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The Fourth Circuit Upholds Application of Section 365(n) of the Bankruptcy Code over Contrary Foreign Law in Chapter 15 Case

In *Jaffé v. Samsung Electronics Company, Ltd.*, No. 12-1802, 2013 WL 6388591 (4th Cir. Dec. 3, 2013), the Court of Appeals for the Fourth Circuit (the “Court” or “Fourth Circuit”) affirmed the bankruptcy court’s exercise of discretion when it applied section 365(n) of the Bankruptcy Code, a provision protecting the non-debtor party to an intellectual property agreement, rather than German law, to ensure that licensees of the foreign debtor’s US patents were sufficiently protected in the US Chapter 15 case. In so doing, it ruled that a bankruptcy court must weigh the interests of affected creditors against those of the foreign debtor when it grants discretionary relief in favor of a foreign proceeding in Chapter 15.

Discretionary Relief under Chapter 15

Chapter 15 of the Bankruptcy Code (“Chapter 15”) authorizes “ancillary” proceedings in a US bankruptcy court to complement and assist a foreign insolvency case.¹ Among other things, Chapter 15 brings people and property beyond the foreign proceeding’s jurisdiction into the foreign proceeding through the exercise of US jurisdiction.² Towards that end, section 1521 of the Bankruptcy Code authorizes a bankruptcy court, upon recognition of a foreign proceeding and at the request of a foreign representative, to grant various forms of discretionary relief to protect the assets of the foreign debtor or interests of the creditors in the US.³ Forms of relief include (a) the application of the automatic stay with respect to the foreign debtor’s assets, rights and obligations within the territorial jurisdiction of the US, (b) the examination of witnesses and taking discovery in the US, (c) the entrustment of the administration and realization of all or part of the foreign debtor’s assets within the territorial jurisdiction of the US to the foreign representative, and (d) the grant of any additional relief that may be available to a trustee or debtor under US bankruptcy law, other than US avoidance actions.⁴

Courts liberally and routinely grant discretionary relief under section 1521 of the Bankruptcy Code. Section 1522(a) of the Bankruptcy Code, however, tempers the bankruptcy court’s discretion by requiring

¹ *Jaffé*, 2013 WL 6388591, at * 8.

² *Id.* (citing *In re ABC Learning Ctrs. Ltd.*, 728 F.3d 301, 307 (3d Cir. 2013)).

³ 11 U.S.C. § 1521(a).

⁴ *Id.*

that such relief may only be granted “if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected.”⁵ What exactly does that mean?

At Stake in Qimonda – Can Foreign Law Trump US Interests?

Qimonda AG (“Qimonda”) was a German manufacturer of semiconductor devices and, briefly, one of the world’s largest manufacturers of dynamic random access memory, or “DRAM.”⁶ Qimonda’s principal assets consisted of about 10,000 patents, about 4,000 of which were US patents. The US patents were subject to cross-license agreements with Qimonda’s competitors, a strategy widely employed in the semiconductor industry to protect against infringement claim risks caused by the industry’s “patent thicket” – that is, the many existing overlapping intellectual property rights that may be implicated by the development of any new semiconductor product.⁷

In Qimonda’s Chapter 15 case, Qimonda’s German insolvency administrator (the “Administrator”) asked the bankruptcy court to entrust him with the administration of Qimonda’s US patents under section 1521 of the Bankruptcy Code.⁸ The bankruptcy court entered an order recognizing the German proceeding as a foreign main proceeding, and entered a separate order granting the Administrator the discretionary relief under section 1521(a) to “administer the assets of Qimonda AG within the territorial jurisdiction of the United States,” and, among other things, specified that a number of other provisions of the Bankruptcy Code would apply to the Chapter 15 case, including section 365 of the Bankruptcy Code.⁹ Shortly after entry of those orders, the Administrator sent letters to Qimonda’s cross-licensees notifying them that their US licenses were no longer enforceable under section 103 of the German Insolvency Code.¹⁰ The Administrator sought to reject Qimonda’s cross-licensing agreements with its competitors and re-license the US patents, which according to his expert witness, would have provided about \$47 million per year to

⁵ *Id.* § 1522(a).

⁶ *Jaffe*, 2013 WL 6388591, at *1.

⁷ *Id.* at *2.

⁸ A foreign representative commences a case under Chapter 15 of the Bankruptcy Code by filing a petition for recognition. 11 U.S.C. § 1515. The bankruptcy court will grant an order recognizing the foreign proceeding where the proceeding is pending in the country where the debtor has the center of its main interests (main) or where it has an establishment (nonmain), the foreign representative is a person or body, and where the petition meets the other filing requirements of section 1515 of the Bankruptcy Code. *In re ABC Learning Ctrs. Ltd.*, 728 F.3d at 304 n.4. The Administrator commenced Qimonda’s Chapter 15 proceeding on June 15, 2009, seeking recognition of the German insolvency proceeding as a foreign main proceeding under section 1517 of the Bankruptcy Code. *Jaffe*, 2013 WL 6388591, at *3.

⁹ *Jaffe*, 2013 WL 6388591, at *3.

¹⁰ *Id.* at *4.

Qimonda's estate.¹¹ Several licensees (the "Licensees") disputed application of German law, arguing that the Administrator could only reject the cross-licensing agreements under section 365 of the Bankruptcy Code. Section 365 of the Bankruptcy Code governs the assumption and rejection of executory contracts under US bankruptcy law.¹² Notably, section 365(n) of the Bankruptcy Code reserves to non-debtor intellectual property licensees the option to elect to retain their rights under the licenses, a protection German law does not afford.¹³

The Licensees' insistence that US law should govern the rejection of their licenses prompted the Administrator to seek amendment of the Chapter 15 order under which he was granted the authority to administer Qimonda's US patents. He moved the bankruptcy court to delete from the order reference to section 365 of the Bankruptcy Code, or alternatively, to add language to the order specifying that section 365(n) only applied if the Administrator rejected the licenses under US law (rather than exercising the Administrator's rights under German law). Over the Licensees' objection the bankruptcy court granted the Administrator's request and amended its order to include the alternative proviso that the Administrator had requested as an amendment – that is, that section 365(n) only applied if the Administrator rejected the licenses under US law. It explained that consistent with Chapter 15's goal of "providing a systematic and consistent resolution to cross-border insolvencies," the cross-license agreements should be decided in the German insolvency proceeding applying German law.¹⁴

The Licensees appealed. On appeal, the district court remanded the case back to the bankruptcy court, directing it to consider the requirement of section 1522 of the Bankruptcy Code that "the interests of the creditors and other interested entities, including the debtor, [were] sufficiently protected."¹⁵ As a separate basis for remand, the district court also found that the bankruptcy court had failed to consider whether, under section 1506 of the Bankruptcy Code, section 365(n) embodies a fundamental US public policy which could not be trumped by German law.

Section 1506 of the Bankruptcy Code provides that nothing in Chapter 15 "prevents the court from refusing to take an action governed by [Chapter 15] if the action would be manifestly contrary to the public policy of the United States."¹⁶

¹¹ *Id.* at *5.

¹² 11 U.S.C. § 365.

¹³ *Id.* § 365(n).

¹⁴ *Jaffe*, 2013 WL 6388591, at *4.

¹⁵ *Id.*; 11 U.S.C. § 1522(a).

¹⁶ 11 U.S.C. § 1506.

On remand, the bankruptcy court denied the Administrator's requested relief and confirmed that section 365(n) of the Bankruptcy Code applied to Qimonda's US patents. Recognizing that its ruling would result in less value being realized by Qimonda's estate, it nonetheless concluded that a balancing of the foreign debtor's and creditors' interests – where German law would permit the Administrator to terminate the Licensees' right to practice Qimonda's patents and might harm the semiconductor industry as a whole – weighed in favor of applying the section 365(n) protections.¹⁷

As an independent ground for its decision, the bankruptcy court also concluded that deferring to German law, to the extent it allows cancellation of the US patent licenses, would be manifestly contrary to US public policy.¹⁸ The bankruptcy court noted that Congress enacted section 365(n) to prevent unilateral termination of patent licenses in bankruptcy, which it believed would impose a burden on US technological development.¹⁹ It accordingly reasoned that the uncertainty resulting from the ability to cancel licenses to US patents in a foreign proceeding would slow the pace of technological innovation, to the detriment of the US economy, and thus, the failure to apply section 365(n) would severely impinge an important statutory protection accorded licensees of US patents.²⁰ This, the bankruptcy court held, violated US public policy, a result section 1506 of the Bankruptcy Code precludes.

On further appeal, the Fourth Circuit affirmed. It held that as a prerequisite to awarding any discretionary relief under section 1521 of the Bankruptcy Code, section 1522 of the Bankruptcy Code requires that the bankruptcy court ensure the protection of *both* the creditors and the debtor.²¹ This means that the court must ensure that the relief a foreign representative requests under section 1521 does not impinge excessively on any one entity's interests, but rather, that each entity must receive at least some protection.²² In other words, the Fourth Circuit held, section 1522(a) requires balancing the respective interests based on the relative harms and benefits in light of the circumstances presented.²³ In reaching its conclusion, the Fourth Circuit rejected the Administrator's argument that section 1522(a) is merely a procedural protection designed to ensure that all creditors could participate in the bankruptcy distribution on an equal footing, rather than a provision that could be used to protect parties from the substantive bankruptcy law that would otherwise apply in the foreign proceeding.²⁴ Finally, the Fourth

¹⁷ *Jaffe*, 2013 WL 6388591, at *6.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* at *10-11.

²² *Id.* at *11.

²³ *Id.*

²⁴ *Id.* at *10-11.

Circuit held that section 1506 of the Bankruptcy Code provides an additional, more general protection of US interests that may be evaluated apart from the particularized analysis section 1522(a) requires.²⁵

Conclusion

In affirming the bankruptcy court's exercise of discretion when it applied section 365(n) of the Bankruptcy Code rather than German law to ensure that licensees of the foreign debtor's US patents were sufficiently protected in a US Chapter 15 case, the Fourth Circuit was careful to affirm the importance of Chapter 15 to the global economy. It characterized the statute as representing the full commitment of the US to cooperate with foreign insolvency proceedings in an effort to provide greater legal certainty for trade and business.²⁶ As the result in the case reveals, however, and as the Fourth Circuit also cautioned, this US commitment is not untempered. Significantly, in concluding that section 1522(a) of the Bankruptcy Code requires a particularized balancing analysis that requires weighing the interests of the foreign representative (here, Qimonda's estate) in receiving the requested relief against the competing interests of those who would be adversely affected by the grant of such relief (here, the Licensees), the Fourth Circuit did not need to rule on whether application of German law would have violated US public policy. The Court, however, affirmed that section 1506 of the Bankruptcy Code does provide an additional, more general protection of US interests that may be evaluated apart from the particularized analysis of section 1522(a). In this regard, the Fourth Circuit joins the Fifth Circuit Court of Appeals, which interpreted the relationship between sections 1522 and 1506 similarly.²⁷

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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²⁵ *Id.* at *12.

²⁶ *Id.* at *15.

²⁷ *Id.* at *12 (citing *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031, 1060, 1067 n.42 (5th Cir. 2012)).