CLEARY GOTTLIEB
Alert Memo
APRIL 11, 2012
www.clearygottlieb.com

New Developments in IP Licensing under German Insolvency Law

The German Federal Ministry of Justice recently published a proposal to amend the German Insolvency Code (*Insolvenzordnung*) to provide substantial additional clarity to the rights of parties in the event of the insolvency of a German licensor of intellectual property ("IP") and bring the German law more into line with Section 365(n) of the U.S. Bankruptcy Code. The draft *Act to Shorten the Proceedings to Obtain Relief from Remaining Debt, to Strengthen Creditors' Rights, and on the Enforceability of Licenses in Insolvency* (*Gesetz zur Verkürzung des Restschuldbefreiungsverfahrens, zur Stärkung der Gläubigerrechte und zur Insolvenzfestigkeit von Lizenzen*, the "Draft Bill") proposes new rules applicable to licenses in the insolvency of the licensor. If implemented, such rules would significantly improve the position of licensees in the licensor's insolvency.

Licenses not Insolvency-proof Under Existing Law

Under existing German law, generally, IP licenses are not insolvency-proof. License agreements constitute executory contracts. As a consequence, if the licensor becomes subject to German insolvency proceedings, its insolvency receiver is entitled to reject performance of licenses previously granted by it. The insolvency receiver may then sell the licensed right free of the license, or renegotiate the terms of the license with the licensee. Only in exceptional circumstances is the insolvency receiver not entitled to reject performance of IP licenses granted by the debtor. Furthermore, any measures proposed to mitigate the licensee's risks (such as taking security over the licensed rights) involve legal complexities and are only to a limited extent tested in court.

On this basis, current German law significantly exposes a licensee to the licensor's insolvency risk, in particular where the licensee has made investments in reliance on the license, *e.g.*, by developing intellectual property rights based upon the license which the licensee would no longer be permitted to use if the license expires. This uncertainty particularly affects the pharmaceutical industry and the software and the music publishing business, but also other publishers and the automotive industry. In 2007, the German Federal Government proposed to exempt licenses from the insolvency receiver's right to reject performance of executory contracts. However, after substantial criticism from practitioners, the proposal was dropped.

Proposed Amendments

Under the amendments proposed by the Draft Bill, the insolvency receiver would retain the right to reject performance of licenses granted by the debtor, and any previously existing exemptions from such right would also continue to exist. Under the proposed new rule, however, the licensee would be entitled to require the insolvency receiver (within one month after its receipt of the receiver's notice of rejection to perform) to enter into a new license agreement upon commercially reasonable terms. When determining such terms, the parties would have to ensure that the insolvency estate receive an adequate share in the licensee's benefits resulting from the use of the license. Furthermore, the parties would have to take into account whether the licensee had made, prior to the insolvency, any investments that increased the license's value.

If the insolvency receiver sold the licensed intellectual property right to a third party, the licensee would be entitled to require such third party to enter into a new license agreement. Similarly, where the licensor had granted the license as a sub-license, and the (sub-)licensor's receiver rejected performance, the sub-licensee would be entitled to require the main licensor to enter into a direct new license. Furthermore, the Draft Bill provides that the licensee would be entitled to continue to use the license until a new license agreement is concluded. If the insolvency receiver and the licensee would not be able to agree on a new license agreement within three months, the licensee would have to sue the insolvency receiver for the entry into a new agreement to avoid losing the right to use the license.

As yet, reactions to the proposed amendments from relevant associations and practitioners have been generally positive, although it has been argued that the amendments are not far-reaching enough and still give insolvency receivers too much leverage. Generally, the Draft Bill balances the interests of the insolvency estate and licensees: while the licensee would remain entitled to use the license (and any of its developments based thereon), the insolvency receiver would not be prevented from disposing of the licensed right. Furthermore, the insolvency estate would receive its share in the benefits of the licensee based upon the re-negotiated license fee. Thus, giving the insolvency estate an adequate share without impairing the rights of the licensee more than necessary to allow the liquidation or reorganization of the insolvent licensor, the proposed amendments would not create any friction with the general principle that the insolvency receiver may reject performance of executory contracts. The requirement to negotiate and enter into a new license agreement also allows finding tailored solutions for cross-licenses and change of control clauses contained in existing license agreements.

The proposed amendments would also more closely align German insolvency laws applicable to licenses with the laws of other jurisdictions, such as Section 365 of the U.S. Bankruptcy Code and Article 56 of the Japanese Bankruptcy Code. In this respect, the potential conflict of insolvency laws is not a mere theoretical issue. *See, e.g.*, the U.S. Bankruptcy Court for the Eastern District of Virginia decision of October 28, 2011 (In re Qimonda, Case No. 09-14766-SSM). The U.S. court held that if a German insolvency receiver in Chapter 15 proceedings rejects performance of licenses relating to U.S. patents (as opposed to non-U.S. patents) then the licensees have the right (under Section 365(n) of the U.S. Bankruptcy Code) to retain their license rights because denying such a right would be manifestly contrary to U.S. public policy, particularly where the German insolvency receiver had specifically sought the protections of section 365 of the U.S. Bankruptcy Code earlier in its Chapter 15 proceeding.

CLEARY
GOTTLIEB

*

* *

If you have any questions in regard to the issues addressed herein, please feel free to contact Dr. Werner Meier (wmeier@cgsh.com), Michael Kern (mkern@cgsh.com) or Christoph Schauenburg (cschauenburg@cgsh.com) at the Frankfurt office of Cleary Gottlieb or any of our partners and counsel listed under “Germany”, “Lawyers in this Practice”, under the “Practices” section, “Regions”, of our website at http://www.cgsh.com.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

Office Locations

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS
12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW
Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE
Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME
Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN
Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG
Bank of China Tower
One Garden Road
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING
Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES
CGSH International Legal
Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO
Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299