

## Qimonda's Impact on Patent Licenses When a Licensor Goes Bankrupt in a Foreign Land

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Can a U.S. patent licensee whose license has been rejected by a licensor under foreign law in a foreign bankruptcy rely on the protections of § 365(n) of the U.S. Bankruptcy Code? On October 28, 2011, the United States Bankruptcy Court for the Eastern District of Virginia issued an opinion addressing this in the Chapter 15 case of Qimonda AG (“Qimonda”).<sup>5</sup> The bankruptcy court held that the application of § 365(n) to executory licenses to U.S. patents was required to sufficiently protect the interests of U.S. patent licensees under Chapter 15 of the Bankruptcy Code, and that the failure of German insolvency law to protect patent licensees was “manifestly contrary” to United States public policy. Bankruptcy Code § 365(n) provides that if a trustee or debtor-in-possession (or in this case a foreign representative under Chapter 15) rejects an intellectual property contract between a debtor/licensor and a licensee, the licensee may elect to either treat the contract as terminated or retain its rights under the contract (including the right to enforce any exclusivity provision of the contract, but excluding any rights to specific performance) for the duration of the contract and any extension period available to the licensee under non-bankruptcy law.

### Factual Background

Qimonda, a manufacturer of semiconductor memory devices headquartered in Munich, Germany, filed an insolvency proceeding in Munich (the “Munich Proceeding”), and Dr. Michael Jaffé (“Jaffé”) was appointed as the insolvency administrator.

Jaffé then filed a petition for recognition under Chapter 15 of the Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Virginia. The bankruptcy court recognized the Munich Proceeding as a foreign main proceeding.<sup>6</sup>

Qimonda owned approximately 10,000 patents, including approximately 4,000 U.S. patents. After unsuccessful attempts to sell small packages of Qimonda’s patents, Jaffé decided the best way to realize the value of the patent portfolio was to license the patents, and Jaffé intended to renegotiate existing patent agreements in an attempt to achieve greater royalties for Qimonda. Jaffé provided notice to many of Qimonda’s patent licensees, including U.S. patent licensees, that Qimonda would not perform under their existing patent licenses pursuant to German Insolvency Code § 103. German Insolvency Code § 103 does not provide the same type of protection that is available under U.S. Bankruptcy Code

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<sup>5</sup> Memorandum Opinion, *In re Qimonda AG*, Case No. 09-14766-SSM (E.D. Va. Oct. 28, 2011) [Docket No. 635].

<sup>6</sup> The bankruptcy court later entered a supplemental recognition order making Bankruptcy Code § 365 applicable to the Chapter 15 proceeding. The provisions of Bankruptcy Code § 365 do not apply automatically in a Chapter 15 proceeding. Instead, a foreign representative or other party-in-interest must petition the court to apply § 365 pursuant to Bankruptcy Code § 1521.

§ 365(n), but instead provides that executory contracts are automatically unenforceable unless the insolvency administrator, in this case Jaffé, affirmatively elects to perform the contracts.

Two U.S. patent licensees, Samsung Electronics Co., Ltd. (“Samsung”) and Elpida Memory, Inc. (“Elpida”) (the “U.S. Licensees”), responded to Jaffé’s notice by asserting that they were entitled to the protection of U.S. Bankruptcy Code § 365(n).

In an effort to convince the U.S. bankruptcy court that he did not intend to take advantage of the U.S. Licensees, Jaffé filed pleadings committing to re-license Qimonda’s patent portfolio at a reasonable and non-discriminatory royalty to be determined through good faith negotiations where possible or through arbitration under the auspices of the World Intellectual Property Organization.

### **The U.S. Bankruptcy Court’s Decision**

The court explained that the semiconductor industry is characterized by the existence of a “patent thicket,” such that any given semiconductor device may incorporate technologies covered by a multitude of patents not owned by the manufacturer, and it is difficult, if not impossible, to identify all potential patents or design around each and every patented technology. As a result, semiconductor manufacturers must obtain licenses to many different patents prior to developing new technologies to avoid infringement claims.

In reaching its decision, the court considered that Congress’ reason for including § 365(n) in the Bankruptcy Code was to remove what had become an unintended burden on American technological development. The court explained that in the absence of appropriate cross-license agreements in the semiconductor industry, “design freedom” gives way to a “hold-up premium” because manufacturers must attempt to license patented technology after potential infringement has already occurred and after an initial, non-recoverable investment has been made in anticipation of new production. The court considered testimony from an expert for the U.S. Licensees that eliminating the protection of § 365(n) would harm innovation by creating uncertainty, which in turn negatively affects investment decisions.

Jaffé’s expert testified that there was no reason to believe that innovation would be harmed given Jaffé’s commitment to re-license the Qimonda patent portfolio on reasonable and non-discriminatory terms. Jaffé’s expert also explained that a decision applying § 365(n) would only preserve rights in the licensing of U.S. patents, not the non-U.S. patents, which would have to be renegotiated. Jaffé’s expert calculated that Qimonda would lose approximately \$47 million dollars in revenues if the U.S. Licensees did not have to pay for the continued right to use the U.S. patents.

The court first addressed whether limiting the applicability of § 365(n) “appropriately balanced” the interests of Qimonda and the U.S. Licensees. The court determined that the application of § 365(n) to the U.S. patents was required to ensure that the interests of the U.S. Licensees were “sufficiently protected” under U.S. Bankruptcy Code § 1522(a). While the court recognized that the “hold-up premium” caused by requiring the re-licensing of the U.S. patents was lessened by Jaffé’s promise to re-license the U.S. patents on reasonable and non-discriminatory terms, the risk to the substantial investments that the U.S. Licensees had made in research and manufacturing facilities in reliance on the design freedom provided by the agreements outweighed any loss of revenue to the Qimonda estate.

The court then addressed whether granting comity to German insolvency law would be “manifestly contrary to the public policy of the United States” within the meaning of Bankruptcy Code § 1506. The court explained that the public policy exception to granting comity to applicable foreign law must be

limited to the *most fundamental policies* of the United States, and the fact that application of foreign law results in a different outcome than applying U.S. law is insufficient to deny comity. The court explained that in order to be manifestly contrary to public policy, foreign law must either (i) be procedurally unfair or (ii) severely impinge a U.S. statutory or Constitutional right in a way that would offend the most fundamental policies and purposes of such right.

The court acknowledged that no party had claimed, nor was there any reason to find, that German insolvency law or proceedings were procedurally unfair. Instead, the court focused on the second basis for the public policy exception to comity. The court determined that German insolvency law, as it applies to licenses to U.S. patents, implicated the statutory right found in Bankruptcy Code § 365(n). While the bankruptcy court recognized that Congress did not make the protection of § 365(n) automatic upon recognition in a Chapter 15 proceeding, and that the harm discussed in the legislative history of § 365(n) differed from the “hold-up premium” discussed by the U.S. Licensees, the court determined that the uncertainty resulting from not applying § 365(n) would slow the *pace* of innovation to the detriment of the U.S. economy. Thus, under the circumstances of this case and for *this industry*, the court determined that the failure to apply § 365(n) would “severely impinge” an important statutory protection accorded licensees of U.S. patents and thereby undermine a fundamental U.S. public policy promoting technological innovation.

There is some question as to whether the bankruptcy court’s holdings in *Qimonda* will be affirmed on appeal given the high threshold regarding the meaning of “manifestly contrary.” Additionally, questions remain as to whether other courts would reach the same conclusions in other Chapter 15 cases involving intellectual property given the *Qimonda* court’s limitation of its holdings to these particular circumstances and the semiconductor industry.

Licensees should note that § 365(n) does not automatically apply in a Chapter 15 bankruptcy case. Instead, a licensee must take affirmative action in Chapter 15 bankruptcy cases requesting the application of the § 365(n) protections.