

***PATENT PORTFOLIOS OF PHARMAS AND BIOTECH COMPANIES
IN BANKRUPTCY CASES:
PROTECTING THE ASSETS AND MAXIMIZING VALUE***

by

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I. INTRODUCTION

A. Basic bankruptcy context

This paper discusses how to protect patent portfolios of pharmas and biotech companies and to maximize the value of such portfolios when the owner of the portfolio files a Chapter 7 or Chapter 11 bankruptcy petition. The filing of such a petition creates an estate under 11 U.S.C. § 541. This estate includes “all legal and equitable interest of the debtor³ in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). Thus an owner’s portfolio of patents and patent applications will become property of the bankruptcy estate at the moment the owner files a bankruptcy petition. Bankruptcy is often preceded by financial difficulties and a deterioration in the owner’s business operations. The owner may have ceased to manage, maintain, and prosecute patents and patent applications. The owner may have ceased to even maintain comprehensively organized hard or electronic copies of the file history of patents and

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³ The term “debtor” means person or municipality concerning whom a case under Title 11 of the United States Code has been filed. In a Chapter 11 case, a “debtor-in-possession” has most of the powers of a bankruptcy trustee. 11 U.S.C. § 1107.

patent applications. Thus, when counsel is employed by a Chapter 11 debtor-in-possession, Chapter 11 trustee or by a Chapter 7 trustee in a case involving a patent portfolio, counsel should take certain steps to protect the patent portfolio and to maximize its value. A bankruptcy case which has assets including patents and patent applications will require skilled patent counsel as well as skilled bankruptcy counsel. In the case of patent counsel, specific technical knowledge in the subject matter of the patents can be very useful. Many sophisticated patent attorneys have doctorates in various technical areas.

B. Introduction to general process of drug development

Under the new drug development process described by the Food and Drug Administration (“FDA”), an agency of the United States Department of Health and Human Services responsible for regulating drugs, food, dietary supplements and other products, there are multiple steps from test tube to new drug application (“NDA”) review, encompassing three stages: (1) pre-clinical research; (2) clinical studies split into three phases; (3) NDA review for approval to sell and market a product. Once a sequence or protein has been synthesized and purified by research and development efforts, this new drug can further be applied and tested in animals with approval from appropriate review boards. Results from the pre-clinical research are collected to move to the next stage of clinical research by obtaining approval from the FDA for safe human testing. An investigational new drug (“IND”) application is submitted to the FDA at this stage by a drug sponsor to get approval from the FDA to start clinical trials in humans. The FDA gives an approximate figure of testing on twenty to eighty subjects at phase one, and the FDA can stop the clinical trial at any time. Phase two studies are typically conducted on several hundred subjects. When phase one and phase two clinical trials establish safe testing without major side effects and with promising results, then phase three is allowed by the FDA for testing the new drug on several hundred to several thousand subjects. The next NDA review process is

rigorous, consisting of FDA review of the data, an interview process and analysis by advisory committees. This entire process of a new drug development from the initial scientific discovery through its NDA review process can take many years without any guarantees of success due to the unpredictability of the drug being tested. (*See the FDA Web site for the New Drug Development Process.*)

C. Power-of-attorney requirements for patent counsel

A power of attorney naming the hired firm handling the prosecution of patent applications must be filed with the United States Patent and Trademark Office (“USPTO”). In order to act in a representative capacity for the debtor, a paper form must be filed by a registered patent attorney or patent agent for patent applications in which he or she is not of record. A power of attorney with more than ten names of patent practitioners can be accepted only if associated with a customer number. In filing this form, the registered patent attorney or patent agent must include the registration number and name with his or her signature. 37 C.F.R. § 1.32.

II. PROTECTING THE ASSETS AND MAXIMIZING VALUE

A. Determine what patents and patent applications are in the estate:

1. Debtor’s records

Counsel must obtain, organize, and review debtor’s records. The task can be more difficult if the debtor has failed pre-filing and records are in poor condition, particularly when employees of the debtor have moved on.

2. Debtor’s IP staff/IP counsel/inventors

Debtor’s inventors, other IP staff, and management team could be a great source of information for finding out relevant technology at issue, status of patent applications and patents and other IP agreements in place.

3. Debtor's general counsel, patent counsel and special patent counsel

Typically for pharmas and biotech companies, in-house patent counsel or an IP patent portfolio manager was most likely involved pre-bankruptcy in managing patent portfolios and outside counsel was hired to prosecute patent applications. Communicating with all patent counsel, both domestic and foreign, who were involved in prosecution can be a way to gather more information, particularly if complete, organized records were not properly kept and maintained.

4. Different Patent Office Databases

(a) United States Patent & Trademark Office ("USPTO")

Database: The USPTO Web site, particularly the Private PAIR and database for assignment records, is useful for any patent counsel to obtain current status information for pending patent applications, patents and assignment records. Assignment records are open to public inspection. 37 C.F.R. § 1.12. However, file history including records such as office actions issued and replies filed in response to issued office actions for patent applications and patents are uploaded only as far back as two to three years from the present. Therefore, file history for patent applications and patents older than two to three years should be ordered since only indexing of dates for office actions issued or replies filed is shown for files older than two to three years.

(b) World Intellectual Property Office ("WIPO") Database:

The WIPO Web site also contains data for PCT applications, foreign counterparts to U.S. applications, which are easily searchable in WIPO's database.

(c) Foreign Patent Office Databases: Foreign patent office

databases such as the European Patent Office ("EPO") database, the Canadian Intellectual Property Office ("CIPO") and the Japanese Patent Office ("JPO") database also contain

data for national stage applications based on the PCT applications. The JPO database contains newer as well as older applications. However, the EPO and CIPO databases only contain more recent applications and patent information. Therefore, it is crucial to have good records such as correspondence from various patent offices and foreign counsel regarding the patent applications at issue because the patent rules can vary significantly for different patent offices for requesting examination, responding to office actions, complying with international patent rules and filing other applications based on the pending application.

5. Patent file folders transferred from debtor and/or outside counsel

Patent file folders are particularly useful in determining status and file history for U.S. as well as foreign applications if records are kept and maintained in proper condition. Since the USPTO database only contains a complete file history for the more recent years, good records are certainly helpful for checking status and ascertaining issues, including records such as past correspondence between the USPTO and patent counsel, replies to office actions and foreign counsel's recommendations. Patent file folders for foreign applications are particularly important for including records such as correspondence between a foreign patent office and foreign counsel as well as correspondence from foreign counsel regarding issues involved.

6. Debtor licensors or licensees

Counsel should review patent license agreements to identify rights in licensed patent applications and/or patents as licensor and licensee. As described below, there are specific rules in Title 11 of the Bankruptcy Code which affect the interests of parties to a license of property, including intellectual property such as patents, when one of the parties to a license files bankruptcy. For joint collaborations with universities, it is often helpful to contact the technology transfer office of the university for finding licensing arrangements and/or

agreements. Typically, any university with research activities will have a technology transfer office that keeps track of licenses with other companies. Contacting a technology transfer office of a university can be an easy way to identify previous licensing arrangements between the debtor and a particular university if the original licensing agreements cannot be found.

Technology transfer offices of universities may provide existing licensing agreements with the debtor. However, certain agreements with a specific laboratory within the university may not be centrally located and recorded with all technology transfer offices. For licenses with other companies, contacting the companies directly can aid in tracking down existing licenses to find out the exact licensing arrangement between the debtor and the other party to a license.

Reviewing licensing agreements in place and making sure royalties from the licenses are being paid accurately will ensure a steady flow of income into the estate.

7. Other Contracts

Joint collaborations with other parties are also important to ascertain because of the joint ownership of patent rights involved. When the debtor collaborated prepetition with other companies or universities to improve and/or develop a technology, counsel must identify what kind of joint ownership arrangement was agreed upon and who is responsible for paying the fees and costs of prosecuting the patent applications. Reviewing the joint collaborative agreements closely can reveal joint ownership rights.

B. Organize the records

1. Create a summary of all patents and patent applications, status of each matter, and deadlines

(a) Create a summary document that has “all information.” A sample form of a summary of patent applications and patents is attached as Exhibit A.

(b) For organization purposes and to avoid missing upcoming deadlines, it is crucial to create a summary list of all patents and patent applications information. Lead IP counsel, preferably a patent counsel, should create and manage this patent portfolio with others on the IP team having access to such information.

2. Unless case is a Chapter 11 with a functioning debtor and competent general patent counsel with a current existing comprehensive deadline docket, create a maintenance and deadline docket

As soon as a comprehensive deadline docket is created, it would also be useful to enter all information into counsel's IP docketing system if the hired firm has capability to do so in order to have double reminders for all upcoming deadlines.

C. Triage: responses to office actions and payment of maintenance fees

1. Response to office actions from the USPTO

(a) U.S. national patent applications fall under three types: (i) applications for patent under 35 U.S.C. § 101 relating to a "new and useful process, machine, manufacture, or composition of matter"; (ii) applications for plant patents under 35 U.S.C. § 161; and (iii) applications for design patents under 35 U.S.C. § 171.

Typically, a patent application under the first type is referred to as a utility patent application because the invention must be a new and useful invention. After a utility patent application is filed with the USPTO, an examiner will issue what is called an office action. An office action can reject claims based on substantive issues under 35 U.S.C. § 102(a)-(g), 103(a)-(c), 112, or 101. An examiner can also object to nonsubstantive, improper form issues, distinguished from rejections, in the office action. Office actions are issued for substantive and nonsubstantive reasons and applicants are allowed to respond.

(b) Typically, after an examiner from the USPTO has issued an office action, the period for reply to such office action can be extended only as far as up to six months from the mailing date of the office action. This maximum statutory period for reply to an office action is six months. If a shortened three-month period is set in the office action, the reply can be extended only up to three more months by paying extension fees for every month thereafter from the shortened statutory period. The six-month deadline is not extendable and the application is abandoned if the reply to the office action is not filed on time. Therefore, it is very important to look for pressing deadlines for responding to office actions in order to keep the patent applications alive. Determining which ones to continue to prosecute and which ones to abandon can be addressed later because it is more critical to save the applications at the inception of the bankruptcy case by responding to all office actions. Manual Patent Examination Procedures (“MPEP”) § 710; 35 U.S.C. § 133; 37 C.F.R. § 1.135

(c) A nonsubstantive office action can require that the applicant comply with certain requirements and respond to such office action without options for extension. For example, compliance for sequence listing can require an applicant to respond within one month from the mailing date of the office action without options to extend the period beyond the one month. Not responding to such a noncompliance based office action can result in abandonment of the application, whereas the substantive portion of the office action can be extended up to six months from the mailing date of the office action. Therefore, it is very important to have patent counsel managing the patent portfolio to stay highly vigilant, to know the patent rules and to ensure that deadlines are not missed.

2. Payment of maintenance fees for U.S. patents

(a) Maintenance fees may be paid for patents without surcharge during the periods extending respectively from three years through three years and six months after grant of the patent for the first maintenance fee, seven years through seven years and six months after grant of the patent for the second maintenance fee, and eleven years through eleven years and six months after grant of the patent for the third maintenance fee. Maintenance fees may also be paid in patents with surcharge from three years and six months through the day of the fourth anniversary of the grant of the patent for the first maintenance fee, seven years and six months through the day of the eighth anniversary of the grant of the patent for the second maintenance fee and eleven years and six months through the day of the twelfth anniversary of the grant of the patent for the third maintenance fee. MPEP § 2506; 37 C.F.R. § 1.362; 35 U.S.C. § 41(f). The maintenance fee amounts and the grace period surcharge are set in 37 C.F.R. § 1.20(e)-(h) and the amounts are subject to change depending on fluctuations occurring in the Consumer Price Index according to 35 U.S.C. § 41(f).

(b) If the maintenance fees are not paid within the windows previously mentioned, a patent expires for the failure to pay the maintenance fee. Therefore, maintenance fees should be paid on time to avoid expiration of patents. MPEP § 2504; 37 C.F.R. § 1.362; 37 C.F.R. § 1.20(e)-(h); 35 U.S.C. § 41.

(c) If a maintenance fee has not been paid on time for an important patent, it is possible to have the USPTO accept delayed payment of the maintenance fee to reinstate the patent under certain conditions. A patent counsel can file a petition to accept late payment of maintenance fees with the USPTO where the delay was unavoidable or unintentional. The process for reinstatement is involved, and success

is not assured. It is much better to practice to timely pay maintenance fees, if at all possible. MPEP § 2590; 37 C.F.R. § 1.378; 35 U.S.C. § 41(c).

3. Foreign applications

(a) Patent Cooperation Treaty (“PCT”) applications. An international application or a PCT application can be filed with a Receiving Office (35 U.S.C. § 361) under the PCT to allow a PCT applicant to designate countries in which foreign patent protection is to be pursued. Basically, filing a PCT application allows a U.S. applicant or a foreign applicant to file patent applications in the contracting countries of the PCT. Filing a PCT application allows the applicant to enter into a national stage in the countries previously selected in the PCT application. Entering a national stage refers to pursuing a national application in that country to seek foreign protection for the invention. When we state that an application is filed with the EPO or with another foreign patent office, this indicates that a PCT application has been filed with a Receiving Office and that the applicant has chosen to pursue a national application in Europe, Japan, or other countries selected based on the international application or PCT application filed. 37 C.F.R. §§ 1.9, 1.401, 1.431, 1.432.

(b) Foreign patent counsel hired to prosecute foreign patent applications before foreign patent offices of interest. For foreign patent applications based on PCT applications, foreign counsel in a specific country is typically hired to handle patent applications. Therefore, foreign counsel handling foreign patent applications generally should continue to handle prosecution before various patent offices post bankruptcy and be employed by the bankruptcy trustee or debtor-in-possession.

(c) Foreign patent rules. Foreign deadlines and patent rules can vary significantly. It is prudent to seek advice from local foreign patent counsel for

advice in prosecuting before various foreign patent offices. Even among Asian countries, such as Korea, Japan, and China, the patent examination rules can vary significantly. Therefore, it is crucial that patent counsel managing foreign applications are in close, working communication with foreign counsel to understand the issues before the foreign patent office and to instruct foreign patent counsel in continued prosecution. Typically, good records can help primary patent counsel manage foreign patent counsel for different pending foreign applications and continue to instruct foreign counsel before various foreign patent offices.

D. Identify and protect other IP rights

Other IP assets, including trademarks, can be valuable. It is important to find out the current status of any pending trademark applications with the USPTO by searching in the database of the Trademark Office. Certain trademarks, if already registered, may be of great value, and it is important to keep marks alive instead of abandoning the mark by failing to file necessary documents. It may also be useful to do a simple search for domain names and to pay the registration fee to keep the domain names current.

E. Investigate patent assignments and security interests

1. Assignments: USPTO

Subject to the bankruptcy issues identified below, patents and patent applications are assignable in law by writing. Assignments are a transfer of an ownership interest, so assignments of patents must be recorded with the USPTO to be valid. 35 U.S.C. § 261.

(a) Assignment records relating to patents, published patent applications, registrations of trademarks, and applications for registration of trademarks are searchable and available on the USPTO Web site. 37 C.F.R. § 1.12.

(b) It is important to research the chain of title to patents and patent applications by checking for assignment of inventors' rights to the debtor and records of such assignment with the USPTO. In most cases, the inventors will have assigned their rights to the debtor and the assignment should be recorded with the USPTO.

(c) Foreign law for filing assignments can vary from country to country. For Canada, any assignment records with the USPTO or other documents accepted in the U.S. can be filed with CIPO. Mere name changes from one company name to another can also be filed with the EPO for assignment purposes. Foreign counsel can advise on these issues, therefore, retaining competent foreign counsel is essential. Absent imminent deadlines, primary patent counsel should search the assignment records in the patent files prior to approaching foreign counsel due to economic factors. Retaining foreign counsel can be quite expensive in most countries and doing homework first is not only essential but critical in preserving the estate.

2. Security interests: secretary of state

Patents are general intangibles under Uniform Commercial Code ("UCC") and security interests must be recorded in the state of incorporation of the owner of the patents and patent applications pursuant to Article 9 of the UCC. (*See* Section V below).

3. Name changes

If a debtor changed the company's name, either a certificate of amendment and/or articles of amendment is filed with the Secretary of State. Records of name change can be ordered and filed with the USPTO to establish clear chain of title if a debtor's name was changed and not recorded.

F. Obtaining bankruptcy court orders authorizing the employment of counsel, including special patent counsel (11 U.S.C. § 327)

1. If in Chapter 7, payment of every expenditure in excess of \$1,000 will require an order, on notice to creditors and parties and interest and the opportunity for hearing (Fed. R. Bankr. P. 2002(a)(6)). Expenses of \$1,000 or less may be approved by the court on an ex parte basis. Further, patent counsel for the debtor-in-possession or trustee in bankruptcy are “professionals” under the Bankruptcy Code and must be employed under 11 U.S.C. § 327 prior to beginning work in order to be compensated. Compensation is usually contingent on notice to creditors and the opportunity for a hearing.

2. In most cases, special patent counsel can be employed under 11 U.S.C. § 327(e), which requires a lack of adverse interest. Often, using the same patent counsel who represented the debtor prepetition is in the best interests of the debtor and its creditors. If special patent counsel is a prepetition creditor, special patent counsel is subject to a preference claim, etc., that could be but may not be disqualifying. Unlike 327(a), 327(e) employment doesn’t contain a disinterestedness requirement, but prohibits employment of a professional in the bankruptcy case who has an “adverse interest.” The term “adverse interest” is not defined in the Bankruptcy Code. Generally, an adverse interest includes any interest or relationship, however slight, “that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy Rules.” *In re BH&P Inc.*, 949 F.2d 1300, 1308 (3d Cir. 1091); *See In re Crivello*, 134 F.3d 831, 835 (7th Cir. 1998). The court has wide discretion to determine what constitutes an adverse interest. An adverse interest can be “either (1) the possession or assertion of any economic interest that would tend to lessen the value of the bankruptcy estate or create an actual or potential dispute with the estate as a rival claimant, or (2) a predisposition of bias against the estate.” *In re Granite Partners, L.P.*, 219 B.R. 22, 33 (Bankr. S.D.N.Y.) 1998; *see In re*

Crivello, 134 F.3d at 835-36. It is possible that notwithstanding what appears to be *per se* disqualifying language, a court may allow the employment of special patent counsel even if that counsel holds a prepetition creditor's claim if such counsel's retention is critical to the protection of a patent or patent application, or if hiring new counsel would cause an economic hardship to the bankruptcy estate. Full disclosure of any possible adverse interests is a non-discretionary part of applying for a court order to employ counsel, including special patent counsel, for a trustee or debtor-in-possession. Fed. R. Bankr. P. 2014.

3. It is often best to use existing patent counsel at least until patent portfolio is stabilized. Retention of existing patent counsel is much easier if the estate has ample funds.

4. Patent counsel will want to be paid promptly. Most patent counsel will agree to wait to be paid through bankruptcy court employment and fee application process, but some will want retainers, especially those who are in foreign countries or who have had trouble getting paid by the debtor prepetition. As stated above, payment of professionals in a bankruptcy case is generally contingent on notice to all creditors and the opportunity for a hearing. In our experience, foreign counsel tend to request retainers prior to preparing and filing a response or attending to other matters. Requesting payment or retainers depends primarily on the relationship established between managing patent counsel and foreign counsel.

5. It is not unreasonable to request an estimate for a particular service required from outside patent counsel whether from U.S. counsel or foreign counsel. Foreign counsel fees and costs tend to be higher, so, it is prudent to obtain an estimate and future fees and costs prior to proceeding with prosecution before a foreign patent office. The Office of the United States Trustee, and the Bankruptcy Court usually appreciate having some estimate of special counsel fees before approving retention. Generally, outside patent counsel are quite

cooperative and understanding of the situation. It is also important to get a clear understanding with patent counsel about what is expected by both patent counsel and the debtor-in-possession or trustee.

G. Determine the value of the patent portfolio

1. Collect information from various sources

(a) Investors. Sophisticated investors may have knowledge bearing on value of the patent portfolio and may be interested in purchasing some or all of the portfolio, or in participating in the recapitalization of the company. Obviously, the statements of insiders are not disinterested, and are not a substitute for information and analysis from independent outside experts.

(b) Angels. Angels can be a source for valuation and for initial funding.

(c) Incubators. For Biotech or Pharma patent portfolios, incubators can be interested in either investing in the technology in various stages of development or licensing the technology to add to the incubator's existing licensing portfolio. The debtor-in-possession or the trustee may wish to hire an independent consultant to provide valuation information and/or approach an incubator, particularly through established connections, for investment and potential licensing opportunities. Even if an incubator decides not to invest, the incubator can provide invaluable expertise by assessing the technology and determining other competitors in the relevant field.

(d) Inventors, officers, and employees of debtor. When attempting to understand a particular technology, inventors, officers and/or employees of the debtor who were intimately involved in the prosecution process can be helpful in explaining the relevance of the technology, assisting counsel with understanding the

marketplace for the technology involved and networking with investors. Opinions from inventors, officers and employees of the debtor company or previous insiders can never substitute for independent analysis by an outside consultant with knowledge and expertise in the technology involved.

(e) Patent counsel can research the technology. Patent counsel hired to manage the patent portfolio or to prosecute before the USPTO can do his/her own homework in assessing the technology and determining potential investment opportunities. If the technology is a promising one with positive feedback from potential investors, patent counsel can approach other Pharms or Biotech companies in the technology area to arrange meetings to participate in the recapitalization of the company and/or further develop the technology by establishing contractual arrangements.

(f) Seek advice from an experienced consultant to help determine value. Knowing whom to approach for the technology at issue can best position the debtor or trustee to either pursue future investments, reorganize, collaborate and/or sell some or all of the patent portfolio.

If the debtor is in Chapter 7, it would be optimal to obtain advice from a consultant with experience in either commercializing and/or developing technology to help determine value. The consultant should have some understanding of the specific technology at issue. The feedback gathered and analyzed from previously mentioned experts in the field can help the debtor or trustee determine how to best proceed.

2. Licenses and other agreements in place

In the process of investigating and performing due diligence for the patent portfolio, it is also important to know all the relevant licenses and agreements in place in the

relevant technology area to determine market saturation and the level of interest in the technology.

H. Security interests in patents

Any determination of value must include a thorough review of security interests and assignments of patent applications and patents.

1. Assignments of patents must be recorded with the USPTO

See Section II above. 35 U.S.C. § 261.

2. Security interests in patent portfolios

(a) Because the federal patent statute deals with ownership but not security interests, federal patent law does not preempt state law as to the perfection of security interests in patents and the perfection of security interests in patent applications is governed by Article 9 of the UCC.

(b) In *In re Cybernetic Services, Inc.*, 239 B.R. 917 (9th Cir. BAP 1999), *aff'd*, 252 F.3d 1039, 2001, *cert. denied*, 524 U.S. 1130 (2002), the court dealt with whether a UCC filing perfected a creditor's security interest in a patent. The creditor, Matsco Financial Corp., had a security interest in debtor's assets that included "general intangibles," perfected under California's version of the UCC.

(1) Matsco and the bankruptcy trustee agreed that patents were within the definition of "general intangibles" of UCC § 9-106. Matsco had filed its financing statement with the California Secretary of State, but did not file with the USPTO. Matsco sought relief from stay to foreclose on the patent. The bankruptcy trustee asserted that Matsco was unperfected absent a filing with the USPTO.

(2) The court determined that the federal patent statute (35 U.S.C. § 261) did not preempt state law (Article 9 of the UCC). Assignments under

the Patent Act connote transfer of full “title” to the patent. Adoption of UCC § 9-202 made “title” irrelevant to creating security interests in personal property. Thus, the Patent Act does not include security interests. Matsco’s security interest was perfected by the UCC filing with the California Secretary of State, and Matsco was granted relief from stay. The Ninth Circuit affirmed, holding that neither 35 U.S.C. § 261 nor Article 9 of the UCC requires the holder of a security interest in a patent to record that interest with the USPTO. *In re Cybernetic Servs., Inc. d/b/a Silent Radio, Inc.*, 252 F.3d 1039 (9th Cir. 2001). The Patent Act’s recording provisions require only the recording of ownership interests with the USPTO. *Id.* at 1059. Lenders and purchasers/assignees of patents must also be concerned about whether an “implied license” exists.

I. Executory contracts/licensing issues

1. Executory contracts defined

In bankruptcy, an executory contract is one “under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.” Countryman, *Contracts in Bankruptcy*, 57 Minn. L. Rev. 439, 446 (1973). See *Sharon Steel Corp. v. National Fuel Gas Distrib. Corp.*, 872 F.2d 36, 39 (3d Cir. 1989). A license of intellectual property is an executory contract. See *Everex Sys. Inc. v. Cadrak Corp. (In re CFLC Inc.)*, 89 F.3d 673, 677 (9th Cir. 1996). A patent application is “intellectual property,” pursuant to 11 U.S.C. § 101(35)(C), as is a patent (11 U.S.C. § 101(35A)(b) (invention, process, design, or plant protected under title 35). 11 U.S.C. § 365(a) provides that the “trustee, subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.” This section also applies to debtors in possession pursuant to 11 U.S.C. § 1107(a). As a part of the examination of a contract which may be an executory contract, care must be taken to verify

that the contract is not instead a sale (*see In re Microsoft Corp.*, 66 F.3d 1091, 1095 (9th Cir. 1005)), or a secured transaction.

2. Assumption

In the Ninth Circuit, in *Perlman v. Catapult Entertainment Inc.*, 165 F.3d 747 (9th Cir. 1999), the court ruled that if applicable nonbankruptcy law prohibits the assignment of an executory contract, a debtor-in-possession may not even assume it under 11 U.S.C. § 365(c)(1)(A). Federal patent law constitutes “applicable law” under 11 U.S.C. § 365(c)(1)(A). The Bankruptcy Code’s assumption provision, 11 U.S.C. § 365, bars assumption of an executory contract without the non-debtor’s consent where applicable law precludes assignment or the contract to a third party. This precluded assignment of a patent license, absent debtor’s consent, because the debtor licensee could not first assume the patent licenses without the non-debtor licensee’s consent. *Everex*, 89 F.3d at 680. Under federal patent law, patent licenses are personal and nondelegable. *Catapult*, 165 F.3d at 750. The First Circuit has ruled otherwise in *Institute Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489 (1st Cir. 1997). A debtor-in-possession or a trustee may not assign a contract unless it assumes it. 11 U.S.C. § 365(f)(2).

3. Restrictions on assignment

In *Everex*, 89 F.3d 673, the court held that under federal patent law, a nonexclusive patent license is personal and nondelegable. Allowing free assignability in such a circumstance would undermine the reward that encourages invention, because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from the licensee. In essence, every licensee becomes a potential competitor with the licensor/patent holder in the market for licenses under the patent. Although the patent holder could presumably control the absolute number of licenses in existence under a free assignability regime, it would lose the very important ability to control the

identity of the licensees. Thus, any license to a patent holder granted, even to the smallest firm in the product market most remote from its own, would be fraught with the danger that the licensee would assign it to the patent holder's most serious competitor, a party to whom the patent holder itself might be absolutely unwilling to license. As a practical matter, free assignability of patent licenses might spell the end to paid-up licenses such as the one involved in this case. Few patent holders would be willing to grant a license in return for a one-time lump-sum payment, rather than for-use royalties if the license could be assigned to a completely different company that might make far greater use of the patented invention than could the original licensee." In those circuits that follow the *Everex* holding, a bankruptcy licensee will likely have to obtain written permission from the licensor in order to obtain a court order authorizing the bankrupt licensee to assume, let alone assign, the license.

4. Adequate assurance

A predicate to assumption of an executory contract under 11 U.S.C. § 365(b)(1) (assuming that assumption is even possible given the *Everex* holding) is that the trustee or debtor-in-possession must provide adequate assurance of future performance of the executory contract or lease. Under 11 U.S.C. § 365(f)(2), in order to assign the estate's interests in an executory contract, the trustee or debtor-in-possession must give adequate assurance of the assignee's future performance. The Bankruptcy Code does not define "adequate assurance" in the context of either assumption or assignment. The term "adequate assurance of future performance," adopted from Section 2-609(1) of the UCC, "is to be given a practical, pragmatic construction based on the facts and circumstances of each case." *In re Carlisle Homes, Inc.*, 103 B.R. 524, 528 (Bankr. D.N.J. 1988). *See also In re Martin Paint Stores*, 199 B.R. 258, 263 (Bankr. S.D.N.Y. 1997) ("at a minimum, the primary focus of adequate assurance concerns the assignee's (or debtor's) ability to fulfill the financial obligations under the lease.").

5. Rejection of executory contracts/business judgment test

A bankruptcy court will usually approve a motion by the trustee to reject a contract. Courts generally defer to the reasonable business judgment of a debtor-in-possession's management or the trustee. But some courts have found a proposed license rejection not to be within the sound business judgment of debtors.

6. Licensor as debtor (11 U.S.C § 365(n))

In *In re Storm Technology*, the debtor, Storm, prepetition, purchased assignments of Logitech, Inc.'s rights to scanner technology. The agreement provided that if the debtor did not make a \$4 million note payment by a second maturity date of March 26, 1999, Logitech would have a "world-wide, nonexclusive royalty-free, fully paid up license..." Storm filed a Chapter 11 petition on October 21, 1998, but converted the case to Chapter 7 on November 25, 1998. Neither the debtor nor the trustee made the note payment by the second maturity date. The trustee served notice of its intent to sell the patents free and clear of liens. Logitech filed a limited objection to the sale, asserting a license in certain of the patents based on default on the second maturity date. The court approved a sale of the estate's interest in the patents free and clear of interests pursuant to Section 363(f) but retained jurisdiction over Logitech's claimed license.

Logitech argued that the court should deem the trustee to have rejected the prepetition agreement between it and Storm. On such deemed rejection, Logitech argued, it would have rights under 11 U.S.C. § 365(n), which provides in part:

(n)(1) If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—

(B) to retain its rights under such contract to such intellectual property . . . as such rights existed immediately before the case commenced.

The court found that because the default date for the second maturity date had not passed pre-bankruptcy, at the bankruptcy petition date Logitech had merely a contingent right to a license upon Storm's default on the second maturity date payment obligation. Because the rejection date would be deemed to be immediately prepetition, before the claimed license arose, Logitech could not now assert a license in the patents. Even if Logitech had prevailed, its rights to the license would have been limited. When a debtor licensor rejects a license and the non-debtor licensee elects to retain its rights under 11 U.S.C. § 365(n), it can enforce exclusivity rights, but the debtor licensor is freed of duties as to "any other right under applicable non-bankruptcy law to specific performance of the contract."

III. SELLING THE PATENT PORTFOLIO

A. Look for potential buyers

1. Start close to home

Insiders of the debtor company such as executives, inventors or other management members may have an interest in investing in or acquiring some or all of the patent portfolio. Depending on the value of such patent assets and how willing the insiders are to invest in or to reorganize the debtor company, this may be a good place to look for initial investments.

2. Venture capital ("VC") firms

Through networking of VC firms or other potentially interested companies, the patent portfolio can be introduced to interested parties to obtain either an initial bid for acquisition of the patent portfolio or potential financing.

3. Pharma/Biotech companies

Pharmas and biotech companies in a similar field may be interested in viewing the patent portfolio and performing their own buyer analysis to value the patent portfolio.

B. Prioritize key assets

After understanding the relevant technology, speaking with angels, incubators, consultants, and/or other interested parties, it is a good time to determine the technology at issue and to value the technology. Determining which patent applications and patents to prosecute and/or maintain can be one of the hardest decisions to make if and when the estate is low in funds. Asking some of the questions below can assist the debtor, trustee and patent counsel in deciding which patent applications and/or patents to abandon or to keep. Buyers or investors also may look to value a patent portfolio by asking the following questions:

1. What patents and patent applications are of value according to others in the field?
2. What is the potential market position? How strong is the technology in the potential market niche?
3. What does the marketplace competition look like?
4. Is there a potential for licensing or other collaborative work ?
5. How developed is the technology? How far along the pipeline?
6. What does the management team look like? Is there a business plan? How likely is the management team to raise funds to further continue running the company?

C. Marketing strategies

Can the technology be described in 10 to 15 minutes with pertinent data results supporting strong claims made in the presentation? Investors are only interested in hearing about the technology in a concise and succinct presentation that is supported by data. Investors are not interested in hearing about what should, could or did not happen.

From our experience, investors typically want to know what kind of technology was licensed out, licensed in, and jointly developed, to help the investor assess and determine the technology's position in the marketplace.

D. In Chapter 11: DIP financing or funding pursuant to plan of reorganization

The plan of reorganization could include a refinance of the company, through the infusion of new capital, or the sale of the company or its assets.

E. In Chapter 11 or 7: Section 363 asset sales (Section 363 sale may have to be pursuant to plan in Chapter 11)

Sales of assets are clearly appropriate in Chapter 7 cases. Not all courts will allow sales of major estate assets in a Chapter 11 plan, other than pursuant to a confirmed Chapter 11 plan of reorganization or liquidation.

F. Types of sale

1. Negotiated stalking horse bid

Get bid procedures authorized prior to the auction.

2. Internet auction

Get employment and bid procedures authorized by notice and opportunity for hearing (Rule 2002). One advantage of an Internet auction is the large pool of interested buyers or representatives of interested parties.

3. Live auction

As with an Internet auction, counsel must get the auctioneer and the bid procedures approved in advance of the auction. Bid procedures must be approved pursuant to motion practice, with notice and the opportunity for a hearing.

As with Internet auctions, companies specializing in live auctions of intellectual property have extensive and specialized contact lists. However, the fees for live auction companies can be significantly higher than for Internet auction companies.

IV. SUMMARY

When a company that owns a patent portfolio files bankruptcy, whether Chapter 7 or 11, numerous patent, bankruptcy, scientific, and business considerations are implicated. The best result will be obtained by the use of professionals with specialized skills in each area of law, such as bankruptcy, business, and patent.