Qimonda Ruling Protects Licensees of U.S. Patents, Holding that Application of German Insolvency Law to Cancel Licenses is "Manifestly Contrary" to U.S. Public Policy

In a case of first impression, a U.S. bankruptcy court charged with enforcing the rights of a foreign insolvency administrator against assets in the United States has held that foreign insolvency law may not be invoked to cancel the rights of licensees of U.S. patents.

Licensees of U.S. patents rely on § 365(n) of the U.S. Bankruptcy Code for assurance that licensed rights will continue notwithstanding a bankruptcy of the licensor. Section 365(n) permits a licensee, in exchange for continued payment of royalties, to elect to continue to use licensed intellectual property in the event that the license is rejected in bankruptcy. Conventional wisdom among intellectual property lawyers identifies two important limitations on the protections of § 365(n): (i) the statute does not protect a licensee's rights to trademarks or to non-U.S. intellectual property, and (ii) the statute, as a provision of the U.S. Bankruptcy Code, is not applicable if a licensor files for bankruptcy outside of the United States.

On October 28, 2011, the U.S. Bankruptcy Court for the Eastern District of Virginia called this conventional wisdom into question by extending the reach of § 365(n) so that it applies to U.S. patents owned by a German licensor in bankruptcy in Germany. In re Qimonda AG, is a case under Chapter 15 of the Bankruptcy Code. Chapter 15 allows a foreign insolvency administrator to obtain control over U.S. based assets of the non-U.S. debtor. In most cases, a U.S. bankruptcy court that has recognized a non-U.S. bankruptcy proceeding as a main proceeding will defer to the substantive law of the foreign jurisdiction.

The Qimonda court, however, considered objections to application of German law filed by seven licensees of U.S. patents. The licenses in question related primarily to Dynamic Random Access Memory technology for semi-conductors used in the automotive, industrial and security industries. Evidence at trial established that the semi-conductor industry is characterized by what one expert called a "patent thicket" whereby any semi-conductor device may incorporate technologies covered by a multitude of patents, many of which are licensed rather than owned. The objecting licensees also introduced evidence that billions of dollars in non-recoverable "sunk costs" were invested in manufacturing facilities in reliance on cross-licenses affording freedom of action with respect to licensed patents. Permitting cancellation of the Qimonda licenses, the licensees argued, would force licensees either to suffer enormous losses or to pay extortionate royalties to relicense the rights.

Based on a balancing of the interests of the German debtor/licensor and the licensees of U.S. patents and after considering Congressional policy in enacting § 365(n), the Qimonda court found that the policy that § 365(n) seeks to promote is fundamental U.S. public policy and held that failure to apply § 365(n) in the Qimonda case to preserve licensee access to U.S. patents would be "manifestly contrary" to that policy.

The Qimonda case establishes the possibility that § 365(n) of the Bankruptcy Code will protect licensees of U.S. patents in a Chapter 15 case of a foreign debtor/licensor. The case, however, must be viewed in perspective. As a decision of a single bankruptcy court, the opinion is persuasive but not binding authority regarding application of § 365(n) in other Chapter 15 cases. The decision was based on an extensive factual record establishing the importance of patent cross licensing in the semi-conductor industry; the rationale of the Qimonda court may not apply to licenses in other industries. Moreover, the Qimonda court noted that the protections of § 365(n) and the scope of its decision would not affect German law as it applies to non-U.S. patents.

Overall, the Qimonda case both serves as a reminder of the limits of protections for licensees of intellectual property in cross border insolvencies and offers the possibility of an extension of protections to cases under Chapter 15 of the Bankruptcy Code. Licensees will still need to assess the risk of insolvency in structuring licenses with non-U.S. licensors and in situations where non-U.S. intellectual property rights are an important element of a transaction.

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