Law360

December 12, 2013

No Bright-Line For Foreign Insolvency Law In Ch. 15

by J.R. Smith, Jason W. Harbour and Shannon E. Daily

In Jaffé v. Samsung Electronics Co. Ltd., et al.,[1] the Fourth Circuit confirmed the absence of a bright-line rule governing whether foreign insolvency law will apply in cases under Chapter 15 of the Bankruptcy Code.[2] Rather, the Fourth Circuit joined the Fifth Circuit[3] in concluding that Bankruptcy Code § 1522(a) requires balancing the interests of a foreign debtor and its creditors when considering whether to apply a foreign law.

Here, the German insolvency administrator sought to reject patent licenses under § 103 of the German Insolvency Code (the "Insolvency Code"), which provides no protections for licensees and, consequently, directly conflicts with Bankruptcy Code § 365(n). The latter gives licensees the well-established option to retain certain rights under licenses if rejected. The Fourth Circuit affirmed the Bankruptcy Court's decision to condition the administration of U.S. assets upon the application of § 365(n) to "sufficiently [protect]" licensees as required by Bankruptcy Code § 1522(a).

Case Background

In January 2009, German-based Qimonda AG, a manufacturer of semiconductor memory devices, commenced an insolvency proceeding before the Amtsgericht München - Insolvenzgericht.[4] Dr. Michael Jaffé was appointed insolvency administrator and tasked with administering Qimonda's estate, consisting of approximately 10,000 patents, including about 4,000 U.S. patents. Jaffé filed a Chapter 15 petition with the Bankruptcy Court seeking to administer Qimonda's U.S. assets.[5]

To avoid infringement risks caused by the large number of existing patents in the semiconductor industry, Qimonda followed standard industry practice and negotiated patent cross-license agreements with many of its competitors.[6] Jaffé's strategy to achieve value for the Qimonda

---

1 Jaffé v. Samsung Electronics Co., Ltd., et al. (In re Qimonda AG), 2013 U.S. App. LEXIS 24041 (4th Cir. Dec. 3, 2013).

2 All references herein to the "Bankruptcy Code" refer to title 11 of the United States Code.

3 See Ad Hoc Group of Vitro Noteholders v. Vitro SAB De CV (In re Vitro SAB De CV), 701 F.3d 1031, 1060 (5th Cir. 2012) (holding that § 1522 requires that the relief contemplated under § 1521 balance the interests of creditors and debtors).

4 See Jaffé, 2013 U.S. App. LEXIS at *7.

5 Id. at *4-5.

6 The Fourth Circuit's decision includes a considerable discussion of the problem of the "patent thicket" and the potential "holdup" scenario that may result when bringing a new

estate centered on rejecting the existing cross-license agreements under German law and renegotiating them to secure royalties for Qimonda's patents that Qimonda was not receiving under its existing licenses. Unlike Bankruptcy Code § 365(n), § 103 of the Insolvency Code would allow Jaffé to reject the licenses without affording licensees the option to retain rights under the licenses. Ultimately, the question arose as to whether U.S. law permitted Jaffé to reject the U.S. licenses pursuant to German law, and consequently, prevent the U.S. licensees from invoking the protections of § 365(n).

On remand from an appeal to the District Court, the Bankruptcy Court held that "the balancing of debtor and creditor interests required by § 1522(a) ... weighs in favor of making § 365(n) applicable to Dr. Jaffé's administration of Qimonda's U.S. patents" because the harm to the estate was outweighed by the risk a contrary ruling would create to the substantial investment of the licensees.[7] The Bankruptcy Court also found that deferring to German law with respect to the cancellation of the U.S. cross-license agreements would be "manifestly contrary to U.S. public policy" under Bankruptcy Code § 1506.[8] With permission, Jaffé appealed directly to the Fourth Circuit.

The Fourth Circuit Decision

The Fourth Circuit affirmed the Bankruptcy Court's decision under § 1522, holding that the Bankruptcy Court reasonably exercised its discretion in balancing the parties' competing interests and concluding that § 365(n) must apply to sufficiently protect the licensees.[9] The Fourth Circuit declined to address the Bankruptcy Court's alternative holding under § 1506.[10]

Jaffé argued three points on appeal concerning § 1522: (i) the Bankruptcy Court erred in considering the sufficient protection requirement of § 1522 because § 1522(a) only applies to relief granted under § 1521, which relief may only be requested by the foreign representative, and that he, as foreign representative, did not request the inclusion of § 365(n) as part of the relief; (ii) even if the Bankruptcy Court was correct to consider § 1522's sufficient protection requirement, it applied the wrong test in applying § 1522(a); and (iii) in balancing the competing interests of the licensees and the estate, the Bankruptcy Court overstated the risks to the licensees.[11]

---

product to market, which also was a key consideration of the Bankruptcy Court. See Id. at *9-10.

7 In re Qimonda AG, 462 B.R. 165, 181-82 (Bankr. E.D. Va. Oct. 28, 2011).

8 Id. at 185.

9 Jaffé, 2013 U.S. App. LEXIS at *7.

10 Id. at *40-41.

11 Id. at *28-29.

The Fourth Circuit found Jaffé's first argument unpersuasive because § 1522 authorizes the Bankruptcy Court to subject § 1521 relief "to conditions it considers appropriate"[12] to ensure sufficient protection of the parties' interests as required by § 1522(a). The Fourth Circuit held that by subjecting discretionary relief to the requirements of § 365(n), the Bankruptcy Court appropriately applied § 1522(b).[13] The Fourth Circuit found Jaffé's failure to request the inclusion of § 365(n) in the supplemental order inconsequential.

Noting that Jaffé's second argument was "not illogical," the Fourth Circuit nevertheless concluded that the text of § 1522(a) and related legislative history supported the balancing test employed by the Bankruptcy Court.[14] Mirroring the In re Vitro analysis, the Fourth Circuit explained that because § 1522(a) requires sufficient protection of both the creditors' and debtor's interests, it logically follows that a court should employ a balancing test to consider the relative harms and benefits to all interested parties.[15]

Addressing Jaffé's final argument, the Fourth Circuit affirmed the Bankruptcy Court's conclusion that the risk of harm to the licensees justified application of § 365(n) to the U.S. cross-license agreements.[16] The Bankruptcy Court determined the licensees' considerable sunk costs in reliance on the design freedom provided by the cross-license agreements outweighed the harm to Qimonda's estate of applying § 365(n). Additionally, the Fourth Circuit held that the Bankruptcy Court reasonably concluded Jaffé's proposal to re-license the patents on reasonable and nondiscriminatory royalty terms, though mitigating the hold-up risk to the licensees of securing new licenses, did not allow the licensees to avoid royalties altogether by designing around the patent due to their already substantial investments in reliance on the licenses.[17]

Implications

At its core, the Fourth Circuit's decision confirms there is no bright-line rule with respect to applying foreign insolvency law in a Chapter 15 proceeding. Neither the Fourth Circuit nor the Bankruptcy Court concluded as a matter of law that a foreign representative may never apply foreign law over U.S. law. Instead, § 1522 requires a court to balance the interests of the foreign debtor with the interests of its creditors before granting discretionary relief under § 1521.

Although the breadth of application of this decision remains to be seen, we note that the facts of this case, particularly with respect to the unique semiconductor industry cross-licensing practice,

---

[12] 11 U.S.C. § 1522(b).

[13] Jaffé, 2013 U.S. App. LEXIS at *33.

[14] Id. at *35.

[15] Id. at *36.

[16] Id. at *46-47.

[17] Id. at *45-46 (quoting In re Qimonda AG, 462 B.R. at 181-82).

appeared to play a significant role in the balancing analysis under § 1522(a). A contrary ruling essentially could encourage licensors to forum shop for international jurisdictions with favorable insolvency laws governing the rejection of intellectual property licenses and then seek enforcement of that foreign law in the U.S. through Chapter 15.

Licensees should remember that § 365(n) does not automatically trigger retention of a licensee's rights under a license. Instead, if the license is rejected, the licensee must notify the trustee in writing of its decision to retain its rights pursuant to § 365(n).

Finally, legislative efforts are underway to amend § 1520 so that § 365(n) applies in all foreign main proceedings, but face a strong headwind and unlikely success given the current political environment.[18]

J.R. Smith is managing partner of Hunton & Williams LLP's Tokyo office. Jason Harbour is a partner in the firm's Richmond office. Shannon Daily is an associate in the firm's Richmond office.

[18] Patent Transparency and Improvements Act of 2013, S. 1720, 113th Cong. (1st Sess. 2013).