EDVA Decision Drives Pending Patent and Bankruptcy Reforms

By Brian Pandya and Paul Kim

While most of the pending patent reform legislation in Congress has focused on changes meant to deter abusive litigation, particularly in lawsuits filed by patent assertion entities, one of the lesser discussed aspects of the legislation includes changes to the Bankruptcy Code that both bankruptcy and patent litigators, and judges handling such cases, should be aware. What’s more, this legislation was the direct result of an Eastern District case and sponsored by a Virginia Congressman.

Section 6(d) of the Innovation Act – sponsored by Rep. Robert Goodlatte (R-VA), Chairman of the House Judiciary Committee and whose district spans the western part of the Commonwealth – seeks to close a loophole in the Bankruptcy Code (11 U. S. C. §§ 1 et seq.) that was exposed in a recent Eastern District of Virginia bankruptcy decision. This loophole could subject patent licensees to continued licensing attempts and/or infringement suits over intellectual property that was previously believed to be licensed. Innovation Act of 2013, H.R. 3309, 113th Cong. (2013). The Innovation Act passed the full House of Representatives by a vote of 325 to 91 on December 5, 2013.

In In re Qimonda AG, Judge Mitchell of the Eastern District of Virginia’s bankruptcy court ruled that the Bankruptcy Code favored making the IP licensee protections provided in § 365(n) of the Bankruptcy Code available in cross-border or foreign bankruptcy proceedings, i.e., bankruptcy cases that are subject to foreign jurisdiction but where some of the debtor assets are within the United States. This ruling is significant because it drew attention to the previously unsettled question of whether § 365(n) of the Bankruptcy Code, which generally allows an intellectual property licensee whose license has been terminated by a licensor in bankruptcy proceedings to either elect to treat the license as terminated or to retain a non-exclusive license to the intellectual property on comparable terms, applied automatically in “Chapter 15” foreign or cross-border bankruptcy proceedings under 11 U.S.C. § 1520(a) or, in the alternative, whether a bankruptcy judge has the discretionary authority to require a foreign bankruptcy administrator to observe § 365(n) as a condition of recognizing a foreign bankruptcy proceeding under § 1521(a).

The case arose when Qimonda AG, a German spin-off of the semiconductor company Infineon, filed for insolvency in Germany. The German insolvency estate administrator then sought to terminate the cross-licenses binding Qimonda’s semiconductor patent portfolio under § 103 of the German Insolvency Code in order to sell or re-license the patents on more favorable terms to presumably the current licensees of the Qimonda patents or to possibly bring patent infringement suits against them. The licensees – who included nearly the entire semiconductor industry – objected to the administrator’s attempt to terminate the already paid-for patent licenses because upon termination, the licensees could be “held up” for exorbitant licensing demands to take new licenses because the licensees had already invested billions of dollars in reliance on the Qimonda AG patent licenses. Additionally, the licensees argued that the precedent set by an unfavorable ruling would create a bankruptcy loophole that would be abused by unscrupulous foreign patent owners that could buy previously licensed patents, file bankruptcy in a country that allows debtors to terminate patent licensing agreements, and then seek additional licensing fees from the previously licensed companies, or file patent infringement suits against the former licensees after they had started to practice
the patents and could not economically design around the patents.

Initially, the bankruptcy court had granted comity to the German insolvency proceeding and rejected the licensees’ request to modify the German proceeding recognition order to include the § 365(n) provision. However, after the order was appealed to the district court, Judge Ellis remanded the case for further fact finding to determine whether the creditors’ interests were sufficiently protected as required by § 1522 of the Bankruptcy Code, as well as to determine whether granting comity to German bankruptcy law without conditioning it to § 365(n) protection would violate the public policy provision of § 1506. On remand, the bankruptcy court modified the recognition order to include § 365(n) protection under both § 1522 and § 1506. The Fourth Circuit recently affirmed the decision below, holding that the bankruptcy court correctly balanced the interests of both the debtor and the creditors in choosing to grant the creditors’ rights under § 365(n). One issue that still remains open after the Fourth Circuit opinion, however, is whether a foreign representative’s attempts to terminate IP licenses without applying § 365(n) would violate the public policy provision of § 1506.

Under Chairman Goodlatte’s Innovation Act, which passed the full House in early December, § 1522 would be amended to explicitly state that § 365(n)’s protections would be available in all bankruptcy proceedings, including foreign or cross-border bankruptcy proceedings, thus closing this loophole in the Bankruptcy Code and providing IP licensees protection from abusive patent litigation tactics by patent trolls who may be aware of this loophole. Thus, this legislation would ensure that U.S. bankruptcy law will supersede the bankruptcy laws of the foreign jurisdiction to provide protections to IP licensees that may not be available under foreign law.

Brian Pandya is a Partner in the Intellectual Property and Litigation groups at Wiley Rein LLP in Washington, DC. Mr. Pandya’s practice focuses on patent litigation and counseling. Paul Kim is an Associate at Wiley Rein. Mr. Pandya and Mr. Kim are both members of the Virginia bar, registered patent attorneys, and have litigated multiple patent cases in the Eastern District of Virginia. Any opinions expressed in this article are strictly the personal views of the authors and do not necessarily reflect the views of their clients or law firm. Jaffe v. Samsung Elecs. Co., et al., No. 12-1802, 2003 WL 26478864 (4th Cir. Dec. 3, 2013). See, 11 U. S. C. § 1520(a).

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