

Bankruptcy Law and Licensing

Changes in U.S. Law will have detrimental impact on licensing parties, unless adequate protection is provided

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Every licensing lawyer who has licensed technology in the United States has seen the clause known as an *ipso facto* bankruptcy clause which says:

8. Bankruptcy. In the event of
- (a) an appointment of a trustee or receiver,
 - (b) assignment of assets for the benefit of LICENSEE's creditors,
 - (c) any levy of execution involving the license here-with granted, or
 - (d) an adjudication of the LICENSEE's bankruptcy, the license herein granted thereupon terminates.

In assignments the common *ipso facto* U.S. bankruptcy clause reads:

8. Bankruptcy. In the event of
- (a) any appointment of a trustee... all rights, titles and interest in the patents herein assigned, including all rights to sue infringers and to grant licenses thereunder, automatically revert to ASSIGTOR without further action by him in any court.

The Bankruptcy Reform Act of 1978, new Title 11, United States Code obliterates all such clauses as of its effective date of October 1, 1979.¹

The reformers did not stop with a simple avoidance of old contract clauses.

Under the new United States bankruptcy law, any debts such as royalty obligations or liability for patent infringement prior to filing of a bankruptcy petition may be forgiven and discharged.² Further, the Reform Act sanctions transfers of the license to the highest bidder which may be an aggressive price-cutting competitor of the licensor.³

Reform goes deeper still.

The statute gives the trustee of a licensor in bankruptcy the authority to reject in toto license. He may then leave the licensor to his infringement suit or negotiate a license at a reduced royalty.⁴

A further word of caution is appropriate. Upon filing of a petition in bankruptcy an "automatic stay"⁵ becomes effective enjoining any acts, judicial or otherwise, to recover from or dispose of property in which the debtor in bankruptcy may have an interest. The effect of the "automatic stay" is to require a party to formally petition the bankruptcy court for relief from the stay prior to taking any action with respect to property in which the trustee claims an interest. The "automatic stay" is an

important feature of bankruptcy which because of the contempt powers of the bankruptcy court everyone should remember.

Any lawyer continuing to incorporate *ipso facto* bankruptcy clauses into transfers of intellectual property seriously misleads his clients. Similarly, any lawyer who relies solely on a default clause has inadequately armed his client for the event of the other party's financial difficulties.

Because intellectual property transfers often involve one party whose finances fall short of the Rock of Gibraltar, and the Reform Act prohibits *ipso facto* bankruptcy clauses, lawyers must couch their clients about the consequences of bankruptcy. Similarly, lawyers must learn to structure licenses and assignments in appropriate cases such that their clients will have the biggest stick possible if and when they deal with a trustee⁶ or debtor in possession.⁷

BANKRUPTCY SERVES TO GIVE DEBTORS A FRESH START WHILE PAYING OFF AS MANY CREDITORS AS POSSIBLE

The ability of a party to an intellectual party transfer to protect his interest when the other party has entered bankruptcy will in large part depend upon the characterization of the debtor's obligations in the bankruptcy context.

The commencement of a bankruptcy case by filing a petition⁸ creates an estate.⁹ The estate includes all legal or equitable interests of the debtor in property as of the commencement.¹⁰ The estate will have a legal representative, either a trustee or a debtor in possession, which will have many powers. Those powers include the power to avoid certain transfers of property made by the debtor prior to commencement of the case.¹¹

Where a petition has been filed for a chapter 7 liquidation under 11 U.S.C. Sec.701 et seq., a trustee will be appointed to collect, classify, and liquidate the estate.¹²

Classification of the estate involves labeling different assets as property subject to a security interest¹³ or rights under an executory contract.¹⁴ The property of the estate may simultaneously bear two labels. For example the situation of a company leasing equipment where the lessor retained a security interest in the company's contractual right to use the equipment demonstrates a property of the estate—the contractual right under the lease—which is the subject of an executory contract and a security interest.

Generally speaking secured creditors will receive the collateral securing their claims¹⁵ or proceed

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from the sale of that collateral to the extent of any allowed claims.¹⁶ Any remaining property will be used first to satisfy administrative expenses¹⁷ which include the lawyers fees leaving perhaps six or seven cents on the dollar for unsecured creditors who fall at the bottom of the totem pole.¹⁸

Reorganization

In a chapter 11 business reorganization case under 11 U.S.C. Sec.1101 et seq. the debtor in possession, or a trustee if one is appointed, will continue to operate the business while the creditors and debtor work out a plan for reorganization.

An important feature of reorganization proceedings which must be appreciated is that the plan for reorganization may impair any obligation¹⁹ and forgive by discharge any obligation of an unsecured creditor.²⁰ Similarly the plan may be imposed on any nonconsenting creditor, including secured creditors, in appropriate circumstances.²¹

The reality of compromised and forgiven debts which occurs everyday in bankruptcy proceedings may come as a shock to the uninitiated. A licensing attorney who keeps in mind and advises his clients to do likewise the policy of the bankruptcy statute and the perspective of the bankruptcy estate will perform a valuable service for his client.

Bankruptcy is a constitutionally²² sanctioned procedure whereby a party with serious financial difficulties may seek the protection of the bankruptcy court, make full disclosures of his obligations, give up most of his property to form the estate, and be discharged of almost all obligations. A person coming out of bankruptcy with a discharge is given a fresh start to begin anew.

The trustee or debtor in possession has as one of his primary goals the duty to collect all property of the estate, including property which has been preferentially or fraudulently transferred by the debtor prior to commencement of the bankruptcy case. By increasing the value of the estate, the trustee increases the value of the dividend which unsecured creditors receive on liquidation.

Similarly, in a reorganization, the trustee, debtor in possession, or a committee of creditors rejects unacceptable contracts and leases, and negotiates new terms for other contracts and leases. Where the debtor in possession and a committee of creditors have put together a plan that a majority of creditors will accept, nonconsenting creditors can be forced to accept the plan. Once the plan has been confirmed, the debtor has a fresh start to begin anew and successfully operate his business.

Provisions

The representative of the estate does not however, have a carte blanche to completely ignore the interests of creditors of the estate. Rather property of the estate must be handled in accordance with provisions of the Reform Act. For example, a trustee or debtor in possession authorized to operate the business may enter into transactions to lease or sell or use property of the estate if such lease, sale, or use occurs in the ordinary course of

business.²³

The trustee or debtor in possession may also, after notice and hearing, lease, sell or use property of the estate out of the ordinary course of business.²⁴ Certain other sections operate to limit the authority of the trustee or debtor in possession to use, lease or sell property covered by that section. Thus, a party claiming an interest, such as a lien, in property may obtain relief from the automatic stay such that the trustee may not use, lease or sell that property in any fashion inconsistent with the order granting relief from the stay.²⁵ Also, the trustee or debtor in possession may assume and assign contracts which have been classified as "executory" after meeting certain obligations to cure defaults and provide adequate assurance of performance.²⁶

The effect and implications of these various statutory provisions on technology transfer contracts will become more clear in the context of concrete examples.

AN ASSIGNOR WHO FAILS TO RETAIN A SECURITY INTEREST WILL HAVE NO CONTROL IN THE EVENT OF THE ASSIGNEE'S BANKRUPTCY

Consider the plight of Salt of the Earth Corp., a family-owned corporation with principal places of business in Muskogee, Oklahoma, under the following circumstances.

In 1975 an employee of Salt of the Earth invented an electronic system which could be used in virtually every combustion engine. The employee pursuant to his employment contract assigned the invention to the corporation.

Since Salt of the Earth was a small company, it was not in a position to undertake the capital investment of developing and introducing the improved electronic ignition into the marketplace. Accordingly, it patented the invention and thereafter found a buyer for the patent, U.S. based Big Daddy Corporation. The assignment included:

1. A \$5000 minimum monthly royalty plus 5% of gross received products sold by Big Daddy Corp.
2. A traditional *ipso facto* bankruptcy clause — in the event of an act or event of bankruptcy all the assigned rights, title and interests revert to the assignor, Salt of the Earth.
3. A default clause to the effect: If any default by Big Daddy Corp. remains uncured for 60 days after notice, all the assigned rights, title and interests revert automatically to the assignor.

Notwithstanding the success of the improved electronic ignition in the marketplace, Big Daddy Corporation suffered great financial difficulties because of Japanese imports and a sudden market shift to smaller cars. A group of creditors filed a petition against Big Daddy Corporation commencing an involuntary bankruptcy. Royalties ceased to be paid under the assignment.

Any Interest of an Assignee-Debtor in Bankruptcy in Patent Belongs to the Bankruptcy Estate Upon Filing of the Petition in Bankruptcy.

The first question the Salt of the Earth Corpora-

tion is likely to ask its lawyer concerns whether it may consider the patent rights reverted under the *ipso facto* bankruptcy clause or whether it may cause a reversion under the default clause. In the few cases that arose under the old law, courts reluctantly enforced *ipso facto* bankruptcy clauses.²⁷

Under the Reform Act, it is quite clear that any rights of the debtor at the time of the petition belong to the bankruptcy estate. That estate includes "all legal and equitable interest of the debtor and property as of commencement of the (bankruptcy) case."²⁸ The drafters intended any contractual interest or legal or equitable property rights of the debtor to belong to the estate.²⁹

The unenforceability of the *ipso facto* clause under the Reform Act is equally clear.

An interest of the debtor in property becomes property of the estate...notwithstanding any provision —

(a) That restricts or conditions transfer of such interest by the debtor; or

(b) That is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or the taking possession by a trustee in a case under this title or a custodian, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.³⁰

Nor may Salt of the Earth exercise its rights under the default clause after commencement of the case. The automatic stay clearly forbids "any act to obtain possession of property of the estate or of property from the estate"³¹

The Representative of the Estate Can Often Reach Behind the Date the Petition in Bankruptcy Was Filed to Recover Property Transferred by the Debtor

Suppose Big Daddy had defaulted in payment of royalties not long before the petition in bankruptcy and Salt of the Earth Company had exercised its rights under the default clause before the creditors filed their petition. In such a situation, Salt of the Earth suffers the risk that a trustee or debtor in possession may later force it to reconvey the rights in the patent to the bankruptcy estate.

This power of the trustee to reach behind the petition date and recover property transferred by the debtor comes from 11 U.S.C. Sec. 547. The trustee may recover property transferred prior to commencement of the case if the transfer created a "voidable preference."³² The first hurdle of a trustee seeking to avoid a transaction requires finding a "transfer of property of the debtor."³³ Inclusion of the default clause in the assignment and exercise of the right of reversion each qualify as transfers.³⁴ The contractual right to take the patent rights and the patent rights themselves fall within the broad definition of "property of the debtor" found in the legislative history.³⁵ Also the contractual rights and the patent rights come within the definitions of property of the debtor found in case law under the predecessor of section 547.³⁶

Once there has been a "transfer of property of the debtor" the five conditions of section 547(b) must be demonstrated. These require that the

transfer be made: to a creditor,³⁷ for or on account of an antecedent debt,³⁸ while the debtor was insolvent,³⁹ and within ninety days before filing of the petition.⁴⁰ Additionally, the transfer must create a "preference" whereby Salt of the Earth receives property — the patent — of a greater value than the dividend it could realize on its claim in a Chapter 7 liquidation of Big Daddy Company's estate — on these facts nothing.⁴¹

Elements

Three of these elements can easily be demonstrated by a trustee seeking to recover the patent rights. Reversion of the patent rights to Salt of the Earth Company qualifies as a transfer to a creditor because Salt of the Earth is an entity with a claim for unpaid royalties. The debt for unpaid royalties is an antecedent debt because under this fact pattern, the reversion is deemed to occur at the actual time of reversion which follows in time by at least 60 days the default.⁴²

The preference requirement will be met in almost any case where an assignor has failed to retain a security interest and actually exercises his termination rights. A decision by Salt of the Earth to exercise the reversion right indicates that the patent has some value. Without a security agreement Salt of the Earth would have a relatively worthless claim against the estate.⁴³ Consequently, exercise of the reversionary right indicates that Salt of the Earth has received more value from the reversion than it would have received in a Chapter 7 liquidation.

The Reform Act gives the trustee an initial advantage with respect to the "transfer while insolvent" requirement because "the debtor is presumed to have been insolvent during the ninety days immediately preceding the date of the filing of the petition."⁴⁴ The legislative history indicates that this presumption is intended only to shift the burden of producing evidence and the trustee must bear the burden of proof.⁴⁵ Thus, the trustee must be prepared to demonstrate that at the time of the reversion "the sum of the entity (Big Daddy Corp.) debts (was) greater than all of such entity property, at a fair valuation..."⁴⁶ The failure of the trustee to prove balance sheet insolvency may be the only factor which allows Salt of the Earth to keep the patent rights.

A trustee seeking to prove a voidable preference must also prove that the transfer occurred within the 90 day period preceding commencement of the bankruptcy case. A transfer of personal property is deemed to have occurred at the time when the transferee's rights in that property will withstand an attempt of a contract creditor to enforce a judgment lien against that property.⁴⁷ The Reform Act contemplates reference to applicable nonbankruptcy law to determine when Salt of the Earth's interest in the patent becomes superior to that of a subsequent judgment lienor having a claim against Big Daddy Corporation.

Since construction of patent assignments is solely a matter of state law,⁴⁸ the applicable state law controls when an assignor's reversionary interest is

superior to the right of a judgment lienor to execute. Under general concepts of property law a reversionary interest will not defeat the rights of a person having judgment lien until that reversionary right has been exercised. Thus, under the facts presented, Salt of the Earth must exercise its reversionary right under the default clause before the 90th day before commencement of the case in order to defeat the requirement of a transfer within the 90-day period. Whenever the assigned patent represents a vitally important asset of the debtor, exercise of the reversionary right may trigger an immediate filing of a voluntary petition in bankruptcy. But people sometimes move slowly before pushing a company into bankruptcy. Thus, 90 days, or more, may often elapse before anyone files a petition in bankruptcy. The lesson is clear that a tangle with the trustee may be avoided by timely exercise of a default clause.

Once the Patent Becomes Property of the Estate, the Assignor with No Security Interest Finds Himself at the Mercy of the Trustee and the Secured Creditors.

The trustee or debtor in possession may use property of the estate in the ordinary course of business regardless of defaults.⁴⁹ Thus, where an effort is being made to find a buyer for Big Daddy Corporation, or where Big Daddy Corporation is going through a business reorganization, the trustee or debtor in possession will keep the business running.

Continued manufacture and sale of electronic ignitions that fall within the scope of the assigned patent's claims will be one aspect of continued operation. Manufacture and sale of the improved electronic ignitions is permissible notwithstanding the fact that the estate fails to pay for royalties. That part of the debt for royalties incurred after filing of the petition has priority, as an administrative expense, over the debt for prepetition defaults. Salt of the Earth still risks receiving far less than full value because in most instances, secured creditors take up the entire estate leaving nothing to pay administration expenses and unsecured creditors.

A Trustee May Be Able to Sell the Patent Rights to the Highest Bidder Free of the Obligation to Pay the Assignor Royalties, While the Debtor's Obligation to Pay Royalties is Discharged in the Bankruptcy Process.

The trustee or debtor in possession may, after notice and hearing, lease, sell, or use property of the estate out of the ordinary course of business.⁵⁰ Thus, the trustee for Big Daddy Corporation could sell the patent for improved electronic ignition sys-

tems for a lump sum to Slick Predatory Inc., a major conglomerate with a subsidiary in direct competition to Salt of the Earth.

The question of whether Slick Predatory buys the patent subject to the obligation to pay royalties of Salt of the Earth presents a problem which is not squarely answered by the statute or case law under the old law. Assuming the original assignment from Salt of the Earth to Big Daddy includes a clause making its terms binding on Big Daddy's successor's, assigns, and licensee's; and further assuming that the assignment was properly recorded in the Patent and Trademark Office, Slick Predatory should be bound by the terms.⁵¹

Alternatively, Slick Predatory could argue that the obligation to pay royalties is a personal covenant to pay the purchase price of Big Daddy that does not run with the property upon further assignment. No cases have been found which support such an argument; nonetheless, its force cannot be ignored.

Salt of the Earth Company could attempt to buy the patent from the estate itself. However, the trustee's interest is to get the highest price for the patent and an assignor such as Salt of the Earth which does not practice the patent probably cannot justify paying very much to repurchase the patent. Accordingly, a large conglomerate competitor desiring to practice the invention could bid a higher price.

Salt of the Earth would be left out under this situation in more ways than one. The obligation of the debtor, Big Daddy, to pay royalties would be discharged in the bankruptcy proceeding. The effect of discharge is to discharge or forgive the debtor from all debts that arose before the order for relief.⁵² Discharge occurs whether or not a proof of claim based on the obligation is filed in the bankruptcy proceeding and whether or not a claim based on the obligation is allowed in the bankruptcy proceeding.⁵³ The obligation to pay royalties would come within the statutory definition of the claim which includes "(a) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."⁵⁴

Accordingly, Salt of the Earth may find that it has no prospective rights with respect to the patent at all.

An Assignor with an Enforceable Security Interest and a Well-Drafted Default Clause Has More Control

Retention of a Security Interest Provides Significant Protection

Treatment of property subject to a security interest differs significantly from treatment of property where the bankruptcy estate's interest is free of any liens or other interest. Thus, where an operation of the business has been authorized, an assignor with a lien against the patent rights may petition the court for an order prohibiting or conditioning use, sale, or lease of the property subject to

the security interest as is necessary to provide adequate protection of the assignor's property interest.⁵⁵ The trustee has the burden of proof on the issue of adequate protection.⁵⁶

Precisely what will be adequate protection remains to be developed by case law.⁵⁷ The code provides three alternatives in 11 U.S.C. Sec. 361. Thus, the trustee can be required to make periodic cash payments to the extent that use, sale or lease decreases the value of the lienor's interest in the property. Alternatively, the lienor may be provided with an additional or replacement lien. Or finally, the court may grant such other relief as will give the lienor the "indubitable equivalent" of the lien. The decision will be a pivotable one in every reorganization case. However, until case law develops, lawyers must make their best guess.

The Security Interest Runs With the Property

The trustee cannot sell property free and clear of any lien unless:

—Applicable nonbankruptcy law permits such a sale.

—Or the lienor consents.

—Or the value of the property sold is greater than the aggregate obligations secured by the lien.

—Or the lien is in good faith disputed.

—Or the lienor could be compelled to accept a money satisfaction of the obligations.⁵⁸

By careful drafting of a security agreement, Salt of the Earth Co. could have foreclosed on the collateral, the patent itself, upon the failure of Slick Predatory, Inc. to pay royalties as agreed in the assignment.

A well drafted security agreement usually lists proceeds from sale of the patent as additional collateral. In that event the secured creditor's lien attaches to the cash received by the state upon sale of the patent. Where the trustee does sell the property free and clear of the security interest, the security interest will usually attach to proceeds of the property free and clear of the security interest.⁵⁹

An Assignor With a Security Interest in the Patent May Bid for Purchase of the Patent and Set Off Against the Purchase Price the Obligations of the Estate Which Are Secured by the Patent

The ability to purchase the patent out of the estate and set off the purchase price against the value of the claim for failure to pay past and future royalties may prove to be one of the most significant protections available to assignors.⁶⁰ Such an alternative would have enabled Salt of the Earth to bid at a bankruptcy sale as high as Slick Predatory Co. with the knowledge that it could set off against the purchase price the entire value of its claim against the estate.

In a Reorganization Case an Assignor with a Security Interest in the Patent Has More Clout

An understanding of how and why a secured creditor has more clout in confirmation of a busi-

ness reorganization plan requires some understanding of the mechanics of formulating and confirming such a plan.⁶¹ Claims of creditors are divided into classes wherein each claim or interest in a class is substantially similar to other claims or interest in the class.⁶² As a practical matter each secured claim is distinctly different from each other secured claim so that the claims of secured parties will each belong in separate classes. It is also likely that the claims of any party arising out of a patent assignment would also be dissimilar to any other claims and therefore in a class of one.

Confirmation of a reorganization plan requires approval of all classes.⁶³ However, a class can be deemed to approve even though its members do not consent. Where a claim or interest, including lien, has not been impaired by the plan, the class will automatically have been deemed to approve the plan.⁶⁴

Nonconsenting secured creditors can only be forced to accept a plan if the requirements of 11 U.S.C. Sec. 1129(b) (2) (A) are met. The mechanics of that section are very complicated. At a very minimum, the property remains subject to the security interest and the secured party will receive deferred cash payments totalling a sum equal to the value of the collateral as of the effective date of the plan to the extent of the creditor's interest in the collateral. Where the collateral is to be sold free and clear of the lien, the security interest must attach to the proceeds and the secured party must receive the same deferred cash payments that it would have received had the collateral not been sold.

Thus, had Salt of the Earth retained a security interest in the patent, any inventoried products which would infringe the patent absent the assignment,⁶⁵ and any proceeds thereof, it would have stood a good chance of receiving deferred cash payments of expectations under the assignment provided the value of the collateral at the effective date of the plan was sufficient to cover such payments.

The treatment of unsecured creditors and a reorganization stands in stark contrast to the treatment of secured creditors. An assignor who votes to reject the plan may find the plan imposed on him if at least one class has accepted the plan and the court determines that all rejecting classes have been treated fairly and equitably.⁶⁶ The assignor will be deemed to have received fair and equitable treatment if he receives property which at the effective date of the plan has a value equal to the amount of his claim or interest, or if any claimant or interest junior to the assignor receives nothing.⁶⁷

Salt of the Earth can have the plan forced upon it if the bankruptcy court determines that the value of the property received under the plan equals the value of Salt of the Earth's interest in being paid past and future royalties. Additionally, the legislative history states:

As long as senior creditors have not been paid more than in full, and classes of equal claims are being treated so that the dissenting class of impaired unsecured claims is not being discriminated against unfairly, the plan may be confirmed if the impaired

class of unsecured claims receives less than 100 cents on the dollar (or nothing at all) as long as no class junior to the dissenting class receives anything at all.⁶⁸

This complex statutory network suggests that an unsecured creditor may walk away from a reorganization proceeding with absolutely no value while the reorganized debtor retains a title to the assigned patent. While it is to be hoped that such a harsh result never occurs, parties should nonetheless be forewarned and retain a security interest to avoid such result.

THE GRANTOR OF A NONEXCLUSIVE LICENSE OCCUPIES A SLIGHTLY BETTER POSITION THAN AN ASSIGNOR WHERE THE LICENSEE ENTERS BANKRUPTCY

A Trustee May Neither Assume Nor Assign Without Consent of the Licensor Where the Contract Is So Personal that Contract Law Prohibits Assignment by the Licensee.

Consider the situation of Jet Set Inc. in the following fact pattern. Jet Set held and practiced a patent for a process to make a contact cement which would bond to a variety of surfaces. Jet Set also manufactured in bulk one of the major reactants for use in the process. The demand for the glue made by the process was far greater than the small company could meet. So the company decided to grant nonexclusive licenses with minimum and running royalties to acceptable manufacturers. Each license contained in addition to the license grant a promise to supply the unpatented reactant.

The treatment of such a license in bankruptcy will surely be governed by the rules for executory contracts in 11 U.S.C. Sec. 365. As will be more fully discussed later, a contract is executory where there are substantial obligations remaining unperformed on both sides of the contract.⁶⁹ In the above example, the obligation of the licensees to pay royalties throughout the term of the license and obligations to further license and provide the reactant insure that there will be mutual unperformed obligations throughout the term.

Section 365 allows the trustee to assume or reject executory contracts and unexpired leases if certain conditions are met. In the case of the patent license which has been characterized as executory, there is a very strong argument that the trustee may not assume or assign the license without consent of the licensor. Section 365 (c) prohibits assumption where:

(1) (A) (A)pplicable law excuses a party, other than the debtor to such contract or lease from accepting performance or rendering performance to the trustee or an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of the rights or delegation of duty; and (B) such party does not consent to such assumption or assignment. . . .

The text of the statute and the legislative history⁷⁰ require that Jet Set be excused from accepting performance from anyone besides its chosen licensee by operation of law and not by contact.

This provision significantly tilts the scales in the favor of the licensor. Patent licenses have long been considered contracts of such a personal nature

that the license cannot be transferred from the licensee either by assignment⁷¹ or by operation of law.⁷² Thus, Jet Set should have good chances of persuading a bankruptcy court that the trustee of its licensee may not assume without its consent.

The question of whether a debtor in possession may assume an executory contract poses some difficulty. One commentator has concluded that Section 365(C) (1) does not preclude assumption by debtor in possession.⁷³ However, it must be recalled that the debtor in possession is "subject to any limitations on a trustee under. . . chapter (11)."⁷⁴ Presumably the prohibition against assumption by the trustee can similarly restrict a debtor in possession.

The force of such a statutory interpretation is doubtful, because a debtor in possession is by definition the debtor⁷⁵ and Jet Set would not be required to accept performance from anyone other than its chosen licensee. Jet Set could argue to the bankruptcy judge, who must approve assumption, the personal nature of the contract and the inherent frustration of his expectations and saddling him with a licensee so importantly different, except in name, from the licensee with whom he originally contracted.

Where Nonexclusive Licenses Are Assumed in a Bankruptcy Proceeding, the Code Provides Some Measures for Protecting the Interest of the Licensor

Where the licensed patent represents a critical asset of a corporation going through a reorganization, the debtor in possession will most assuredly be allowed to assume the executory contract because otherwise chances of successful reorganization would be destroyed. Such a situation would arise where the licensee is in the business of making the glue, cannot easily design around the process, and cannot afford to defend an infringement suit. In such a situation, the licensee-debtor would have to shut down if the contract was not assumed.

Where the debtor is permitted to assume and there has been a default, three requirements must be met. There must be a cure of defaults,⁷⁶ compensation for actual pecuniary loss,⁷⁷ and provision of adequate assurance of future performance.⁷⁸

These requirements will provide some protection for Salt of the Earth Co., but their value should not be over estimated.

Often, cure of defaults and compensation for actual pecuniary loss (that is, payment of past-due royalties) will be much less important than adequate assurance of future performance. The Reform Act fails to define its standard of adequate assurance.

It would be reasonable, however, to give the term the same construction in bankruptcy law as under the Uniform Commercial Code because a major goal of the Reform Act is to bring bankruptcy law insofar as possible into conformance with commercial standards. Article Two of the Uniform Commercial Code requires that adequate assurance of future performance be reasonable according to commercial standards.⁷⁹ The standard to be expected of an insolvent debtor can reasonably

be expected to be less than the standard of assurance required from a solvent going concern. Nonetheless, case law will have to be developed before lawyers can predict with accuracy what the adequate assurance standard means.

A Nonexclusive License Which Has Been Assumed May Be Assigned Notwithstanding a Contractual Prohibition Against Assignment

If Jet Set fails to persuade the bankruptcy court that its nonexclusive license is sufficiently personal to preclude assumption of the contract, the trustee or debtor in possession may assign the license.⁸⁰ As the assignment of a nonexclusive license can be considered a sale of property out of the ordinary course of business, notice and hearing should be required before the trustee assigns the contract.⁸¹ At that hearing, Jet Set will once again have the opportunity to impress the court with the personal nature of the license. However, it seems unlikely that a court that allowed assumption will be any more impressed on a second hearing of the argument.

Apparently, the only way for Jet Set to prevent an undesirable licensee from acquiring the license out of the estate is to purchase back the license itself. Even that alternative may not always be available. For example, where the trustee is able to find one entity that will purchase the entire estate of a bankrupt in liquidation with the purpose of continuing to operate the business, a licensor will more than likely not be allowed to defeat such a purpose by purchasing back any rights of the debtor under the license.

Where a Nonexclusive License Has Been Rejected by a Trustee in Bankruptcy, the Debtor May No Longer Practice the Invention

A trustee also has the power to reject nonexclusive licenses.⁸² Where rejection occurs, the nonexclusive license is deemed breached.⁸³ The timing of the breach is important for purposes of the bankruptcy priority ladder.⁸⁴ Prepetition claims, in the absence of a security agreement, fall at the bottom of the ladder. Claims for administrative expenses, that is expenses of operating a business after the petition has been filed, are the first expenses paid after the secured creditors.⁸⁵ The Reform Act in 11 U.S.C. Sec. 365(g) provided a complex formula for determining when the contract is deemed breached upon rejection.

The timing of the breach is probably not as important as the effect of a rejection on the ability of the bankruptcy estate to practice the invention. Upon rejection the estate may no longer practice the invention. Jet Set may sue the trustee in the bankruptcy court to enjoin further infringement.

As a practical matter, however, it seems that a trustee will probably reject the contract only when he considers the patent rights worth less than the effort to assume. Where a trustee sees no value in a patent, the licensor may have a very difficult time interesting someone else in the invention.

WHERE OBLIGATIONS REMAIN UNPERFORMED BY BOTH TRANSFEROR AND TRANSFEREE, A TRANSFER OF INTELLECTUAL

PROPERTY WILL BE CHARACTERIZED AS AN EXECUTORY CONTRACT

Almost all intellectual property transfers will be treated like either the assignment of Salt of the Earth or the license granted by Jet Set, Inc. In bankruptcy terminology, the debtor's interest under such transfers will be characterized as "property of the estate" or an "executory contract."

The first step in analyzing the prospects for client in a bankruptcy situation is classification of the transaction. The question becomes how does one classify: a trade secret license, a copyright license, a trademark license in a franchising agreement, an exclusive patent license, a cross-licensing agreement, a technical consulting agreement or any of the common variations and combinations of these transfers.

Although the Reform Act fails to define the terms "executory contract" and "unexpired lease"; the legislative history indicated the contracts are executory to the extent the "performance remains due on both sides".⁸⁶ This definition appears to follow case law under the old bankruptcy act. In *Jenson v. Continental Finance Corp.*, the Eighth Circuit considered the meaning of "executory" in the context of the bankruptcy act;

(A) contract under which the obligations of both the bankrupt and the other party to the contract are so unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Thus, where the contractual obligations of the bankrupt and the other contracting party remain at least partially and materially unperformed at bankruptcy, the contract is executory, (citations omitted).⁸⁷

This "mutuality of unperformed obligations" standard suggests that the analysis should begin by making a list of continuing obligations set out in the transfer instrument. A contract will be clearly "executory" where each party has promised to supply something tangible. For example, Jet Set, Inc. promised to supply an unpatented reactant for use in the patented process. The licensee agreed to pay a minimum monthly royalty if it did not practice the invention.

A more difficult problem arises where the licensor transfers a naked promise not to sue the licensee for infringement and makes no affirmative promises. A persuasive argument has been presented by a leading bankruptcy authority for concluding that even though a licensor has not promised to supply something tangible, an unperformed obligation still remains.⁸⁸ Professor Countryman argues:

(T) here may be an implied undertaking by the licensor which brings all patent licenses within the ambit of an executory contract. It has been held in a patentee-licensor infringement action against a third party that a final judgment adjudicating the patent invalid constitutes a "complete failure of consideration" amounting to an "eviction" which releases the licensee from any further obligation to pay royalties.⁸¹³ Moreover, since the death of the doctrine of "licensee estoppel," the licensee can set up the invalidity of the patent as a defense when sued by the licensor for royalties due under the license.⁸¹⁴ Hence, all patentee-licensors are now substantially in the position of having warranted to their licensees the validity of their patents. Al-

though the sanction for the breach of such a warranty is only a forfeiture of royalties rather than liability for damages, this continuing undertaking by the licensor is enough to justify the treatment of all unexpired patent licenses as executory.³¹⁵

313. *Scherr v. Difco Labs, Inc.* 401 F.2d 443 (6th Cir. 1968); *Drackett Chem. Co. v. Chamberlain Co.*, 63 F.2d 853 (6th Cir. 1933). Some courts have confined the eviction doctrine to exclusive licenses. *Ross v. Fuller & Warren Co.*, 105 F. 510 (N.D.N.Y. 1900) Cf. *Automatic Radio Mfg. Co. v. Hazeltine Research*, 176 F.2d 799 (1st Cir. 1949), *aff'd on other grounds*, 339 U.S. 827 (1950); *Thompson Spot Welder Co. v. Oldberg Mfg. Co.*, 256 Mich. 447, 240 N. W. 93 (1932).

314. *Lear v. Adkins*. 395 U.S. 653 (1969).

315. See Countryman, Part I, at 453'. In Countryman, *Executory Contracts in Bankruptcy*, 57 Minn. L. Rev. 439, 453 (1973), the author considers whether any obligation flows from a lessor to a surety after the lessor has granted the lessee a lease. He concludes that the surety has sufficient interest in whether the lessor performs his continuing obligations to the lessee to consider the surety-lessor contract executory. Thus, the surety example demonstrates that a party need not always have a legal remedy for breach in order to have his contract classified as executory.

It could be argued in answer to Professor Countryman's argument that an implied warranty of validity does not occur because the licensee is excused from future performance once an eviction occurs. Justification for the argument can be found by examining the remedy granted a licensee upon eviction. Courts have only allowed the licensee to consider the license terminated.⁸⁹ This remedy is theoretically inconsistent with the remedy that one would expect for breach of a warranty of validity. Theoretically, a warranty of validity requires restitution as the remedy.

The adjudication of invalidity means that for some reason the patent never should have issued.⁹⁰ An adjudication of invalidity then means that the parties to the license operated under a mistake of fact. Where the parties have operated under a mistake of a basic fact and the burden of that risk falls on the transferor, courts have long awarded restitution.⁹¹

The refusal of the courts to award restitution indicates that the licensor has not assumed the risk of invalidity. This conclusion of a conscious ignorance⁹² by both parties with respect to the validity of the licensed patent until recently has been such a basic proposition to patent lawyers that one treatise writer stated: "No warranty of the validity of the Letters Patent is implied in any license given thereunder."⁹³ Additionally, many licenses today have a specific negation of any implication.⁹⁴ Thus, it appears that the conclusion that the doctrine of eviction requires an implied warranty of validity seems to be precluded in light of the well established interpretations of patent licenses.

Reliance on the decision of *Lear v. Adkins*⁹⁵ to characterize the transaction between an exclusive licensor and his licensee as an executory contract is probably misplaced. The Court in *Lear* specifically recognized that federal courts are bound by the interpretation given by a state court to a patent license.⁹⁶ The rule in *Lear* that a licensee may raise invalidity as a defense in a suit for royalties and that a licensee cannot be required to pay

royalties while the royalty suit is pending represents a cautious preemption of state contract law in the interests of federal patent policy.⁹⁷

The court refused to preempt state law beyond the extent necessary in hopes that the state courts could establish rules on trade secret licensing which would not conflict with patent policy.⁹⁸ Since *Lear*, courts have continued to distinguish between a failure of consideration excusing future performance and a breach of warranty entitling the injured party to return to status quo ante.⁹⁹ These courts have reasoned that preemption of state law is unnecessary because the policy of encouraging early adjudication of invalidity would not be served by allowing a licensee to wait until the end of a license term to sue for recovery of all royalties.¹⁰⁰

Thus, *Lear* should not be used to support the proposition that a licensor warrants the validity of a patent unless federal patent policy would be served. The reasoning adopted by the Third and Sixth Circuits in cases such as *Carter-Wallace and Troxel* demonstrates that federal patent policy would not be served by such a rule.

The question then of whether Salt of the Earth could persuade a bankruptcy court that the exclusive license is executory, because of the earth has remaining unperformed continuing obligations is at best close. It may be advisable to include in future exclusive licenses a specific recital that the licensor will join in a suit brought by the exclusive licensee to stop infringers or that the exclusive licensor will itself sue infringers. Such an obligation should be sufficient to make the contract executory.

RETENTION AND PERFECTION OF A SECURITY INTEREST IS ELEMENTARY AND INEXPENSIVE

Patents and probably rights to trade secrets, know-how, patent licenses are all classified as general intangibles within the meaning of the Uniform Commercial Code (U.C.C.).¹⁰¹ The U.C.C. sets out how and when to create and perfect a lien in general intangibles.

Retain and Perfect a Security Interest At the Time When Rights to the Intellectual Property Are Transferred or Give New Consideration When Obtaining a Security Interest For Existing Transfers

Ideally, the security interest should be retained when the patents are first transferred. But, where the effort of renegotiating contracts already in existence is desired, the same result can be accomplished by paying the licensee for the security interest. Timing the security interest at the beginning of the license or giving new value will eliminate any chance of a voidable transfer.¹⁰² A voidable preference would not arise because there would either be no antecedent debt¹⁰³ or there would be new value given for the security interest.¹⁰⁴ Similarly, there can be no fraudulent transfer because the debtor will have received fair value in exchange for his grant of the security interest.¹⁰⁵

There Must Be An Enforceable Contract

The first step toward creation of a valid and enforceable security agreement between Salt of the

Earth and Big Daddy requires a contract signed by the debtor.¹⁰⁶ The contract should identify the parties, contain a description of the collateral and should recite that value has been given consideration for the security interest.¹⁰⁷ The security agreement may be incorporated into the overall transfer agreement or prepared as a separate document. Such a contract could read as follows:

Big Daddy Corp., a corporation of Delaware with a principle place of business at 123 Wall Street, Wall Street, Colorado, in consideration of ten dollars (\$10.00) and other good and valuable consideration, receipt of which is hereby acknowledged, grants to: Salt of the Earth Co., a Company of Oklahoma with principal place of business at One Main Street, Muskogee, Oklahoma a security interest in the following property (hereinafter called "collateral"):

All right, title and interest in and to U.S. Patent No. 5,000,000 entitled "Improved Electronic Ignition"; and any products embodying the inventions defined by the claims of that patent while such products remain in Big Daddy's inventory or control; and all proceeds from sales of, use of or lease of products embodying inventions defined by the claims of that patent

to secure performance of all obligations of Big Daddy Corp. as set out in the "Assignment Agreement" entered today by Salt of the Earth and Big Daddy Co.

Default in performance of any obligations or any default under the above Referenced Assignment Agreement evidencing the obligations of Big Daddy Corp. is a DEFAULT under this security agreement. Upon DEFAULT Salt of the Earth may declare all obligations immediately due and payable and has the remedies of a secured party under the Colorado Uniform Commercial Code.

The security interest attaches, making the agreement enforceable between the licensor and the licensee, as soon as the debtor has rights in the collateral.¹⁰⁸ Thus, the lien created becomes effective against Big Daddy Co. contemporaneously with the assignment.

Filing A Financing Statement Perfects A Purchase Money Security Interest in General Intangibles

Perfection of a security interest is required before the assignor has rights superior to those of a subsequent lienor, either judgment or contractual, or over a bona fide purchaser. Generally, perfection requires filing of a document known as a "financing statement" in the proper office in the proper state and within the proper time limit.

The U.C.C. requires no particular form for a financing statement; but the document filed must contain certain information.¹⁰⁹ The financing statement should be signed by the debtor and the secured party. Additionally, the address where each party can be found should be given and the collateral should be adequately described to put subsequent readers on notice of the security interest.¹¹⁰ Printed forms for use as financing statements are generally available at any bookstore or stationer that sells other printed legal forms.¹¹¹

Filing Must Be Timely

The financing statement must be filed because filing is the only way to perfect a security interest in "general intangibles" and inventory.¹¹² Filing the financing statement within 10 days of the effective

date of the assignment should in many cases give Salt of the Earth priority over preexisting liens in the same collateral.¹¹³ Thus, in a contest with the bank that has a security interest in all property of Big Daddy Co., including after acquired property, Salt of the Earth wins with respect to a lien in the property transferred, but not with respect to other collateral such as inventory.

The time of perfection assumes even greater importance in the bankruptcy context. Where filing is required, the time of perfection is generally the time of filing. However, in the case of a purchase money security agreement the time of perfection relates back to the time of granting the security interest if filing occurs within ten days of the time when the debtor receives the collateral.¹¹⁴ The concept of relation back is very important in the bankruptcy context. One of the requirements for a voidable transfer can be defeated if there is a substantially contemporaneous exchange of value.¹¹⁵ Since the giving of the security interest for bankruptcy purposes occurs at the time of perfection, it is very important that the debtor, Big Daddy, receive rights in the patents at the same time.

The Financing Statement Should Be Filed in The Patent and Trademark Office and in the State With Jurisdiction

The place of filing the financing statement is determined according to the requirements of U.C.C. Sec. 9-103 and 35 U.S.C. Sec. 261

Under U.C.C. Sec. 9-103 filing should take place according to the laws of the jurisdiction where the collateral is located or the collateral is intangible or mobile where the debtor is located. The debtor is located at its place of business or if it has more than one place of business, its chief executive office. Where the debtor has no place of business, it is deemed to be located at its residence. There may be occasions where a company has two offices that may be argued to function as the chief executive office for the named debtor. In that instance filing in both places will cost one extra filing fee, typically \$25.00. Given the uncertainty of our times, the financial strength of every company seventeen years in the future is uncertain. Also the value of the patent rights at the beginning of the patent term are often uncertain. A prudent assignee will file in the extra jurisdiction just to make sure. State filing will cut off the trustee's voiding powers as a judgment or contractual lienor.

Where products embodying a licensed invention or made pursuant to a licensed property are named as collateral which they are "inventory," filing should take place according to the laws of the place where the inventory is located.

The Assignor, Salt of the Earth, should also file in the Patent and Trademark Office in order to give it priority over a subsequent bona fide purchaser.¹¹⁶ The Assignee, Big Daddy Co., will also need to file the assignment in order to protect its interest from subsequent purchasers.¹¹⁷ Thus, the license and the security agreement should both be

filed in the Patent and Trademark Office since they represent two separate legal interests claimed by different people.

Another reason for filing in the Patent and Trademark Office can be found in U.C.C. Sec. 9-104(4) which deals with certificates of title. That code section requires perfection according to the laws of the jurisdiction that issues a certificate of title and requires notation of all liens on the face of the certificate. Since a patent assignment is not a certificate of title, the section probably does not apply as such. But 35 U.S.C. Sec. 261 and U.C.C. Sec. 9-103(4) share the common purpose of providing prospective purchasers with notice of the pre-existing lien in a logical fashion. Hence, the same public policy considerations would dictate the filing in both cases.

Check State Law to Find the Proper Office for Filing Within the State

The office within a jurisdiction for filing is determined by the requirements of U.C.C. Sec. 9-401. In the model code there are three alternatives for that section. Before filing, it would be necessary to check the law in the state where the assignee has his chief executive office to see where filing should take place to perfect rights in intangible or mobile collateral. Similarly, the law of the jurisdiction where tangible collateral is located should be checked when the parties have agreed to name such collateral. In both cases filing will probably be required in the office of the Secretary of State and perhaps also the office of the County Clerk

Filing Must Be Periodically Renewed

Filing of the initial financing statement remains effective for five years.¹¹⁸ The filing may be renewed with perfection relating back to the original filing by filing a continuation statement. The continuation statement must be signed by the secured party, must identify the original financing statement by file number, and must state that the original statement is still effective. The continuation statement should be filed in a period within six months before expiration of the original financing statement. Continuation statements are also effective for five years and may be renewed by filing of another continuation statement.¹¹⁹

CONCLUSION

The Bankruptcy Reform Act of 1978 has some significant changes. These changes will have a very detrimental effect on a party who relies only on an *ipso facto* bankruptcy clause as protection in the event of his licensee's insolvency. Such a licensor may find himself without any rights to his invention at all or be forced into business dealings with an unacceptable licensee.

This exposure can be significantly reduced or easily avoided by the creation of valid and enforceable security interest. The licensor needs only to enter a valid security agreement and to make sure the financing statement is filed in the proper of-

fices.

NOTES

1. 11 U.S.C. Section 365(e), 541(c) (1) (1980).
2. 11 U.S.C. Sections 501, 502, 727(b), 1141(d) (1) (A) (1980).
3. 11 U.S.C. Sections 363(b), 365(f) (1980).
4. 11 U.S.C. Section 365(a) (1980).
5. 11 U.S.C. Section 362 (1980).
6. The trustee acts as the representative of the estate. 11 U.S.C. Section 323 (1980). The trustee actually collects and liquidates the estate in a Chapter 7 case. 11 U.S.C. Section 704 (1980). Although trustees will not usually be appointed in reorganization cases, a trustee may operate the business. 11 U.S.C. Sections 1104, 1108 (1978). The trustee has many special powers under Chapters 3 and 5 to collect property of the estate and to use, lease or sell property of the estate. See Part II, *infra* for a more detailed discussion of these powers.
7. A "debtor in possession" is the debtor in an ordinary Chapter 11 reorganization. 11 U.S.C. Section 1101. The Reform Act contemplates that in most cases the debtor in possession will continue to operate the business. 11 U.S.C. Section 303(f). The debtor in possession has the same powers as a trustee to recover property of the estate. 11 U.S.C. Section 1107. Additionally the debtor in possession has the same restrictions on his ability to liquidate or sell property out of ordinary course of business as does a trustee. *Id.*
8. 11 U.S.C. Sections 301, 302, 303 (1980).
9. 11 U.S.C. Section 541(a) (1980).
10. *Id.*
11. 11 U.S.C. Sections 544, 545, 547 (1980).
12. 11 U.S.C. Sections 702, 704 (1980).
13. A "security interest" is a lien created by an agreement. 11 U.S.C. Section 101(37) (1980).
14. An executory contract is one where obligations remain unperformed by both parties. See part IV *infra*.
15. A proof of "claim is filed by the creditor, the trustee, or the debtor." 11 U.S.C. Section 501. A claim for which proof has been filed is deemed allowed, unless someone objects. 11 U.S.C. Section 502. "Claim" is defined to include "(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, legal, equitable, secured or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured." 11 U.S.C. Section 101(4). Gone is the distinction between tort claims and contract claims. Provision is made for estimating any contingent or unliquidated claim in order to avoid delay in closing of the bankruptcy cases. 11 U.S.C. Section 502(c) (1).
16. 11 U.S.C. Section 506(c) (1980).
17. 11 U.S.C. Section 507(a) (1) (1980).
18. Pursuit of an unsecured claim is probably not justified as unsecured creditors rarely receive a significant portion of their claim. One author notes, "(Y)ear in and year out, less than 15% are 'asset cases' in which something is paid to creditors. Another 15% are 'nominal asset' cases in which there is nothing for creditors after the allowance of exemptions and the payment of administrative expenses. The balance of about 70% are 'no asset' cases in which there is nothing available to pay administrative expenses.
19. In the less than 15% of cases where something is available for creditors, assets in 1969 ... produced about \$113,000,000, almost one fourth of which was consumed by administrative expenses, and unsecured creditors averaged a dividend of 7 or 8% after payment of priority claims." V. countryman, *A History of American Bankruptcy Law*, Commercial J. 231 (1976).
19. 11 U.S.C. Section 1123(b)(1) (1980).
20. 11 U.S.C. Section 1129 (b)(1) (1980).
21. 11 U.S.C. Section 1129 (1980).
22. U. S. Const. Art. I, Section 8, cl. 4.
23. 11 U.S.C. Section 363(c)(1) (1980).
24. 11 U.S.C. Section 363(b) (1980).
25. 11 U.S.C. Sections 362(d), 362(e), 362(f), 363(d) (1980).
26. 11 U.S.C. Section 365 (1980).
27. See in re Schokbeton Indus., Inc., 466 F.2d 171 (5th Cir. 1972) (Where the debtor in possession was not allowed to assume a patent license because the ipso-facto bankruptcy clause was enforceable); In re Diana Shoe Corp., 80 F.2d 827 (2d Cir. 1936) (Where deferred license fees which became due upon the automatic termination of a patent license and equipment lease were held to constitute a liquidated contract claim entitling the licensor to a thirty-five percent payment under the plan); Lichman v. Moore, 131 F. Supp. 434 (D.N.H. 1955) (The court held valid and enforceable a clause in an assignment of a patent in exchange for common stock of the assignee whereby title to the patent was to automatically revert to the assignors upon the insolvency of the assignee); In re Michigan Motor Specialties Co., 288 F. 377 (E.D. Mich. 1923) (The Court enforced a clause which by its terms terminated a license in the event the licensee

"discontinues its business through insolvency,...bankruptcy,...or any other cause"). These cases have been criticized by a leading bankruptcy authority. See Vern Countryman, *Contracts in Bankruptcy*, 59 Minn. L. Rev. 479 (1974).

28. 11 U.S.C. Section 541(a)(1) (1980).

29. The legislative history specifically lists "intangible property, chose in action, cause of action, rights such as copyrights, trademarks, patents and processes, contingent interests, (and) future interests..." H. Rep. No. 595, 95th Cong. 1st Sess. 176 (1977).

30. 11 U.S.C. Section 541(c)(1) (1980).

31. 11 U.S.C. Section 362(a)(3) (1980).

32. A debtor in possession under Chapter 11 may also recover voidable preferences under 11 U.S.C. Section 547 (1980). 11 U.S.C. Sections 541(a)(3), 704(1), 1106(a), 1107(a), (1980).

33. 11 U.S.C. Section 547(b) (1980).

34. The definitional sections of the Reform Act provide that "transfer" means every mode, direct, or indirect, absolute or conditional, voluntary or involuntary, or disposing of or parting with property or with an interest in property, including retention of a security interest." 11 U.S.C. Section 101(40) (1978). The default clause arguably qualifies as a security interest under 11 U.S.C. Section 101(37) (1980).

35. See Note 27, *supra*.

36. *Tatum v. Acadian Production Corp.*, 35 F. Supp. 40 (E.D. La. 1940) ("a transfer of property...includes the giving or conveying of anything of value which has debt-paying or debt-securing power." —oil and gas rights); *Comparone v. M.J. Rippen Co., Inc.*, 270 Mass. 74, 169 N.E. 667 (1930) (Goodwill).

37. 11 U.S.C. Section 547(b)(1) (1980).

38. 11 U.S.C. Section 547(b)(2) (1980).

39. 11 U.S.C. Section 547(b)(3) (1980).

40. 11 U.S.C. Section 547(b)(4) (A) (1980). Note that the preference period expands to a year if the transferee is an insider with reasonable cause to believe that the debtor was insolvent at the time of transfer. 11 U.S.C. Section 547(b)(4)(B) (1980). An "insider" is defined in 11 U.S.C. Section 101(25). Generally the list encompasses relatives, partners, and the partnerships or corporations which an individual debtor controls. In the case of a corporation "insiders" would include officers, directors, control persons and affiliated business entities.

41. 11 U.S.C. Section 547(b)(5) (1980).

42. See text accompanying Note 46, *infra* for an explanation of when a "transfer" is deemed to occur.

43. See Note 16, *supra*.

44. 11 U.S.C. Section 547(f) (1980).

45. H. Rep. No. 595, 95th Cong. 1st Sess. 375 (1977).

46. 11 U.S.C. Section 101(26)(A) (1980). Insolvency under the Code requires casting of a balance sheet at the particular time in question. Moreover, certain items are specifically excluded from the property to be counted as assets. Obviously the problem of reconstructing the financial status at a particular time can be considerable, especially when the entity may not have kept clear records.

47. 11 U.S.C. Section 547(e) (1980).

48. See *Lear v. Adkins*, 395 U.S. 653, 661-2 (1969); *Kysor Industrial Corp. v. Pet, Inc.*, 459 F.2d 1010 (6th Cir.), *cert. denied*, 409 U.S. 980 (1972) (Where the parties lacked diversity of citizenship the court did not have the power to resolve a dispute concerning a patent agreement).

49. 11 U.S.C. Section 363(c)(1) (1980) authorizes use, sale and lease of property in the ordinary course of business. The automatic stay, 11 U.S.C. Section 362 (1980), enjoins a creditor from taking any action on account of a default.

50. 11 U.S.C. Section 363(b) (1980).

51. *Kenyon v. Automatic Instrument Co.*, 160 F.2d 878 (6th Cir. 1947) (holding: The assignee of a receiver assumed the obligation to pay royalties to the inventor where the original assignment from the inventor to the bankrupt contained a clause making it binding on assigns; the Court did note that a bankruptcy court could have ordered sale of the patent free and clear of all obligations).

52. 11 U.S.C. Sections 727(b), 1141(d)(1)(A) (1980).

53. *Id.*

54. 11 U.S.C. Section 101(4)(A) (1980).

55. 11 U.S.C. Sections 362(d), 362(e), 362(f), 363(d) (1980).

56. 11 U.S.C. Section 362(g) (1980).

57. See P.L. Marsari, *Adequate Protection Under The Bankruptcy Reform Act*, 1979 Annual Survey of Bankruptcy Law 171; Trost, *Business Reorganizations Under Chapter 11 of the New Bankruptcy Code*, 34 Bus. Law 1309 (1979), reprinted in 1980 Annual Survey of Bankruptcy Law 165, for descriptions of the alternatives and standards not addressed by the Reform Act.

58. 11 U.S.C. Section 363(f) (1980).

59. 11 U.S.C. Section 361(2) (1980).

60. 11 U.S.C. Section 363(k) (1980).

61. See generally, Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 Am. Bankr. L.J. 133 (1979); Trost, *Business Reorganizations Under Chapter 11 of the New Bankruptcy Code*, 34 Bus. Law. 1309 (1979).

62. 11 U.S.C. Section 1122 (1980).

63. 11 U.S.C. Section 1129 (1980).

64. 11 U.S.C. Section 1129(a)(8)(B) (1980).

65. Security interest in inventory to secure payment of the royalty will be very desirable; but for business reasons not always possible.

66. 11 U.S.C. Section 1129(b)(1) (1980).

67. 11 U.S.C. Section 1129(b)(2)(B) (1980)

68. Statement by Rep. Don Edward, Sept. 28, 1978, 124 Cong. Rec. H. 1109, *Reprinted in* (1978) U.S. Code Cong. & Ad. News, 6436, 6476.

69. See Text accompanying notes 83-103, *infra*.

70. H/Rep. No. 595, 95th Cong. 1st. Sess. 348 (1977).

71. *Lane & Bodley Co. v. Locke*, 150 U.S. 193 (1893); *Hapgood v. Hewitt*, 119 U.S. 226 (1886); *Unarco Ind., Inc. v. Kelley Co., Inc.*, 465 F.2d 1303 (7th Cir. 1972).

72. *Oliver v. Rumford Chemical Works*, 109 U.S. 75 (1883); *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090 (6th Cir. 1979).

73. 2 *Cullier on Bankruptcy*. Paragraph 365.05 (15th ed. 1979).

74. 11 U.S.C. Section 1107(a) (1980).

75. 11 U.S.C. Section 1101(1) (1980).

76. 11 U.S.C. Section 365(b)(1)(A) (1980).

77. 11 U.S.C. Section 365 (b)(1)(B) (1980).

78. 11 U.S.C. Section 365(b)(1)(C) (1980).

79. U.C.C. 2-609 (1976).

80. 11 U.S.C. Section 365(f) (1980).

81. 11 U.S.C. Section 363(b) (1980).

82. 11 U.S.C. Section 365(a) (1980).

83. 11 U.S.C. Section 365(g) (1980).

84. 11 U.S.C. Section 507 (1980).

85. *Id.*

86. H. Rep. No. 595, 95th Cong. 1st Sess. 347 (1977).

87. 591 F.2d 477, 481 (8th Cir. 1979).

88. Vern Countryman, *Executory Contracts In Bankruptcy: Part II* 58 Minn. L. Rev. 479, 502 (1974).

89. *Zenith Lab., Inc. v. Carter-Wallace, Inc.*, 530 F.2d 508 (3d Cir.) *cert. denied*, 429 U.S. 828 (1976); *Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 465 F.2d 1253 (6th Cir. 1972).

90. Invalidity is often the major defense to a patent infringement lawsuit. A defendant will try to find some error in the patent application or some substantive error in the examiner's allowance of claims. For a general discussion of the area, see R. White, *Patent Litigation: Procedure and Tactics* (1979).

91. Restatement of Restitution Section 9(3) (1937).

92. Restatement of Restitution Section 10 Comment a (1937).

93. *Deller's Walker on Patents* 2d. ed. Section 403 (2d ed. 1965) (citing thirty-seven cases for the well established proposition).

94. H. Mayers, *Drafting Patent License Agreements* Section 14.01 (1974).

95. 395 U.S. 653 (1969).

96. *Id.* at 661-2.

97. *Id.* at 670 (where the court said: "Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification. We think if plain that the technical requirements of contract doctrine must give way before the demands of the public interests...").

98. *Id.* at 674.

99. See Note 89, *supra*.

100. *Carter-Wallace, Inc.*, 530 F.2d at 513; *Troxel*, 465 F.2d at 1257.

101. The official comment to U.C.C. Section 9-108 specifically lists "patents" as an example of collateral that the drafters contemplated to be within the term "general intangibles" The Code Made no Mention of technical know-how or trade secrets. However, "general intangibles" is the most logical category.

102. 11 U.S.C. Section 547 (1980).

103. See text accompanying notes 32-48, *supra*.

104. 11 U.S.C. Section 547(c) (1980).

105. 11 U.S.C. Section 548 (1980).

106. U.C.C. Section 9-203 (1976).

107. *Id.*

108. *Id.*

109. U.C.C. Section 9-402 (1976)

110. *Id.*

111. An Exemplary form is attached as Appendix A.

112. U.C.C. Section 9-302.

113. U.C.C. 9-312(4) (1976). That section gives a "Purchase Money Security Interest" priority over pre-existing liens. A Purchase Money Security Agreement is one that is: (a) taken or re-

tained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used. U.C.C. 9-107 (1976).

114. U.C.C. Section 9-301(2) (1976).

115. 11 U.S.C. Section 547(c)(1) (1980).

116. 35 U.S.C. Section 261 (1980).

117. *Id.*

118. U.C.C. Section 9-403 (1976).

119. *Id.*