, Jr.,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, DC.

Dear Mr. Chairman: Thank you for requesting our views on S. 1626, a bill to keep secure the rights of intellectual property licensors and licensees which come under the protection of the bankruptcy code. The Administration supports this bill and urges its speedy enactment.

S. 1626 would amend title 11 of the United States Code by defining intellectual property and mask works and by preserving the rights of intellectual property licensees when a trustee in bankruptcy rejects an executory contract under which the debtor is the licensor. If the trustee rejects such a contract, the licensee may elect either to treat the contract as terminated by the rejection, if the rejection amounts to a material beach, or may elect to retain certain rights under the contract. The licensee would not be able to demand specific performance of affirmative obligations under the contract except certain obligations necessary it implement the license agreement. A licensee who elects to retain its rights would be required to make all payments with respect to such rights under the contract and would be deemed to waive any right of setoff it may have with respect to such contract and any claim allowable under § 503(b) of title 11 arising from the performance of the contract.

We believe that S. 1626 fairly addresses an important need. Several recent cases have interpreted intellectual property license agreements as executory contracts, permitting the trustee to reject the contract and terminate the license. In *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.,* 226 USPQ 961 (4th Cir. 1985), the court held that a technology licensing agreement was an executive contract under 11 U.S.C. § 365(a), citing the "unperformed, continuing core obligations of notice and forbearance" on the part of the licensor and the "unperformed and continuing duty of accounting for and paying royalties for the life of the agreement" on the part of the licensee. *Id.* at 962.

The obligations of forbearance and payment are the essence of a license arrangement, and the duties of notice and accounting are found in many if not most license arrangements. The holding of the court in *Lubrizol* therefore makes it virtually impossible to craft a business arrangement that, in jurisdictions following the rationale of *Lubrizol,* would survive a petition in bankruptcy if the trustee chose to reject the agreement.

We believe this approach places too great a burden on the ability of intellectual property owners to negotiate satisfactory license arrangements. While rejecting an executory contract would ordinarily preclude the licensee from demanding specific performance, the holding in *Lubrizol* would treat an intellectual property license—that is, the covenant not to sue for infringement—as an unperformed continuing duty of forbearance for which specific performance could not be demanded if the contract were rejected. Under this approach, a substantial investment by a licensee would be jeopardized if the licensor petitioned in bankruptcy.

This risk will make licensing less attractive to investors, who may require licensors to demonstrate financial stability, and limit its availability as a means to secure development and commercialization of new technology. This will exacerbate the plight of independent inventors, small businesses, and entrepreneurs in high risk areas, who are often without adequate resources and for whom the availability of risk capital is already a major problem. Even for established enterprises, the financial stability of the licensing partner may introduce unacceptable levels of risk and preclude significant investment in technology that must be acquired by license.

We believe the approach of S. 1626 offers a better solution. The trustee would remain free to reject the contract, including specific performance of most aspects of the contract, but the licensee would remain able to secure performance of negative covenants, such as a covenant not to sue or, in the case of an exclusive license, a covenant not to license others to the technology. This approach would add important and needed certainty to licensing transactions and restore the state of the law to that which was understood to exist before *Lubrizol.*

Among the rights to specific performance that would be preserved under the approach of S. 1626, in addition to the enforcement of negative covenants relating to a license, the bill would also permit the licensee to demand that the trustee provide any intellectual property, including an embodiment of the intellectual property, held by the trustee, to the extent provided in the license agreement or an agreement supplementary to it. Although "embodiment" is not defined, we assume the term arises from the copyright law, which provides in section 101 of title 17, United States Code, that a work is "fixed in a tangible medium of expression when its embodiment in a copy or phonorecord . . . is sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration." Where the licensed intellectual property is not a work of authorship, we assume the term "embodiment" would be interpreted in a similar sense of enablement in a manner reasonable in the circumstances and would not necessarily include all physical manifestations of the intellectual property. For example, an embodiment of a licensed process might be interpreted to include technical data sufficient to enable the licensee to operate the process, but not a manufacturing facility using (or embodying) the process; and an embodiment of a licensed invention might be interpreted to include a sample of the invention, but not all inventory.

In this regard, it would be useful for the term "embodiment" to be interpreted broadly enough to include access to tangible materials required under the license and without which the licensee would be prevented from exercising the license. In biotechnology, for example, a sample or cell culture may be necessary to enable a person to practice an invention. In such circumstances, if the license provides for delivery of or access to a sample or culture, we believe it would be reasonable to require the trustee either to provide the relevant materials or to permit access to them through another source. This construction should not unduly prejudice the licensor or other creditors and would materially assist certain licensees.

Finally, we believe it would be useful to clarify that termination of an executory contract does not excuse the licensee from certain continuing duties. Since the *Lubrizol* court has interpreted a duty of forbearance as an unperformed act, we are concerned that a licensee who elects to treat the contract as terminated may believe itself relieved of such continuing obligations as nondisclosure and protection of trade secret information. We believe it would be useful for the legislative history to reflect that a licensor who elects to treat a rejected contract as terminated is not relieved of such continuing obligations as confidentiality and protection of trade secrets. Without this clarification, a trustee may fear that rejecting an executory contract involving a trade secret would jeopardize the trade secret.

We appreciate the opportunity to comment on this bill and urge its speedy enactment.

Sincerely,

ROBERT H. BRUMLEY,
General Counsel.

VIII. COST ESTIMATE

In accordance with paragraph 11(a), Rule XXVI, of the Standing Rules of the Senate, the committee offers the Report of the Congressional Budget Office:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, August 30, 1988.

Hon. JOSEPH R. BIDEN, Jr.,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 1626, the Intellectual Property Bankruptcy Protection Act of 1988, as ordered reported by the Senate Committee on the Judiciary, August 10, 1988.

We expect that enactment of the bill would not result in any additional cost to the federal government or to state or local governments. S. 1626 would keep secure the rights of intellectual property licensors and licensees which come under the protection of chapter 11 of the Bankruptcy Code. Specifically, the bill would permit a licensee of intellectual property to elect to use that property, after a trustee rejects the license agreement, to the extent that the use existed immediately prior to the bankruptcy case.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Douglas Criscitello, who can be reached on 226-2850.

Sincerely,

C.G. NUCKOLS
(For James L. Blum, Acting Director.)

IX. REGULATORY IMPACT STATEMENT

Pursuant to paragraph 11(b), rule XXVI, of the Standing Rules of the Senate, the committee, after due consideration, concludes that the Act will not have direct regulatory impact.

X. CHANGES IN EXISTING LAW

In compliance with paragraph 12, rule XXVI, of the Standing Rules of the Senate, changes in existing law made by S. 1626 are as follows: Existing law proposed to be omitted is enclosed in black brackets, new material is printed in italic, existing law in which no changes is proposed is shown in roman.

TITLE 11—UNITED STATES CODE

* * * * * * *

CHAPTER 1—GENERAL PROVISIONS

§ 101. Definitions

* * * * * * *

(50) "transfer"means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption; [and]

(51) "United States", when used in a geographical sense, includes all locations where the judicial jurisdiction of the United States extends, including territories and possessions of the United [States.] *States;*

(52) "intellectual property" means—

(A) trade secret;

(B) invention, process, design, plant, or plant variety, including patents or patent applications thereon;

(C) confidential research or development information;

(D) work of authorship, including copyrights therefor; or

(E) mask work;

to the extent protected by applicable nonbankruptcy law; and

(53) "mask work" has the meaning given it in section 901(a)(2) of Title 17.

* * * * * * *

CHAPTER 3—CASE ADMINISTRATION

* * * * * * *

Subchapter IV—Administrative Powers

* * * * * * *

§ 365. Executory contracts and unexpired leases

* * * * * * *

(m) For purposes of this section 365 and sections 541(b)(2) and 362(b)(10), leases of real property shall include any rental agreement to use real property.

(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 (other than a right under applicable nonbankruptcy law to specific performance of future affirmative obligations under such contract, except those affirmative obligations retained in paragraphs (2) and (3)) 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 laws.

(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 payments with respect to such rights due under such contract with respect to the rights retained for the duration of such contract and for any period described in paragraph (1)(B) of this subsection for which the licensee extends such contract; and

(C) the licensee shall be deemed to waive—

(i) any right of setoff it may have with respect to such contract under this title or applicable nonbankruptcy law; and

(ii) any claim allowable under section 503(b) of this title arising from the performance of such contract.

(3) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, then on the written request of the licensee the trustee shall—

(A) to the extent provided in such contract, or any agreement supplementary to such contract, provide to the licensee any intellectual property (including such embodiment) held by the trustee; and

(B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment) including any right to obtain such intellectual property (or such embodiment) from another entity.

(4) Unless and until the trustee rejects such contract, on the written request of the licensee the trustee shall—

(A) to the extent provided in such contract or any agreement supplementary to such contract—

(i) perform such contract; or

(ii) provide to the licensee such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law) held by the trustee; and

(B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment), including any right to obtain such intellectual property (or such embodiment) from a third entity.

SEC. 2. EFFECTIVE DATES; 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 enactment of this Act.

O