



Into The Unknown

Experts go deep into the subject of insolvency with **Johnny Chan** to see what the key problems are and what IP owners can do to minimize the impact.

Do you ever wonder, in the event an insolvency proceeding involves treatment of an IP license between a domestic and a foreign entity, which national bankruptcy laws should be applied? Should this depend on the choice of law clause in the license or the physical location of the entities or the assets involved?

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Our view is that the national bankruptcy laws of the place where entity that has gone into bankruptcy proceedings is incorporated should apply.

- Mark Hargreaves, partner,
AJ Park, Wellington

It is the choice of law clause in a license which determines the appropriate insolvency laws to apply. "Assuming that, under applicable private international law (conflict of laws) principles,

the choice of law clause in a particular contract is effective as a valid choice, that law will govern the interpretation and enforcement of the contract, but only as between the parties to the contract," says Gregory Ross, a partner at Eakin McCaffery Cox in Sydney. "However, that is a very separate issue to broader insolvency issues, including choice of the appropriate jurisdiction

for insolvency proceedings, relating to a party to a contract."

"The answer to the question more depends upon whether the insolvency proceedings relate to the licensor or licensee, the nature and location of the IPRs, of the party the subject of the insolvency problem, what legalities apply to them in the jurisdiction handling the insolvency and other jurisdictions in which the IPRs might subsist and be the subject of licenses or other granted use rights," adds Ross.

Insolvency proceedings are generally jurisdictionally-based so, accordingly, the real issue is determining where the proceedings are to be instituted and, once that is done, normally the law of that place would govern most aspects of the case, Ross says. "However, with all

courts being jurisdictionally limited, administration of assets of an insolvent entity outside the jurisdiction can raise international implications which have to be addressed on a case-by-case

basis.”

Australian insolvency law also allows a liquidator to “disclaim” property and contracts, including IPRs and related contracts, so that too may need consideration in a given situation, says Ross.

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If the bankrupt company is a foreign company, how the IP license will be handled depends on whether that company is the licensee or licensor and the relevant laws and regulations of the country in which it is domiciled.

- Christine Chen, partner,
Winkler Partners, Taipei

In New Zealand, which laws will apply depend on which party has gone into bankruptcy proceedings. “Our view is that the

national bankruptcy laws of the place where entity that has gone into bankruptcy proceedings is incorporated should apply. We do not think that which laws apply to the bankruptcy of an entity should depend on the choice of law clause in the IP license,” says Mark Hargreaves, a partner at AJ Park in Wellington. “The governing law of the license would continue to govern the interpretation of that contract, but should not govern the whole bankruptcy of the entity.”

“It seems that the whole bankruptcy needs to be handled under the same law and that all parties who are handling or have handled the bankrupt entity need certainty about what law applies,” Hargreaves adds. “The law should be chosen based on where the entity concerned has been incorporated, or the case of an individual where the individual is ordinarily resident. This seems a clearer basis for deciding what law would apply than where the assets are physically located.”

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According to Article 42 of the Act Governing the Choice of Law in Civil Matters Involving Foreign Elements in Taiwan, (1) IPRs are governed by the law of the place where the protection of the

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rights are sought (*lex loci protectionis*), and (2) any IPR created by an employee in the performance of his/her duties is governed by the law applicable to the contract of employment, says Ruey-Sen Tsai, a partner at Lee and Li in Taipei.

Taiwan's national bankruptcy laws, which apply in the case of an IP license dispute between a foreign and domestic company in insolvency proceedings, will depend on (a) which of the two companies is bankrupt; and (b) whether the bankrupt party is the licensor or licensee.

Taiwan's bankruptcy law will apply automatically if a Taiwan entity and property is involved. If the Taiwanese company is bankrupt, regardless of whether they are the licensee or licensor, Taiwan's bankruptcy law will be applied, says Christine Chen, a partner at Winkler Partners in Taipei. "If the bankrupt company is a foreign company, how the IP license will be handled depends on whether that company is the licensee or licensor and the relevant laws and regulations of the country in which the foreign company is domiciled."

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The former licensee can establish a new license only by negotiation and agreement with the new owner.

- Takenori Hiroe, patent attorney,
Hiroe and Associates, Gifu-City

In Vietnam, the law chosen by the parties as provided in the license agreement shall be applied, says Steven Jacob, a foreign lawyer at Indochine Counsel in Ho Chi Minh City. "National bankruptcy laws will be applied for insolvency proceeding and the physical location of the insolvent enterprises or the assets involved shall be the ground for determination of the competent court for handling the bankruptcy proceedings."

Is the License Still Valid During Insolvency Proceeding?

Under Australian law, the ability for a licensee to continue using IP after insolvency affecting the license depends primarily upon the terms of the contract. The contract might deal differently with an insolvency of the licensor and/or the licensee, says Christina Cavallaro, an associate at Eakin McCaffery Cox in Sydney. "If, as a consequence of insolvency, there is an effective termination of the license, from the perspective of the licensor no longer being able to license the IPRs to the licensee, then the licensee would necessarily have to obtain a new license. If so, the following questions [which do not necessarily have any easy answer] arise," she says.

1. If the termination of the license is caused by some default of the licensor, does the licensee have some right of damages against the licensor? That necessarily very much depends on the terms of the contract?

2. In that situation, where would the licensee source an alternate supplier of the relevant IPRs and would any additional license fees incurred in having to negotiate a license with

someone else be properly recoverable from the original (now insolvent) licensor?

3. Even if in that situation damages are legally and conceptually recoverable, would it be worthwhile in context of an insolvency even to try?

If the terms of the contract provided a right to the licensor (whether an automatic and/or "drop dead" right or upon notice) to terminate the license so far as concerns the licensee and that right is validly exercised to terminate the license, then the licensee would, have to obtain an alternate license if it wished to continue using relevant IPRs, Cavallaro adds. "If the licensee is insolvent, it is likely to be the case that the original licensor, having terminated the original license, would have nothing further to do with the licensee other than, perhaps, in the absence of some guarantee of relevant license fees, and even then the licensor would probably want to consider whether it is commercially prudent to continue to allow the relevant rights to be used by an entity having insolvency issues."

There is an increasing move towards a policy of assisting insolvent entities to resurrect themselves to trade on and/or to facilitate a sale of the business as a going concern, where possible. It is interesting to note that there are proposals in Australia for "drop dead" (*ipso facto*) termination provisions based on insolvency to be rendered unenforceable, Cavallaro says. "This is in the interests of better realization of assets from an insolvent business and/or to facilitate resurrection and restoration to business operations."

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In Japan, the underlying IPRs are not terminated when the licensor has gone insolvent. The rights continue to be effective when an insolvency proceeding goes on. On the other hand, the license is terminated when the contract is terminated (by cancellation or expiration of the contract). This applies equally during the insolvency proceeding, says Takenori Hiroe, a patent attorney at Hiroe and Associates in Gifu-City. "However, there are restrictions on the right of the bankruptcy administrator to cancel the contract. Accordingly, since the patent continues to be effective during the insolvency proceeding and the license is terminated, the (former) licensee can no longer use the underlying IPRs after the termination of the contract. Use of the IP is an infringement."

The (former) licensee has the right to counter a new owner of the underlying IPRs and can retain the rights of the license against the new owner (an exclusive license needs to be registered at the patent office, while a non-exclusive license does not). "However, when the license is terminated, the licensee loses this right. This right does not enforce a new license between the licensee and the new owner or obligate such, having nothing to do with an establishment of a new license contract. The licensee is not given any legal right to acquire a new license," Hiroe says. "Therefore, the (former) licensee can establish a new license only by negotiation and agreement with the new owner."

During an insolvency proceeding, the licensee may still continue using the licensed IPRs in Taiwan, Tsai says. "But the insolvency or bankruptcy administrator is entitled to terminate the license, [and] once the license is terminated, the licensee cannot continue using the IPRs."

Generally, license agreements will contain a clause to the

effect that they can be terminated unilaterally in the event the other party is declared bankrupt, Chen says. "When a license is terminated during an insolvency proceeding in Taiwan, the licensee cannot continue to use the underlying IPRs. The former licensee will not have a claim to obtaining a new license."

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In Vietnam, the termination of an effective IP license agreement during an insolvency proceeding shall be supervised by the

administrator, or in accordance with the decision on bankruptcy of the competent court, Jacob says. "In the event the license is terminated, except for otherwise agreed upon by the parties or provided in the agreement, the licensee is unable to continue using the underlying IPRs. The (former) licensee may have a claim to obtaining a new license depending on the agreements on termination of the license between parties during the insolvency proceeding."

Splitting the Siamese Twins

If IPRs that are jointly owned by two parties have been licensed to a licensee by one or both of the joint owners, and one of the joint owners becomes insolvent, how would the license be treated during insolvency proceeding? Could the license be terminated even if this would result in termination of an agreement between the solvent, joint rights owner and the solvent licensee?

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This is a complicated question which very much depends on how the laws of the particular jurisdiction handle the implications of "joint" ownership, the types of IP, the terms of any "joint" ownership contract and the terms of the relevant license under which the jointly-owned IPRs

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licensed by one or both of the licensors, says Ross.

If a common law-style joint tenancy of IP exists, then death or insolvency severs the joint tenancy, potentially putting contractual arrangements at significant commercial risk. Tenancy-in-common-type joint ownership is probably less problematic and

solvent joint rights owner and the solvent licensee alone. "As set forth above, during the insolvency proceeding, the bankruptcy administrator cannot cancel the license between the insolvent and the licensee by the authority of him/herself and the license of the insolvent is still

validated. The license is cancelled if the bankruptcy administrator consents to the proposal to cancel the contract made by the licensee when the contracts with the solvent joint rights owner and solvent licensee have become terminated," Hiroe says. "In this case, only the underlying IPRs remain the subject for the bankruptcy administrator to transfer or dispose."

Security Precaution

To ensure the enforcement of the license agreement between licensor and licensee in case of insolvency, it is advised that the agreement contains an insolvency provision, says Hendra Widjaya, a partner at Inter Patent Office in Jakarta. "Such provision shall regulate in event of insolvency and the agreement between the licensor and licensee remains valid. The rights and obligations of the parties according to the agreement

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One has to be very careful in creating joint ownership provisions for IPRs, so as best to avoid acrimonious disputes and problems. Joint tenancy-type joint ownership can be very problematic.

- Gregory Ross, partner,
Eakin McCaffery Cox, Sydney

can allow for greater flexibility if properly documented, Ross says. "The short point is that one has to be very careful in creating joint ownership provisions for IPRs, so as best to avoid acrimonious disputes and problems – joint tenancy-type joint ownership can be very problematic in the absence of a detailed agreement dealing with who can and cannot do what with and without the other 'joint' owners and what the impact of a insolvency is."

During insolvency proceedings, the bankruptcy administrator would discuss the transfer of the share in the underlying IPRs of the insolvent with the solvent joint rights owner, resulting in registration of the change of ownership in the name of the solvent joint rights owner. On the other hand, for a license contract based on the underlying IPRs of the insolvent, in a case where the subject rights are a non-exclusive license or a registered exclusive license, the bankruptcy administrator cannot cancel the contract by his or her authority, and thus the license is still valid.

"In other words, the bankruptcy administrator may choose to either cancel the contract made with the insolvent licensee or fulfill obligations," Hiroe says. "However, the bankruptcy administrator cannot cancel the contract when a legal countering condition such as the existence of a license. Therefore, even when the underlying IPRs have become the assets of the solvent joint rights owner, the license set by the insolvent continue to be effective. The licensee can work this license against the underlying IPRs of the solvent joint rights owner and the solvent joint rights owner has to admit the licensee's work," he says.

In cases where both of the joint rights owners have entered into a license contract, the license does not become invalidated by agreement to terminate the license contract between the

shall then be fulfilled."

The creation by the licensor of a dedicated IP holding company can usefully protect the ownership of its IP if the operating company becomes insolvent or claims are otherwise brought against it. "In the case of a licensee, the creation of a security interest in the licensed IP can be a useful protection against the insolvency of the licensor, provided that the security interest has priority over any other security interests granted by the licensor (for example, to its bank) and is registered on the Personal Property Securities Register," Hargreaves says. "This is only

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likely to be a practical option if the licensee is the only licensee. For the licensor, it can be useful to consider obtaining title to any good created under the license. In New Zealand, the creation of such an interest would be security interest, so that same concerns about ensuring priority of the security interest apply."

Hargreaves says lawyers at her firm do not think that in New Zealand the registration of a license against any registered IP would be of significant practical benefit. "Registration on the

relevant IP register does not constitute constructive notice of the license and would not necessarily prevent any licensed IP being sold to a bona fide purchaser for value without notice of the existing license," Hargreaves says. "Registration of a license is useful in certain circumstances, but the creation and registration of a security interest would give more benefit to a licensee."

The inclusion of a restriction on the assignment of the IP license without the other party's consent can be useful in an insolvency situation, as it prevents the license from being transferred without consent, Hargreaves adds. "This can give the non-transferring party some negotiating power in any sale of the insolvent party's business, and prevent the IP license from being transferred to an undesirable party."

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Licensees should also monitor the financial position of licensors. In addition, the licensee could take security over the IP.

- Debby Lim, partner,
Shook Lin & Bok, Singapore

From the licensee's perspective, a licensee could consider getting the licensor to establish a company solely to hold relevant IPRs without any liabilities for critical IPRs. This will reduce the risk should the licensor become insolvent, says Debby Lim, a partner at Shook Lin & Bok in Singapore. "In software development, a source code deposit or escrow arrangement may be helpful. Licensees should also monitor the financial position of licensors. In addition, the licensee could take security over the IP. It will also be helpful to register the IP license as generally any party who acquires the IP is deemed to have notice of the license and acquires the IP subject to the license. Sub-licensees may also wish to protect themselves against the insolvency of their immediate licensor. They may do so by ensuring that they have step-in rights in the event that the immediate licensor becomes insolvent."

From the licensor's perspective, the judicial management or liquidation of a licensee will give rise to a right to terminate the license in most cases. "That said, the licensor may wish to consider whether it wishes to allow the judicial manager or liquidator to continue using the license (in exchange for royalty payment) and then subsequently allow a new purchaser to take over the license. Where the licensor has concerns as to the identity of its licensee (for instance, where the licensee does not want its competitors to end up as its licensee), the licensor may wish to ensure that the license cannot be assigned without its consent," Lim says. "A change of control provision could also be drafted into the license, to allow the licensor to terminate the license where the control of the licensee is transferred to a third party."

The Power of the Bankruptcy Administrator

With regard to a bankruptcy administrator's ability to adopt,

assign, modify, or terminate an IP license, there are aspects of the law that should be improved to limit the administrator's power, particularly the proposals in Australia for amendment of the law to prevent "drop dead" termination provisions in contracts, including IP licenses, to be rendered unenforceable in context of insolvency, says Cavallaro.

The Singapore government is seeking to become an Asian IP hub, which would entail encouraging companies to enter into license agreements. Licensing is discouraged if it may be terminated against the will of the licensee in the event that the licensor becomes insolvent. Under Singapore law, liquidators may disclaim onerous contracts. A contract may be considered "onerous" if it is unprofitable or gives rise to a liability to pay money or perform any other onerous act.

"We could look towards other jurisdictions that are more developed in terms of protecting the licensee's rights to use the IP where the licensor is insolvent. Under the US Bankruptcy Code, licensees are given special protection and may elect to retain their rights to the licensed IP in return for continuing to make any royalty payment," Lim says. "Similarly in Canada, the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act restrict a licensor's ability to disclaim a license."

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It can be difficult for a court to find a bankruptcy administrator who specializes in both bankruptcy and IP. In addition, Taiwan's bankruptcy law does not regulate a bankruptcy administrator's choice to decide whether to continue or terminate an IP license in the event of insolvency. Similarly, as Taiwan's law does not regulate the basic principles of handling executory contracts, a bankruptcy administrator usually chooses to sell the debtor's property by way of auction or sale in order to avoid further legal complications arising. "This practice is arguably not a suitable means of appropriately handling IP in insolvency cases," Chen says. "Given the above, and in reference to relevant laws in Germany and the US, we would recommend that Taiwan's current bankruptcy law to be revised in two aspects: the basic principles of handling an executory contract should be added, and where the licensor becomes insolvent, the licensee should have the right to choose whether to continue the IP license or require compensation based on the timing of the licensor's declaration of bankruptcy." AIP

