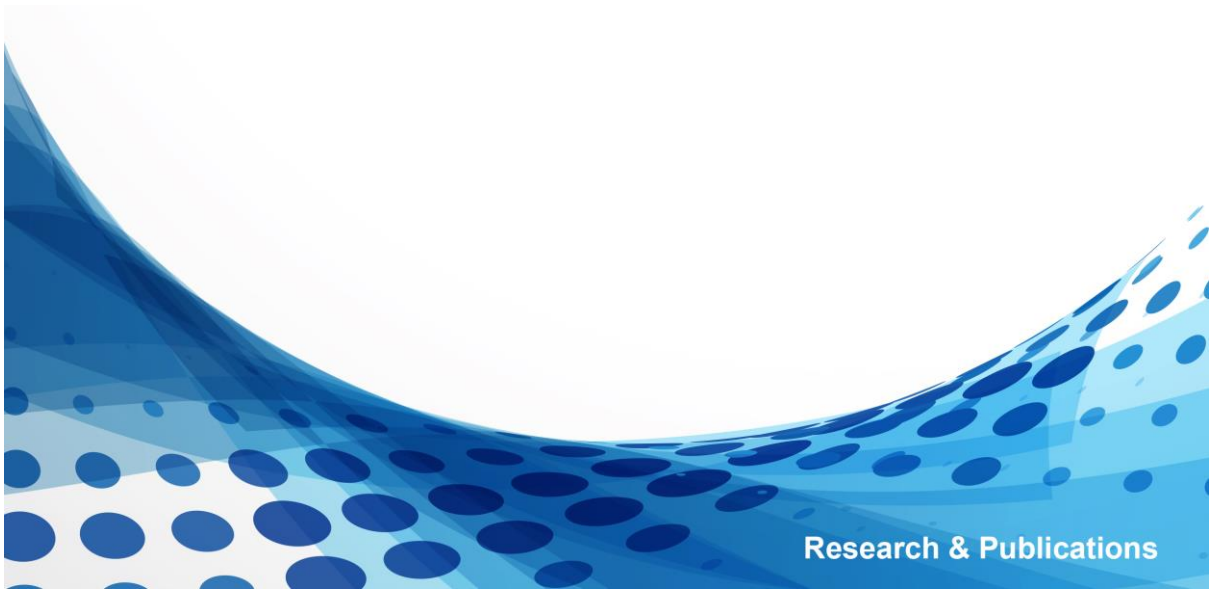
INDIAN INSTITUTE OF MANAGEMENT AHMEDABAD

IIMA
Working Paper

Treatment of Intellectual Property License in Insolvency: Analysing Indian law in comparison with the U.S. and U K

M. P. Ram Mohan
Aditya Gupta



Research &
Publications
W. P. No. 2021-08-01

Treatment of Intellectual Property License in Insolvency: Analysing Indian law in comparison with the U.S. and U K

M. P. Ram Mohan
Aditya Gupta

August 2021

INDIAN INSTITUTE OF MANAGEMENT AHMEDABAD

Treatment of Intellectual Property License in Insolvency: Analysing Indian law in comparison with the U.S. and U K

M P Ram Mohan[*] & Aditya Gupta[Ψ]

Abstract

A bankrupt debtor's ability to escape unprofitable contracts, enshrined in Section 365 of the American Bankruptcy Code, is considered central to a successful reorganisation within Chapter 11. The ambit of this power and the consequence of its application has been the subject of unceasing legal and business controversy. Intellectual property licenses assumed the forefront of this controversy in 1985 when the Court of Appeals for the Fourth Circuit held that Section 365 includes a unilateral power to rescind an Intellectual Property License. Congress reacted to the Court's decision by amending Section 365 and legislating specific protections for Intellectual Property Licensees. This paper explores the American jurisprudence on the treatment of intellectual property licenses during bankruptcy and examines them within the insolvency regimes of the United Kingdom and India. The study reveals an important legal deficiency: neither jurisdiction incorporates any explicit protections for Intellectual Property Licenses during bankruptcy. Further, we find no substantive provisions that deal with the treatment of ongoing contracts during Corporate Insolvency Resolution Proceedings in India and Administration in the UK. For India, this raises an important issue relating to the desirability of a resolution professional's ability to interfere with pre-petition IP licensing agreements. The authors underline the importance of such interference and suggest amendments to the Indian insolvency regime to deal with intellectual property licenses during bankruptcy.

Keywords: Lubrizol; executory contracts; Chapter 11 Bankruptcy; Intellectual Property Licenses; Insolvency and Bankruptcy Code 2016; U K Insolvency Act 1986

[*] Associate Professor, Strategy Area, Indian Institute of Management Ahmedabad & Member, Research Guidance Group, Insolvency and Bankruptcy Board of India. <mprmohan@iima.ac.in>

[Ψ] Researcher, Indian Institute of Management Ahmedabad. <aditya@iima.ac.in>

We are extremely thankful to Pratik Datta and Vishakha Raj for review comments, and Research and Publication Area of IIMA in supporting this project. Views are authors' alone.

1. Introduction 3
2. Treatment of executory contracts in United States Chapter 11 Bankruptcy 5
2.1. Executory Contracts 7
2.2. Understanding assumption and rejection 9
2.3. The Court Approval Requirement 12
3. Treatment of Intellectual Property Licenses under Section 365 14
3.1. Lubrizol: The decision that forced congressional intervention 15
3.2. The Congressional Intervention: The Intellectual Property Bankruptcy Protection Act, 1988 19
3.3. Lubrizol after IPBPA: The continued menace 21
4. Administration in United Kingdom and Corporate Insolvency Resolution Plans in India: Tracing comparable mandates 23
4.1. Termination of Contracts: Ipso Facto Clauses 25
4.1.1. Traditionalist or Proceduralist: Policy Arguments concerning Ipso Facto clauses 26
4.1.2. Legal Position in UK and India 28
4.2. Disclaimer of contracts 32
4.3. Vulnerable Transactions in Bankruptcy 35
5. Lessons for Insolvency and Bankruptcy Code, 2016 40
5.1. Examining the need for amendment 40
5.2. Proposal to amend IBC, 2016 42
6. Conclusion 45

1. Introduction

Imagine that an automobile manufacturer, Company C, has developed an engine that allows cars to run on distilled water. Soon enough, C registers a patent in reference to the newly developed technology. Recognising the potential financial implications of the ground-breaking automobile technology, Company B successfully negotiates a patent licensing agreement from C. In order to develop the required infrastructure to exploit the licensed technology, Company B incurs substantial monetary investments. However, before Company B can begin production and start monetising their licensing agreement, they hear that C, owing to financial difficulties, has filed for bankruptcy.[1] Meanwhile, Company B receives a notice from C's lawyers that their contract has been 'rejected.' Company B's lawyers explain that rejection of their licensing agreement means that they are no longer entitled to use the licensed technology. Any further use of the licensed technology will result in infringement of the patent. Given the rejection of B's license and the losses accrued because of such rejection, what would be the remedies available to B? In the United States, Company B would be reduced to an unsecured creditor. Since unsecured creditors are amongst the last business creditors to receive any compensation, given the bankrupt state of company C, B's claim would be repaid as '*pennies on the dollar.*'

A similar situation arose in 1985 in the United States of America. A licensor, Richmond Metal Finishers, rejected a patent licensing agreement before the licensee, Lubrizol Enterprises, could begin using the licensed technology. The Court of Appeals for the Fourth Circuit interpreted Richmond's rejection as a bar on the licensee's ability to continue using the licensed technology.[2] The Fourth Circuit court precedent essentially meant that a licensor could unilaterally rescind a licensing agreement during insolvency proceedings.[3]

The decision in *Lubrizol* v. *RMF* received overwhelming criticism, which centred on the market instability created by the decision.[4] After the decision, the licensees realised that they were vulnerable to their licensor's bankruptcy. The American Congress acknowledged the policy

[1] The term bankruptcy is used commonly in the American context and the term insolvency is primarily used in the Indian context while referring to corporations which is the thrust of this study. While the authors acknowledge the differences between the two terms, in the present paper, the terms insolvency and bankruptcy have been used interchangeably.

[2] Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F2d 4th Cir 1043, 1048 (1985).

[3] See: Mark DuVal, *High technology bankruptcies: What the licensor giveth it may taketh away.*, 57 HENNEPIN LAWYER 8, 23 (1987).

[4] Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding Rejection*, 59 UNIV. COLO. LAW REV. 845, 881–901 (1988).

concerns voiced after the *Lubrizol* ruling[5] and enacted a specific legislation, *the Intellectual Property Bankruptcy Protection Act, 1988*, to denude the *Lubrizol* ruling from its precedential authority. Despite the intervention from Congress, the ramifications of the *Lubrizol* judgment plagued the American Insolvency jurisprudence till 2019,[6] when ultimately, the United States Supreme Court intervened and settled the issue.[7] The Supreme Court's intervention came as a relief for trademark licensees, who were initially omitted from the protection offered by the American Congress in 1988.[8]

It is possible that in the late 1970s when the American Bankruptcy Code was enacted, the concerns related to the treatment of intellectual property licenses during insolvency were not obvious. However, decades of litigation have brought these concerns to the forefront of bankruptcy jurisprudence. To avoid a jurisprudential predicament and ensure that Intellectual Property licensees are treated in a fair and equitable manner, the experience of the American Bankruptcy Code should serve as an essential lesson for the recently enacted Insolvency and Bankruptcy Code, 2016 (IBC, 2016) in India.

Towards this objective, this paper seeks to investigate the treatment afforded to Intellectual Property licenses during insolvency proceedings in the United Kingdom and India. The provisions that can proffer a power to interfere with pre-petition contractual agreements appear in similar iterations in the English and the Indian Insolvency Law. Some provisions of the IBC 2016 examined by the present study derive their origin from the United Kingdom Insolvency Act, 1986 (Insolvency Act, 1986).[9] Therefore, to achieve its objective, the provisions of IBC 2016 are examined and interpreted along with their counterparts from the Insolvency Act, 1986.

Part 2 of the paper explains the underlying statutory construction from the American Bankruptcy Code responsible for the *Lubrizol* ruling. Part 3 of the paper describes the possible

---

[5] Bernard D. Jr.; Manz Reams, William H. *Federal Bankruptcy Law: A Legislative History of the Bankruptcy Reform Act of 1994* Pub. L. No. 103-394, 108 Stat. 4106 including the National Bankruptcy Commission Act and Other Bankruptcy Code Amendments (1987-1993) (1987-1993).

[6] See: Peter C. Blain, *Trademarks and Distribution Rights in Bankruptcy: The Dissonance Continues*, 29 INTELLECT. PROP. TECHNOL. LAW J. 10 (2017); Lynne B. Xerras & John J. Monaghan, *First Circuit's Rejection of Sunbeam Sheds a Different Light on § 365(n)*, AM. BANKRUPTCY INST. J., https://www.hklaw.com/files/Uploads/Documents/Articles/XerrasMonaghanABIJournalMay2018.pdf (last visited Apr 14, 2021).

[7] Mission Product Holding Inc. v. Tempnology LLC, 139 S. Ct. 1652 (2019).

[8] See: Aditya Gupta & Hiral Mehta Kumar, *In Re Tempnology: Revisiting trade mark licensing in bankruptcy in the USA and India*, 15 J. INTELLECT. PROP. LAW PRACT. 749–760 (2020).

[9] BANKRUPTCY LAW REFORM COMMITTEE, *Interim Report of The Bankruptcy Law Reform Committee* 53–57, 97–99 (2015), https://ibbi.gov.in/uploads/resources/57420f272e1515f0c9c137f1a6423d78.pdf (last visited Mar 24, 2021).

treatment afforded to an Intellectual Property license during a Chapter 11 insolvency proceeding. Part 4 of the paper explores the prevalent insolvency law in India and the United Kingdom. It seeks to analyse if an insolvent licensor can unilaterally rescind an IP license through a resolution professional or bankruptcy administrator. Part 5 of the paper examines if the Indian Insolvency regime should be amended to provide for interference with pre-bankruptcy transactions.

2. Treatment of executory contracts in United States Chapter 11 Bankruptcy

Bankruptcy seeks to mitigate the risks of financial failure. The United States Bankruptcy law is a federal law and can be found in Title 11 of the United States Code.[10] The United States Supreme Court has time and again reiterated "*that the principal purpose of bankruptcy is to grant a fresh start to an honest but unfortunate debtor.*"[11] Currently, the US Bankruptcy Code is codified into nine chapters. For the present study, the most important of these nine chapters is Chapter 11, which addresses the restructuring and reorganising of businesses.[12] The primary purpose of a Chapter 11 proceeding is the successful rehabilitation of the debtor.[13]

The American Bankruptcy Code tends to favour the debtor[14] and follows a Debtor-in-Possession Model.[15] The underlying belief in the Code is that in order to maximise the debtor's assets, it is critical to protect the debtor from being fragmented by its creditors.[16] To release the debtor's estate from burdensome obligations which can impede successful reorganisation, the Code permits the rejection of burdensome or unproductive executory contracts.[17] The power to reject onerous executory contracts is legislated in Section 365 of the Bankruptcy Code.[18] According to the legislative mandate, the beneficial contracts that posit a net benefit to the bankruptcy estate are swept into the estate while the detrimental contracts are rejected.[19] The

[10] 11 U.S.C.
[11] Hanover Nat'l Bank v. Moyses, , 186 U.S. 181, 192, 22 S. Ct. 857, 46 L. Ed. 1113 (1902); Local Loan Co. v. Hunt, , 292 U.S. 234, 244, 54 S. Ct. 695, 78 L. Ed. 1230 (1934); Marrama v. Citizens Bank of Massachusetts, , 549 U.S. 365, 367, 127 S. Ct. 1105, 166 L. Ed. 2d 956, 57 C.B.C.2d 1 (2007); G. Eric Brunstad, *Bankruptcy and the Problems of Economic Futility: A Theory on the Unique Role of Bankruptcy Law*, 55 BUS. LAWYER 499–591, 524–526 (2000).
[12] 11 U.S.C.; KEVIN M. LEWIS, *Bankruptcy Basics: A Primer* 12–14 (2018), https://fas.org/sgp/crs/misc/R45137.pdf (last visited Jun 5, 2021).
[13] *Id.* at 12.
[14] Innoventive Industries v. ICICI Bank, (2018) 1 SCC (Civ) 356, 422–423 (2017).
[15] A GLOBAL VIEW OF BUSINESS INSOLVENCY SYSTEMS, 76 (Jay Lawrence Westbrook ed., 2010).
[16] Susana Dávalos, *The Rejection of Executory Contracts: A Comparative Economic Analysis*, 10 MEX. LAW REV. 69–101, 74 (2017).
[17] NLRB v. Bildisco & Bildisco, , 465 U.S. 513, 527 (1984), 528; Also see: In Re Orion Pictures Corp., , 4 F.3d 1095, 1098 (2d Cir. 1993).
[18] 11 U.S.C. § 365.
[19] DOUGLAS G. BAIRD, BAIRD'S ELEMENTS OF BANKRUPTCY 120–126 (5th edition ed. 2010).

power to reject unprofitable contracts enables the bankrupt estate to avoid debts that such contacts' performance would otherwise create.[20] Rejection increases the funds available to the estate, which can be structured into payments to the creditors in reorganisation.[21] Given the advantages of rejection, some scholars argue that "thousands of bankruptcy cases are filed each year for the primary purpose of rejecting executory contracts".[22]

The provenance of Section 365 can be traced back to Section 70b and Section 63c of the United States Bankruptcy Act, 1938.[23] The Act of 1938, also known as the Chandler Act, was the first statute wherein the power to reject executory contracts was codified.[24] Section 70b set out the procedures and requirements for assuming or rejecting contracts, while Section 63c provided that the rejection of an executory contract would amount to the breach of such contract.[25] Although, it should be mentioned that while first codified in 1938, these sections reflected prior law, which developed through judicial decisions.[26]

The power to assume and reject contractual arrangements has time and again been the subject of academic criticism[27] and has been suggested to proffer a radical departure from contract law.[28] The power has been remarked as being '*extraordinary and almost superhuman.*'[29] Given the multiple amendments and confusing language of section 365, the provision has yielded "*wasteful litigation, absurd results and dramatic distortions of bankruptcy law*."[30] Despite the criticism received by the power to reject executory contracts, it is pertinent to note that Section 365 is a 'compulsory bankruptcy rule.' Parties cannot waive the right to assume or reject a contract by a pre-petition agreement.[31] Prior to the enactment of the Bankruptcy Code of 1978,

[20] James E Meadows, *Lubrizol: What Will It Mean for the Software Industry?*, 3 ST. CLARA HIGH TECHNOL. J. 19, 316 (1987).
[21] Meadows, *supra* note 22.
[22] Jesse M Fried, *Executory Contracts and Performance Decisions in Bankruptcy*, 46 DUKE LAW J. 517, 520 (1996); Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. LAW REV. 228, 229 (1989).
[23] David G. Epstein, *Legislative update*, 22 AM. BANKRUPTCY INST. J. 51, 6 (2003).
[24] *Id.* at 6.
[25] See: Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 UNIV. COLO. LAW REV. 1, 7 (1991).
[26] Lee Silverstein, *Rejection of Executory Contracts in Bankruptcy and Reorganization*, 31 UNIV. CHIC. LAW REV. 467, 470–475 (1964).
[27] See: Baumgartner Alexandra, The Effect of Bankruptcy on Executory Contracts in General and on Licensing Agreements of Intellectual Property in Particular (Jan. 1, 1996) (LLM Theses and Essays, University of Georgia).
[28] Silverstein, *supra* note 29 at 468.
[29] Stephen Lubben, *Chapter 5: Executory contracts and unexpired leases*, *in* AMERICAN BUSINESS BANKRUPTCY: A PRIMER , 58–62 (2019).
[30] Andrew, *supra* note 6 at 849.
[31] In Re Trans World Airlines Inc. 261 B.R. 103 (Bankr. D. Del. 2001).

ipso facto clauses were not explicitly unenforceable.[32] With the 1978 enactment, Section 365(e) was introduced to the American Bankruptcy Code.[33] Subject to a limited set of exceptions,[34] the subsection invalidates ipso facto clauses in executory contracts.[35] The House Report on the Bankruptcy Reform Act, 1978 makes it clear that the primary purpose behind the enactment of Section 365(e) was "*to protect the debtor from losing valuable contract rights as a result of bankruptcy filing."*[36]

Presently, as long as an agreement posits ongoing obligations for both parties, each party to the agreement shall remain vulnerable to the insolvency proceedings of the other party. During such proceedings, the bankrupt debtor assumes a unilateral power to reject the continued performance of a contract.[37] Further, the Code is so designed that the parties cannot 'contract out' such unilateral rejections.[38] Therefore, it is essential to understand what does Section 365 entail and when does it assume importance.

2.1. Executory Contracts

The threshold requirement for the application of Section 365 is that the contract should be executory.[39] In enacting the Code, the Congress noted that '*there is no precise definition of what contracts are executory*,' but said that the definition '*generally includes contract on which performance remains due to some extent on both sides*.'[40] Although, owing to the unceasing controversy Section 365 has remained a part of, there is ample judicial and academic opinion to establish the meaning of executory contracts.

Professor Vern Countryman wrote a series of influential papers wherein he defined an 'executory contract.'[41] Often referred to as the 'Countryman analysis' or the 'material breach

[32] Emil A. Kleinhaus & Peter B. Zuckerman, *The Enforceability of Ipso Facto Clauses in Financing Agreements: American Airlines and Beyond*, 23 NORT. J. BANKRUPTCY LAW PRACT. 193, 195, 196 (2014).
[33] The Bankruptcy Reform Act, 1978.
[34] 11 U.S.C. § 365(e)(1).
[35] 11 U.S.C. § 365(e)(2).
[36] Kleinhaus and Zuckerman, *supra* note 35 at 195.
[37] 11 U.S.C. § 365.
[38] 11 U.S.C. 365(e)(1)(A).
[39] Timothy J. Keough, *You're Asking the Wrong Question- The Effect of a Licensor's Rejection on the Trademark License*, 47 SUFFOLK UNIV. LAW REV. 165, 169 (2014).
[40] H.R. Rep. No. 95-595, at 347 (1978) reprinted in 1978 U.S.C.C.A.N. 5787, 6303; Phx. Exploration, Inc. v. Yaquinto, 15 F.3d. 60, 62 (1994) The Court noted that the Code does not define executory contracts.;
[41] Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. LAW REV. 439 (1973); Vern Countryman, *Executory Contracts in Bankruptcy: Part II*, 58 MINN. LAW REV. 479 (1974).

test,' Prof. Countryman's treatise has assumed approval from the US Congress[42] as well as the judiciary.[43] The 2013 American Bankruptcy Institute's report to study the Reform of Chapter 11 suggested that the Countryman analysis should be drafted into law.[44] The Countryman analysis states that "*a contract is executory if both parties have sufficient unperformed obligations so that either party's discontinuance would constitute a material breach.*"[45] Therefore, according to the Countryman Analysis, as long as the parties to the contract owe continuing obligations to each other, such a contract would be an executory contract.

Prof. Jay Lawrence Westbrook, another influential academic, has been a vocal advocate of abandoning the executoriness requirement as a gateway to Section 365.[46] He suggests that a 'functional' analysis focusing on debtor-centric economic benefit should subsume or replace the executory requirement.[47] Prof. Westbrook's analysis reasoned that as long as a *contract remains unperfomed to some extent*, it should be subject to Section 365.[48] Further, the course of action that benefits the estate should determine which contracts should be assumed or rejected.[49] The functional analysis posits working "*backward from an examination of the purposes to be accomplished by rejection, and if they have already been accomplished, then the contract cannot be executory.*"[50] Understood simply, Professor Westbrook never sought to interpret the executoriness requirement; his argument called for abolishing the requirement altogether.[51] The Courts which reject the approach espoused by Prof. Countryman[52] have sought recluse within the functional analysis approach.[53]

---

[42] H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 347 (1977); Mary A Moy, *The Intellectual Property Bankruptcy Protection Act: An Unbalanced Solution to the International Software Licensing Dilemma*, 11 UNIV. PA. J. INT. BUS. LAW 151, 166 (1985).
[43] *Lewis Bros Bakeries Inc v Interstate Brands Corp (In re Interstate Bakeries Corp)* (2012) 690 F.3d 1069, 1073 (8th Cir. 2012) (Court of Appeals for the Eighth Circuit, The Countryman test is binding in the eighth circuit; *Sharon Steel Corp. v. National Fuel Gas Distribution* 872 F. 2d. 36, 39 (3rd Cir. 1989), *Wilson v. TXO Production Corp*. 69 B.R. 960, 962 (Bankr. N.D. Tex. 1987), *Lewis Bros. Bakeries v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, 751 F.3d 955, 962 (8th Cir. 2014), *In re Exide Technologies*, 607 F.3d 957, 962 (3d Cir. 2010).
[44] See: D. J BAKER & MICHELLE M HARNER, FINAL REPORT OF THE ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11 112 (2014).
[45] Countryman, *supra* note 44.
[46] See: Jay Lawrence Westbrook & Kelsi Stayart White, *The Demystification of Contracts in Bankruptcy*, 91 AM. BANKRUPTCY LAW J. 481, 483 (2017).
[47] Westbrook, *supra* note 24 at 239.
[48] Westbrook and White, *supra* note 49 at 495.
[49] *Id.* at 488.
[50] Roberta Righi & Jesica J. Winters, *National Report of the United States*, *in* EXECUTORY CONTRACTS IN INSOLVENCY LAW: A GLOBAL GUIDE 584, 589–590 (Jason Chuah & Eugenio Vaccari eds., 2019).
[51] John A E Pottow, *A New Approach to Executory Contracts*, 96 TEX. LAW REV. 1437, 1449 (2018).
[52] See: *In re Jolly*, 574 2d. 349 (6th Cir., 1978), *Holzer v. Barnard*, 2016 U.S. Dist. LEXIS 98175 at 34-35 (E.D.N.Y. July 27, 2016).
[53] See: *Sipes v. Atlantic Gulf Communities Corp. (In Re General Dev. Corp.)* 84 F.3d 1364 (11th Cir. 1996), *Thompkins v. Lil Joe Records, Inc*., 476 F.3d. 1294, 1306 (11th Cir. 2007).

IP licenses share an interesting relationship with the executoriness requirement. While some IP licenses fail to fulfil the requirement,[54] an overwhelming majority of IP licenses are found to be executory.[55] IP licensing agreements often include material obligations that are due to be performed by either party.[56] Some examples of such covenants would include:[57] assisting in production,[58] reporting events at regular intervals,[59] defending against litigation.[60]

2.2. Understanding assumption and rejection

Once the threshold inquiry of Section 365 is completed, and the Court returns a finding favouring the executoriness of the contract, the Debtor-In-Possession (DIP) is authorised to assume or reject[61] the executory contract.[62] This section explains the meaning of these two terms- assumption and rejection and the treatment afforded to the creditor of an assumed or rejected contract.

As should be clear from the discussion above, a contract relevant to Section 365 is both an asset (the right to receive performance) and an obligation (the obligation to render performance) to the debtor.[63] Any contract which fails to fulfil this dual purpose is irrelevant to Section 365. A good example of such a contract would be: a nonexclusive patent licensing agreement where the licensor received a lump sum compensation at the time of effectuating the licensing agreement. Assuming that the licensing agreement does not posit any other foregoing obligations, such license has been completely concluded and is neither an asset nor a liability for the licensor.

---

[54] See: *In re Quintex Entertainment Inc.* 950 F.2d. 1492, 1495 (9th Cir. 1991) "*Licensing agreements are not, however, universally considered executory contracts*"; Ron E. Meisler et al., *Rejection of Intellectual Property License Agreements under Section 365(n) of the Bankruptcy Code: Still Hazy after all these years*, 19 NORT. J. BANKRUPTCY LAW PRACT. 163, 164 (2010).

[55] See: Eric Stenshoel, *The Treatment of Intellectual Property Licenses under U.S. Bankruptcy Law*, 10 INT. CORP. RESCUE, 42, 43 (2013); *RCC Tech. Corp. v. Sunterra Corp.*, 287 B.R. 864, 865 (D. Md. 2003) "*There is a long line of authority holding that intellectual property licensing agreements such as software licensing agreements are executory contracts.*"

[56] For discussion on ongoing obligations see: Benjamin Howard, *Reconciling Trademark Law with Bankruptcy Law in License Rejection*, 2014 COLUMBIA BUS. LAW REV. 172 (2014).

[57] Amanda E James, *Rejection Hurts: Trademark Licenses and the Bankruptcy Code*, 73 VANDERBILT LAW REV. 889, 896 (2020).

[58] See: In Re Petur U.S.A. Instruments Co.,35 B.R. 561 (Bankr. W.D. Wash. 1983)., 543.

[59] See: *Tech Pharm. Services. v. RPD Holdings, LLC (In re Provider Meds, LLC)*, 2017 Bankr. LEXIS 166, at 43 (Bankr. N.D. Tex. Jan. 18, 2017).

[60] See: *In re Aerobox Composite Structures*, 373 B.R. 135, 139 (Bankr. D.N.M. 2007)

[61] 11. U.S.C. 365(a).

[62] 11. U.S.C. § 365(f)(1).

[63] Andrea Coles-Bjerre, *Ipso Facto: The Pattern of Assumable Contracts in Bankruptcy*, 40 N. M. LAW REV. 77, 84 (2010).

While allowing a debtor to reject the performance of a contract, the Bankruptcy Code limits this power by mandating that all aspects of that particular contract have to be treated similarly. A debtor is not allowed to "*cherry pick*" profibtale aspects of the contract and choose to perform them. A contract has to be assumed or rejected *in its entirety.* This requirement is referred to as *cum onere* (subject to existing burdens).[64] The Code, in this way, maintains the integrity of pre-petition transactions.[65]

A contract that has been assumed within Section 365 shall be performed in the same manner had bankruptcy not intervened.[66] Once assumed, an executory contract retains the same status as a contract entered into post-petition.[67] If a breach follows the assumption, any resulting claims shall be entitled to payment as an administrative expense.[68] Administrative expenses are paid first, usually in full,[69] and assume priority over other unsecured creditors.[70] Moreover, in a Chapter 11 case, unless a resolution plan proposes to pay administrative claims in full on the plan's effective date, it cannot be confirmed. Alternatively, once the DIP rejects an executory contract, the non-bankrupt party's claim for breach of contract is relegated to the status of a pre-petition general unsecured claim.[71] Since general unsecured claims usually receive only a fraction of their claims, by application of Section 365, a bankruptcy estate benefits from the favourable contracts of the debtor, while the cost of unburdening the debtor from unfavourable contracts is dramatically reduced.[72]

As for the contractual obligations between the parties to a rejected executory contract, Section 365(g) provides that a rejection under Section 365 should be treated as a 'breach.'[73] Neither does the Code delineate the consequences of the rejection of an executory contract nor does

[64] In Re Chicago Rock Island & Pac. R.R. Co., 860 F.2d. 267, 272 (7th Cir. 1988), *Richmond Leasing Co. v. Capital Bank N.A.* 762 F. 2d. 1303, 1311 (5th Cir. 1985)
[65] Coles-Bjerre, *supra* note 66 at 84.
[66] Don Fogel, *Executory Contracts and Unexpired Leases in the Bankruptcy Code*, 64 MINN. LAW REV. 341, 376–378 (1980).
[67] Pottow, *supra* note 54 at 1453.
[68] 11 U.S.C. §503(b).
[69] Fried, *supra* note 24 at 524–25.
[70] 11 U.S.C. § 507(a)(2); See: *American Anthracite & Bituminous Coal Corp. v Leonardo Arrivabene, S.A.*, 250 F. 2d. 119, 124 (2d Cir. 1960).
[71] 11 U.S.C. § 502(g)(1); If a security interest was created, the status would be that of a General Secured Creditor. Section 502 relates to allowance and disallowance of claims; For details see: 4 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY 502.08 (2020).
[72] Fried, *supra* note 24 at 519, 520.
[73] 11 U.S.C. § 365(g).

the term 'rejection' assume an obvious contract law analogue.[74] Owing to this lack of clarity, the Courts have interpreted the concept of rejection inconsistently, which has led to multiple special interest amendments to the provision.[75]

On the concept of rejection, Prof. Westbrook and Prof. Michael T. Andrew have published three influential articles.[76] Despite being published more than 20 years ago, these articles bear influence on the interpretation of Section 365.[77] On the legislative history of the power to reject contracts as embodied in Section 365, Prof. Andrew noted: "*What the history teaches, most importantly, is that "rejection" is not some mystical power to cause contracts to vanish, nor a power to breach them in any meaningful sense… Rejection is very simple. It is the estate's decision not to assume.*"[78] Further, "*Rejection of a contract or lease is not an avoiding power that somehow clears the estate's title to some underlying asset to which the contract or lease relates.*"[79] While the two authors disagree on the conceptual underpinnings of Section 365, they agree on the meaning of rejection.[80]

Multiple courts have conflated the meaning of rejection and termination.[81] A perusal of the statutory scheme of Section 365 clearly reflects Congress' intention of differentiating between rejection and termination. There are specific provisions within Section 365 that allow for the termination of a contract. For example, Section 365(i) provides a vendee of real property with an option to terminate the contract if such a contract has been rejected during insolvency proceedings.[82] The Courts have repeatedly cautioned against interpretations that result in superfluous terms in legislation.[83]

---

[74] International Trademark Association, *Brief as Amicus Curiae and Brief of International Trademark Association in Sumbeam Products Inc. v. Chicago American Manufacturing*, 102 TRADEMARK REPORT. 1374, 1359 (2012); NATIONAL BANKRUPTCY REVIEW COMMISSION (U.S.), *Report of the National Bankruptcy Review Commission: The Next Twenty Years* 460 (1997).

[75] For eg. see: Intellectual Property Bankruptcy Protection Act, 1988; Also see: NATIONAL BANKRUPTCY REVIEW COMMISSION (U.S.), *supra* note 77.

[76] Andrew, *supra* note 6; Andrew, *supra* note 28; Westbrook, *supra* note 24.

[77] In Re Bergt, , 241 B.R. 17 (Bankr. D. Alaska 1999); Also see: Edward J. Janger, Jay Lawrence Westbrook & Eric F. Citron, *Brief of Law Professors as Amici Curiae supporting Petitioners in Mission Product Holding, Inc., v. Tempnology, LLC.* 3 (2018).

[78] Andrew, *supra* note 28 at 8.

[79] *Id.* at 10.

[80] Barnett v. Blachura, , 242 Mich. App. 395; Westbrook, *supra* note 24 at 335–36; Andrew, *supra* note 28 at 2.

[81] See e.g.: In re Giles Assocs., Ltd, , 92 B.R. 695, 698 (Bankr. W.D. Tex. 1988); Sea Harvest Corp. v. Riviera Land Co., , 868 F.2d 1077, 1080–81 (9th Cir. 1989).

[82] 11 U.S.C. § 365(i).

[83] Similar option to terminate on rejection can be seen in 11 U.S.C. § 365(n) & 365(h); Vivek Sankaran, *Rejection versus Termination: A Sublessee's Rights in a Lease Rejected in a Bankruptcy Proceeding under 11 U.S.C. Section 365(d)(4)*, 99 MICH. LAW REV. 853–875, 858–862 (2001).

The courts have consistently cautioned against interpreting a statute that results in superfluous terms.[84] Furthermore, a closer look at the American Bankruptcy Code would reveal that the option to terminate contracts is exclusive to the non-bankrupt party, without whose concurrence the bankrupt party cannot unilaterally terminate contractual relationships.[85] The Fifth Circuit Court in 1994 noted that "*the trustee may reject any of the contracts, but termination does not occur except at the other party's option.*"[86] Therefore, it can be safely concluded that the contract does not disappear by application of Section 365.[87] This position has been vouched by the Bankruptcy Court of the Southern District of New York in very explicit terms "*Rejection has absolutely no effect upon the contract's continued existence; the contract is not cancelled, repudiated, rescinded, or in any other fashion terminated.*"[88]

The effect of the rejection is that the debtor relinquishes any right to receive future benefits under the contract and relieves himself from the obligations of the contractual relationship. In the context of intellectual property licenses, a rejection does not impede the right of an intellectual property licensee to continue the use of the licensed intellectual property post rejection of the subject licensing agreement. A rejection would simply mean that the licensor shall not perform any residual obligations on his part. Once a DIP decides to reject an executory contract, the decision has to be approved by the Court.[89] The following section explores this court approval requirement and delineates the standard of review incorporated therein.

2.3. The Court Approval Requirement

The Bankruptcy Code renders the decision to assume or reject a contract subject to the bankruptcy court's approval.[90] The requirement of court approval was added to the Code in 1978. Prior to 1978, Section 70b of the Bankruptcy Act of 1898 did not require approval of the Court before the rejection/ assumption of an executory contract.[91]

The overwhelming majority of bankruptcy courts adjudge a decision to accept or reject an executory contract on the pedestal of the 'business judgement rule'.[92] This rule is satisfied as

[84] United States v. Alaska, , 521 U.S. 1, 59 (1997); Walters v. Metro, , 519 U.S. 202, 209 (1997).
[85] Sankaran, *supra* note 86 at 860–862.
[86] In re Austin Dev. Co., , 19 F.3d 1077, 1082 (5th Cir. 1994).
[87] See: In re Locke, , 180 B.R. 245 (Bankr. C.D. Cal. March 29, 1995); IN RE BERGT, *supra* note 80.
[88] In re: Drexel Burnham Lambert Group, , 138 B.R. 687, 703 (Bankr. S.D.N.Y. 1992); Apple, Inc. v. Spansion, Inc., , 2011 U.S. Dist. LEXIS 82829 (D. Del. July 28, 2011).
[89] 11 U.S.C. § 365(a).
[90] 11 U.S.C. § 365(a).
[91] In re Thinking Machines Corp., 67 F.3d 1021 (1st Cir. 1995).
[92] Clayton A. Smith, *It's Not you, It's Us: Assessing the Contribution of Trademark Goodwill to Propertly Balance the Results of Trademark License Rejection*, 35 EMORY BANKRUPTCY DEV. J., 271, 272 (2019).

long as it can be shown that the rejection of an executory contract will benefit the debtor's estate. Proper business judgement is said to be exercised as long as the decision reflected investigation or analysis consistent with its probable consequences, and the choice of the DIP bears some relationship to the reasonable operation of the business.[93] Generally, a court would summarily approve the debtor's decision to reject an executory contract unless the decision is the "*product of bad faith, whim or caprice.*"[94] The bankruptcy courts rarely overrule the business decisions made in relation to assumption or rejection of executory contracts.[95] The reason for such delegation of responsibility on the debtor is that business managers should make business choices, not the Court. The bankruptcy court is not a business consultant.[96]

Despite the widespread judicial popularity of the business judgement rule, some bankruptcy courts have deviated from this approach. Such deviation is premised on the '*Burdensome approach'* also known as the '*Balancing Tests Approach*,' which requires proof of the burden caused to the bankrupt estate by the performance of the contract.[97] Premised in providing an equitable solution to rejection, this approach is employed when the rejection causes disproportionate harm to the other party.[98]

The approach is best explained in an IP licensing context by the Bankruptcy Court of the Western District of Washington in *In Re Petur.*[99] Here, the Court disallowed a rejection of a licensing agreement, despite compliance with the business judgement rule. The licensing arrangement between the licensee, Petur of Canada and the licensor, Petur of U.S.A, provided for continuing contractual obligations and was executory. The business of the licensee entirely depended on the licensing agreement. The Court observed that, bankruptcy courts are courts of equity and cannot authorise rejection which would result in the "*actual ruination of an otherwise profitable, successful and ongoing business.*"[100] The *balancing tests approach* has been developed to ensure that rejection by the licensor does not result in the actual ruination of the licensee's business. Therefore, it has been applied in a minimal number of cases. Another

[93] Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKRUPTCY DEV. J. 1, 13 (1989).
[94] *Ibid. In re Pisces Energy, LLC* Bankr. S.D. Tex. Dec. 21, 2009; *In Re Trans World Airlines Inc.* (n 29); *Summit Land Co v Allen (In re Summit Land Co)* 13 B.R. 310, 315 (Bankr. D. Utah 1981) Court approval under Section 365(a), if required, except in extraordinary situations, should be granted as a matter of course.
[95] Benjamin H Roth, 'Retaining the Hope That Rejection Promises: Why Sunbeam Is a Light That Should Not Be Followed' (2014) 30 Emory Bankruptcy Developments Journal 529, 539–541
[96] Nimmer and Feinberg, *supra* note 96 at 14.
[97] In re Chi-Feng Huang, , 23 B.R. 798 (Bankr. 9th Cir. 1982).
[98] Nimmer and Feinberg, *supra* note 96 at 14.
[99] IN RE PETUR U.S.A. INSTRUMENTS CO., *supra* note 61.
[100] *Id.* at 564.

case where the test was applied comes from the Bankruptcy Court of the Southern District of Florida.[101]

3. Treatment of Intellectual Property Licenses under Section 365

With an understanding of the mandate enshrined under Section 365 and the meaning of rejection, this section explores the treatment afforded to IP licensing agreements within Section 365. Before analysing the *Lubrizol* judgement, it is necessary to understand the state of law which existed before the judgement was declared i.e., before 1985.

A judicial decision that assumed importance in this regard is Justice Steiner's opinion in *In Re Petur*, which dates back to 1983. As elaborated above, Justice Steiner did not allow the debtor to reject the executory trademark licensing agreement and relied on the *burdensome test* in coming to a conclusion.[102]

Be that as it may, even before the *In Re Petur* decision, the Ninth Circuit court in *In re Select-a-Seat* decision, decided in 1980, adopted a different approach.[103] The Court in the case was called upon to approve rejection of a licensing agreement that allowed the licensee exclusive rights to use and license the debtor's software package. Underlining that the licensing agreement provided for payment of pro-rata royalties and the continuing obligation of the debtor/licensor not to sell its software package, the court ruled that the agreement was executory in nature. The Ninth Circuit Court allowed the rejection as the trustee had only sought to reject the debtor's continuing obligations. Therefore, the licensee could continue to use the licensed IP, with the exception that the exclusivity obligation could not be enforced.[104]

The Ninth Circuit Court's position in *In re Select-a-Seat* provides an interesting analysis. Firstly, if a bankrupt debtor's rejection only seeks to withdraw from its ongoing obligations, the rejection can be approved. Secondly, the exclusivity requirement falls within the ambit of obligations, the performance of which can be omitted post rejection. Justice Steiner's approach in *In re Petur* is considerably different from the position in *In re Select-a-Seat.*

The Court in *In re Select a Seat* analysed what the bankrupt debtor sought to achieve from the rejection, which in that particular case was independence from foregoing obligations. On the

[101] *In re Matusalem*, 158 B.R. 514 (Bankr. S.D. Fla. 1993).
[102] IN RE PETUR U.S.A. INSTRUMENTS CO., *supra* note 61.
[103] In Re Select-A-Seat,625 F.2d 290 (9th Cir. 1980).
[104] Stuart S. Moskowitz, *Intellectual Property Licenses in Bankruptcy: New "Veto Power" for Licensees Under Section 365(n)*, 44 BUS. LAWYER 771–790, 776–778 (1989).

other hand, Justice Steiner in *In re Petur* considered what would be the effect of the rejection on the licensee. When called upon to approve the rejection of the licensing arrangements the courts adopted two unique approaches. While, the Court in *In Re Petur* gave importance to what would be the effect of rejection on the licensee, the Court in *In Re Select-A-Seat* premised its discussion on what the licensor sought to achieve from the rejection. Thus, the vantage point assumed by the two courts while reviewing the decision to reject the licensing agreement was considerably different. It can be argued that this difference in vantage points was responsible for one Court favouring, while another disapproving, the decision to reject an executory IP license.

Having analysed *In re Select-a-Seat* and *In Re Petur,* we may conclude that, even before *Lubrizol,* the treatment afforded to IP licenses under Section 365 was not uniform. The next section will further deal with the *Lubrizol* decision of the Fourth Circuit Court, which mandated Congressional intervention to delineate the rights of a licensee whose IP licensing agreement had been denied by application of Section 365.

3.1. Lubrizol: The decision that forced congressional intervention

In August of 1983, Richmond Metal Finishers (Richmond) filed for Chapter 11 bankruptcy. Thirteen months before declaring bankruptcy, Richmond entered into a non-exclusive patent licensing agreement with Lubrizol Enterprises. Within the terms of the licensing agreement, Lubrizol was entitled to use Richmond's patented metal coating process. The terms of the license stipulated that Lubrizol shall not exploit the patented process till May 1, 1983.

On August 16, 1983, Richmond filed a Chapter 11 bankruptcy petition. As part of its plan, Richmond sought to reject the contract with Lubrizol. The Bankruptcy Court ruled in favour of Richmond and allowed rejection of the licensing agreement.[105] On appeal, the district court ruled in favour of Lubrizol and opined that the contract is not executory and its rejection would not be beneficial to the bankruptcy estate.[106] In coming to the conclusion, the Court relied on the fact that Lubrizol's contract was not exclusive in nature, which meant that the Richmond could readily license it to other firms. The lack of an exclusive licensing covenant was read to disfavour the rejection. According to the District Court the nature of obligations remaining on

[105] *In re Richmond Metal Finishers, Inc.,* 34 B.R. 521, 522 (Bankr. E.D. Va. 1983.
[106] *In re Richmond Metal Finishers, Inc.,* 38 B.R. 341, 342 (E.D. Va. 1984).

part of Richmond were not burdensome and there was no rationale for exercising the business judgement rule in favour of rejection.[107]

Subsequently, on appeal by Richmond, the Court of Appeals for the Fourth Circuit rejected the district court's reversal.[108] The Court concluded that the contract was executory and the rejection was a sound business decision.[109] In deciding whether or not the contract was executory, the Court relied on the Prof. Countryman's material breach test.[110] Richmond owed two obligations to Lubrizol. First, it had to notify Lubrizol of any patent infringement suits and had to indemnify Lubrizol from such suits. Second, Richmond had to notify Lubrizol if it licensed the patent to any other entity. Also, if a subsequent license was granted at a royalty rate lower than what was paid by Lubrizol, Richmond was obligated to reduce Lubrizol's rate accordingly. Coming to Lubrizol's set of obligations, the Court summarily concluded that payment of a flat rate of royalty was not sufficient to mean that substantial obligations were remaining. Although, the Court later underlined that such an imposition was not relevant in the present case, as Lubrizol's agreement provided for a percentage-based pro rata royalty scheme. Lubrizol was also obligated to maintain a record of its accounts and submit it to Richmond. Owing to the materiality of obligations, the Court ruled that the contract was executory. The Court's succinctly concluded:

> *"Therefore, if Lubrizol had owed RMF nothing more than a duty to make fixed payments or cancel specified indebtedness under the agreement, the agreement would not be executory as to Lubrizol. However, the promise to account for and pay royalties required that Lubrizol deliver written quarterly sales reports and keep books of account subject to inspection by an independent Certified Public Accountant. This promise goes beyond a mere debt, or promise to pay money, and was at the critical time, executory."*

Coming to the court approval requirement, which was explained in Section 1.3, the Fourth Circuit Court decided to apply the business judgement rule.[111] The Court impugned burden of proof on Lubrizol i.e. the licensee, to prove that the decision of rejection was entered into in bad faith. Lubrizol failed to provide any such evidence.[112] On the other hand, Richmond provided evidence to the effect that the patent was the primary source of funds for Richmond.

---

[107] *Ibid.*
[108] LUBRIZOL ENTERPRISES, INC. V. RICHMOND METAL FINISHERS, INC., *supra* note 4.
[109] *Id.* at 1046–1047.
[110] *Id.* at 1045–1046.
[111] *Id.* at 1045.
[112] *Id.* at 1045.

Therefore, in order to effectuate a fresh start, the patent was more valuable as an unencumbered asset.[113] The Court therefore upheld the decision of the bankruptcy court which had approved the rejection of the licensing agreement.

The Lubrizol judgement from the Fourth Circuit Court was potentially problematic on multiple fronts. From the definition accorded to executory contracts to the test employed for approving the rejection decision, there are multiple findings in the judgement which deserves analysis on the basis of precedential authority. However, the most problematic part of the Court's ruling did not relate to the rejection of the contract, it related to what the rejection meant and what would be the effect of such rejection of the licensee i.e Lubrizol.[114]

Justice Philips, who delivered the decision in *Lubrizol,* was of the opinion that if Lubrizol was allowed to continue the use of licensed technology, such continuance would be akin to specific performance. Further, if *Lubrizol* were allowed to enforce specific performance of the contract, it would *"obviously undercut the core purpose of rejection under Section 365(a), and that consequence cannot therefore be read into congressional intent."*[115] In coming to this conclusion, the Court dealt with the legislative history of Section 365(g) and concluded "*purpose of the provision is to provide only a damages remedy.*"[116] Not only would rejection mean that the licensor is freed from his obligations in the agreement, it would also mean that the licensee cannot continue to exploit the intellectual property licensed through the, now rejected, licensing agreement. The court interpretation effectively meant that rejection of a contract under Section 365 would constitute complete recission.[117]

Further, the Court adopted a '*negative inference approach*' to substantiate its decision. Meaning, the Court opined that the Congress was aware of what would be the result of the rejection of an executory contract, which is why it had legislated specific 'carve-outs' to protect certain classes of creditors. For example, Section under 365(h) of the American Bankruptcy Code, if the debtor landlord rejects a property lease, the tenants are allowed to remain in possession.[118] Absent from the statutory scheme of Section 365 was a similar protection for IP licenses. Therefore, an intellectual property licensee shall have to "*share the general hazards*

[113] *Id.* at 1047.
[114] James, *supra* note 60 at 897.
[115] LUBRIZOL ENTERPRISES, INC. V. RICHMOND METAL FINISHERS, INC., *supra* note 4 at 1048.
[116] *Id.* at 1048.; See: Alan Resnick, *Sunbeam Offers A Ray of Sunshine for the Licensee when A Licensor Rejects A Trademark License Agreement in Bankruptcy*, 66 SMU LAW REV. 817, 825–830 (2013).
[117] James, *supra* note 60 at 897.
[118] LUBRIZOL ENTERPRISES, INC. V. RICHMOND METAL FINISHERS, INC., *supra* note 4 at 1048; Resnick, *supra* note 119 at 830.

created by Section 365 for all business entities dealing with potential bankrupts."[119] The hazard being the loss of the right to use the licensed intellectual property.

The Court's reliance on the legislative history was later disputed by Prof. Michael Andrew.[120] He traced the passage from the legislative history on which the *Lubrizol* court placed reliance: "*Subsection(g) defines the time as of which a rejection of an executory contract or unexpired lease constitutes a breach of contract or lease. Generally, the breach is as of the date immediately preceding the date of the petition. The purpose is to treat the rejection claims as pre-petition damages.*"[121] The passage does not support the Court's conclusion that the purpose of Section 365(g) of the American Bankruptcy Code is to provide *only* a damages remedy.[122] Despite such inconsistency in the Court's reasoning, the Supreme Court of the United States denied *certiorari* in *Lubrizol.*[123]

Apart from the possible fallacies in judicial interpretation, the *Lubrizol* decision was accompanied by cogent policy considerations. As explained in Part 1, after a contract is rejected under Section 365(a), the non-debtor party's claim for damages is unsecured,[124] non-priority[125] and dischargeable.[126] The statutory construction coupled with the *Lubrizol* ruling essentially means that the non-debtor licensee shall not only lose the right to use the licensed intellectual property right, all the investments made towards exploitation of the patent can potentially be reduced to sunk costs.[127] The *Lubrizol* court was aware of the possible implications of its decision and noted that such rejection can have a "*chilling effect upon the willingness of such parties to contract at all with businesses with financial difficulties*"[128] Although, according to the Court the bankruptcy law does not allow a court to indulge in such equitable considerations.

As a result of the *Lubrizol* judgement, the intellectual property licensing landscape witnessed a substantial overhaul. Licensees had now realised that they were vulnerable to the bankruptcy

[119] LUBRIZOL ENTERPRISES, INC. V. RICHMOND METAL FINISHERS, INC., *supra* note 4.
[120] Andrew, *supra* note 6 at 923–926.
[121] S.REP. No. 989, 95th Cong., 2d Sess. 58 (1978), reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787; H.R. REP. No. 595, 95th Cong., 1st Sess. 347 (1977) reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5963.
[122] Andrew, *supra* note 6 at 923–926.
[123] Lubrizol Enters., Inc. v. Canfield, , 475 US 1057 (1986).
[124] See 11 U.S.C. § 506(a)(1), defining secured claims to include only those secured by a lien on the debtor's property; James, *supra* note 60 at 897, 898.
[125] See 11 U.S.C. § 507, prioritizing payment of certain types of claims; *Id.* at 897, 898.
[126] See 11 U.S.C. § 1141(d)(1): The confirmation plan discharges the debtor from…any debt of a kind specified in Section 502(g); *Id.* at 897, 898.
[127] See: Laura B. Bartell, *Straddle Obligations Under Prepetition Contracts: Prepetition Claims, Postpetition Claims or Administrative Expenses?*, 25 EMORY BANKRUPTCY DEV. J. 39, 48, 49 (2008).
[128] LUBRIZOL ENTERPRISES, INC. V. RICHMOND METAL FINISHERS, INC., *supra* note 4 at 1048.

of the licensor. This was met with a demand for structuring transactions as completed sales, requiring security interests in the licensor's estate and third-party software escrows.[129]

3.2. The Congressional Intervention: The Intellectual Property Bankruptcy Protection Act, 1988

If we look at the decision in the cases of *Select-A-Seat, In re Petur* and *Lubrizol*, we realise that three courts faced with the option to approve rejection of IP licensing agreements rendered three significantly different judgements. This confusion around treatment of Intellectual Property licenses within Section 365 should have been sufficient to mandate Congressional intervention. Although, it was possibly the changing licensing landscape, a consequence of the *Lubrizol* ruling, which mandated a Congressional course correction.[130] After the *Lubrizol* decision a licensee was at the mercy of its licensor who could use its rejection powers to "*reclaim intellectual property licenses in an effort to negotiate better terms.*"[131] A licensor who can reclaim its property could effectively put licensees out of business.[132]

On August 7 1987, Senators DeConcini and Heflin introduced the Intellectual Property Bankruptcy Protection Bill.[133] The bill was designed to clarify "*the rights of the parties when a licensor or licensee declares bankruptcy.*"[134] Highlighting the need of such clarification, Senator DeConcini referred to the *Lubrizol* judgement and submitted that "*The Lubrizol ruling occurred because Congress never considered this issue, because no courts had considered it before the Bankruptcy Reform of 1978 and because it requires the application in bankruptcy cases of the very specialised area of intellectual property law."*[135] The Bill was signed into law on October 18, 1988. The Intellectual Property Bankruptcy Protection Act (IPBPA), 1988 introduced Section 365(n) to the statutory scheme of Section 365.[136] In order to delineate the

---

[129] Michael J. Shpizner, *Congress passes new legislation protecting licensees of intellectual property*, 4 COMPUT. LAW SECUR. REV. 27–28 (1989).
[130] DECONCINI, *supra* note 6 "*This quirk in bankruptcy law threatens American licensors competing in the international marketplace. Uncertainty over the law jeopardizes American Technology licenses in the world market."*
[131] Alexander N Kreisman, 'Calling All Supreme Court Justices! It Might Be Time to Settle This "Rejection" Business Once and For All: A Look at Sunbeam Products v. Chicago American Manufacturing and the Resulting Circuit Split' (2012) 8 Seventh Circuit Review 30, 44–46.
[132] *Id.* at 45.
[133] DECONCINI, *supra* note 133; For a detailed legislative history of the bill see: Moy, *supra* note 45 at 178–183.
[134] DECONCINI, *supra* note 133 at 24588.
[135] *Id.* at 24588.
[136] John Fry, *The Rejection of Executory Contracts under the Intellectual Property Bankruptcy Protection Act of 1988*, 37 CLEVEL. STATE LAW REV. 621, 639 (1989).

protection provided within Section 365(n), the Act also defines what is '*intellectual property.*'[137]

The protection under Section 365(n) is available only on the confluence of three conditions. First, the bankruptcy debtor should be the licensor. Second, the concerned licensing transaction should be for intellectual property as defined by the Bankruptcy Code. Third, the license should have been executed before the commencement of the bankruptcy proceedings.[138]

Section 365(n) is further divided into four subsections.[139] The first subsection provides the licensee with an option in case the licensor rejects an executory licensing agreement. On rejection, the licensee can treat such contract as terminated by the licensor's rejection and seek a remedy under Section 365(g).[140] Alternatively, the licensee can choose to retain his rights in the licensing agreement.[141] If so retained, the licensor shall be released of his contractual obligations. Although such release would not disentitle a licensee from enforcing an exclusivity covenant for the remainder of the term of the contract[142] and any period for which the license can be extended as a matter of contractual right.[143] Although, the licensee cannot compel specific performance of the contract. Specific performance can increase the burden of a bankrupt debtor and has therefore been prohibited.[144]

The second subsection elaborates the consequences of the licensee's option to retain. It provides that a trustee shall allow the licensee to exercise the rights as provided within the retained agreement[145] and in return the licensee shall continue to make royalty payments for the period of the licensing agreement.[146] In conclusion, a rejection does not force the licensee to relinquish its right of continued usage of the intellectual property licensed vide the rejected licensing agreement.[147] The second subsection also provides that a licensee shall waive any

[137] 11 U.S.C. § 101(35A).
[138] Michael Schein & Brandon J Fleischman, *Licensing issues in today's bankruptcy world*, 17 J. COMMER. BIOTECHNOL. 195, 196 (2011).
[139] For overview of Section 365(n) see: Fry, *supra* note 139; 3 COLLIER ON BANKRUPTCY, 365.15 (Richard B. Levin et al. eds., Sixteenth edition ed. 2009).
[140] 11 U.S.C. § 365(n)(1)(a).
[141] 11 U.S.C. § 365(n)(1)(b).
[142] 11 U.S.C. § 365(n)(1)(b)(i); Moskowitz, *supra* note 107 at 786.
[143] 11 U.S.C. § 365(n)(1)(b)(ii).
[144] 11 U.S.C. § 365(n)(1)(b); Moy, *supra* note 45 at 184.
[145] 11 U.S.C. § 365(n)(2)(a).
[146] 11 U.S.C. § 365(n)(2)(b); see: In re Sima Int'l, Inc., 65 Bankr. Ct. Dec. 188 (Bankr. D. Conn.) (2018).
[147] Fry, *supra* note 139 at 639–644.

right of setoff and any administrative claims against the estate. Any offset or administrative expenses can defeat the right to royalty payments and have therefore been omitted.[148]

The third subsection imposes an affirmative and a passive duty on the DIP. Affirmatively, on a written request by the licensee, the DIP shall provide the intellectual property to the licensee as provided within the terms of the license agreement.[149] Passively, the DIP is also directed not to interfere with the licensee right to use the technology or with efforts by the license to obtain technology from another party.[150] The last subsection provides that the DIP shall continue to shall duly perform the licensing agreement before it either accepted or rejected in accordance with Section 365.[151]

IPBPA provided substantial protection for the intellectual property licensees in the form of a new "veto-power" over the licensors.[152] This power allows a licensee to determine what would be the effect of a rejection of an intellectual property licensor by a bankrupt licensor.[153] The mandate of IPBPA was clear and provided substantial protection for an IP licensee. The success of the legislation can be gauged by the fact that no other federal appellate court had the cause to interpret the legislative instruction embodied in the IPBPA for 24 years, till 2012.[154] Even in 2012, the factual matrix before the federal Court involved a trademark license, which was explicitly omitted from the scope of IPBPA.[155] The next section addresses the continued effect of the Lubrizol judgement in reference to trademark licenses after the implementation of IPBPA.

3.3. Lubrizol after IPBPA: The continued menace

Given that the IPBPA, 1988 was enforced specifically to counter the effects of the *Lubrizol* ruling, one would assume that rejection in case of intellectual property licensing was clarified post 1988. Although, when IPBPA, 1988 defined 'intellectual property,' it omitted 'trademarks' from the definition.[156] The Congress was of the opinion that trademark licenses

[148] Moy, *supra* note 45 at 185.
[149] 11 U.S.C. § 365(n)(3)(a).
[150] 11 U.S.C. § 365(n)(3)(b).
[151] 11 U.S.C. § 365(n)(4); See: Moy, *supra* note 45 at 184–186.
[152] Moskowitz, *supra* note 107 at 786.
[153] *Id.* at 786.
[154] Sunbeam Products Inc. v. Chicago American Manufacturing LLC, 686 F.3d 372, (7th Cir. 2012), "*No other court of appeals has agreed with Lubrizol—or for that matter disagreed with it. Exide, the only other appellate case in which the subject came up, was resolved on the ground that the contract was not executory and therefore could not be rejected.*"; James M. Wilton & Andrew G. Devore, *Trademark Licensing in the Shadow of Bankruptcy*, 68 BUS. LAWYER 739–780, 740 (2013).
[155] 11 U.S.C. § 101(35A).
[156] See: 11 U.S.C. § 101(35A).

were beyond the scope of IPBPA as they required "*a more extensive study.*"[157] Many courts considered this omission to mean that the Congress intended the *Lubrizol* ruling to continue to apply on trademark licenses.[158]

Between 1985 and 2012, multiple bankruptcy courts including the ones from Southern District of New York,[159] Rhode Island,[160] Northern District of California[161] and the District of Delaware,[162] relied on *Lubrizol v. RMF* to determine the treatment that would be afforded to trademark licenses.[163] It was only in 2010 that the Court of Appeals for the Third Circuit in *In Re Exide Technologies* considered the merits of deviating from the *Lubrizol* approach.[164] However, even in 2010 the Court had only pre-empted such a deviation. The licensing agreement therein was not executory and therefore the issue of rejection could not be entertained.[165]

It was only in 2012 that Justice Easterbrook in *Sunbeam Products*[166] addressed the incorrect interpretation of the *Lubrizol* court. The Court's approach was premised on the interpretation of Section 365(g), which as explained in Part 2.2, provides that rejection under Section 365 amounts to breach. Justice Easterbrook opined that outside bankruptcy, the breach would not amount to rescission of the intellectual property license and therefore, similar treatment should be within bankruptcy. In order to explain its position, the Court created an analogy with a lease for actual property. The Court argued that when by breaching a contract for lease, the lessor cannot reacquire the leased property, why would the breach of an intellectual property license denude the licensee of his right to continue the use of the licensed intellectual property.[167] The *Sunbeam* approach assumed validation from the United States Supreme Court in 2019.[168]

After the Supreme Court intervened, the protection afforded to IP licensees within IPBPA in 1988 was extended to trademark licensees. The Supreme Court concluded a judicial confusion that plagued the American Bankruptcy jurisprudence for more than 25 years (1988-2019). The

[157] S. REP. NO. 100-505, at 3 (1988), reprinted in 1988 U.S.C.C.A.N. 3200, 3201–02; see: Roth, *supra* note 98 at 547.
[158] In re Old Carco LLC, (2009) 406 BR 180, 211 (Bankr SDNY); Meisler et al., *supra* note 48 at 166–167.
[159] In re Chipwich, Inc., 54 B.R. 427, 431 (Bankr. S.D.N.Y. 1985).
[160] In re Blackstone Potato Chip Co., 109 B.R. 557 (Bankr. D.R.I. 1990).
[161] In re Centura Software Corp., 281 B.R. 660 (Bankr. N.D. Cal. 2002).
[162] In re HQ Global Holdings, Inc., 290 B.R. 507 (Bankr. D. Del. 2003).
[163] Roth, *supra* note 98 at 548–552.
[164] In re Exide Technologies, 607 F.3d 957 (3d Cir. 2010).
[165] Gupta and Mehta Kumar, *supra* note 10 at 753.
[166] SUNBEAM PRODUCTS INC. V. CHICAGO AMERICAN MANUFACTURING LLC, *supra* note 157.
[167] For a detailed discussion see: Gupta and Mehta Kumar, *supra* note 10 at 755, 756.
[168] Mission Prod. Holdings v. Tempnology, LLC, 139 S. Ct. 1652 (2019).

next section seeks to investigate the United Kingdom and India's insolvency regimes to find a power analogous to Section 365 of the American Bankruptcy Code.

4. Administration in United Kingdom and Corporate Insolvency Resolution Plans in India: Tracing comparable mandates

Having dealt with the statutory construction of the American Bankruptcy Code regarding intellectual property licenses, the paper now turns to the prevailing laws in the United Kingdom and India.

The Insolvency Act, 1986, governs the English Insolvency Regime. The statute unified both personal and corporate insolvency law for the first time in the United Kingdom.[169] The Act of 1986 was the legislative response to the recommendations of the Cork Committee, whose mandate was to review the insolvency law and practice in the later 1970s.[170] The English bankruptcy regime received a significant overhaul in 2002 with the introduction of the Enterprise Act. The Enterprise Act amended the Administration procedure of the UK insolvency regime and followed a Chapter 11 template.[171] An enabling provision was included in the Enterprise Act, which created a new Section 8 of the Insolvency Act, 1986 and enacted Schedule B1 of the Act, which contains the provisions for administration of companies.[172] The primary purpose of the administration regime is to rescue a company so that it can continue trading as a going concern. This objective is very similar to a Chapter 11 bankruptcy proceeding.[173]

On the other hand, the Indian insolvency regime was substantially revamped in 2016, when the Insolvency and Bankruptcy Code (IBC) was introduced. IBC resulted from decades of recommendations and suggested changes to an insolvency regime, which was fragmented and plagued with delays and poor recoveries for creditors.[174] There have been nine government committees that worked on insolvency laws and have time and again suggested an overhaul of

[169] INTERNATIONAL INSOLVENCY LAW: THEMES AND PERSPECTIVES, 107 (Paul J. Omar ed., 2008).
[170] Sandra Frisby, *In Search of a Rescue Regime: The Enterprise Act 2002*, 67 MOD. LAW REV. 247–272, 247 (2004).
[171] 'Introduction to the United Kingdom's Enterprise Act 2002' [2004] American Bankruptcy Institute Journal <https://www.abi.org/abi-journal/introduction-to-the-united-kingdoms-enterprise-act-2002> accessed 24 March 2021.
[172] See: Frisby, *supra* note 173 at 257–258.
[173] Alexandra Rhim, *Reorganization Schemes under U.K. Insolvency Act of 1986: Chapter 11 as a Springboard for Discussion*, 16 LOYOLA LOS ANGEL. INT. COMP. LAW REV. 985, 986 (1994).
[174] BANKRUPTCY LAW REFORMS COMMITTEE, *The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design* (2015).

the bankruptcy framework.[175] IBC marked a significant departure from the previous insolvency regime. The Code introduced a creditor-in-control regime, a time-bound resolution process and reduced the scope of judicial intervention.[176] In order to reduce the uncertainty that arises from multiplicity of legislation, the Code was enacted to consolidate the fragmented law of insolvency in India.[177]

In November 2015, the Bankruptcy Law Reforms Committee set up by the Government of India, submitted a two-volume report which included a draft of the IBC.[178] IBC, 2016 provides for initiating a Corporate Insolvency Resolution Process (CIRP)[179] by a corporate applicant.[180] A CIRP is initiated when the corporate debtor defaults on making payments to its creditors and should mandatorily be completed within 330 days.[181] Similar to a Chapter 11 proceeding in the American Bankruptcy Code, a CIRP aims to reorganise a company's debt structure and its revival from a state of insolvency. Unlike Chapter 11, IBC is designed for the sale of the corporate debtor as a going concern. Unless in exceptional circumstances,[182] the corporate debtor does not retain control of the business after the initiation of the CIRP proceedings.[183]

Unlike Section 365(n) of the American Bankruptcy Code, neither the UK nor the Indian insolvency regime affords any special protection to intellectual property licensees during the insolvency proceedings of the licensor. Further, neither the Indian[184] nor the English Insolvency regime[185] provide any special protections to an IP license agreement.

The American Bankruptcy Code incorporates a Debtor-in-Possession (DIP) financing model,[186] wherein the management of the bankrupt debtor retains control over the assets and business activities of the debtor during the insolvency proceedings.[187] The English and the

---

[175] *Id.* at 3.1; Also see: Akshaya Kamalnath, *Corporate Insolvency Resolution Law in India - A Proposal to Overcome the "Initiation Problem"*, 88 UNIV. MO.-KANS. CITY LAW REV. 631 (2019).
[176] VIDHI CENTRE FOR LEGAL POLICY, *Understanding the Insolvency and Bankruptcy Code, 2016* 8 (2019).
[177] *Id.* at 11.; Swiss Ribbons Pvt. Ltd. and Another v. Union of India And Others, , (2019) 4 SCC 17.
[178] BANKRUPTCY LAW REFORMS COMMITTEE, *The Report of the Bankruptcy Law Reforms Committee Volume II: Draft Code* (2015).
[179] Section 6, Insolvency and Bankruptcy Code, 2016.
[180] Section 10, Corporate Applicant has been defined in Section 5(5), Insolvency and Bankruptcy Code, 2016.
[181] Proviso 1, Section 12(3), Insolvency and Bankruptcy Code, 2016.
[182] Section 12A, Insolvency and Bankruptcy Code, 2016.
[183] See: Pratik Datta, *Value destruction and wealth transfer under the Insolvency and Bankruptcy Code, 2016*, NIPFP Working Paper No. 247 NATL. INST. PUBLIC FINANCE POLICY (2018).
[184] Gupta and Mehta Kumar, *supra* note 10.
[185] Brett Israel, *Intellectual property rights and English insolvency law: a need for new tools?* CORP. RESCUE INSOLV. J. 59 (2009).
[186] See: A GLOBAL VIEW OF BUSINESS INSOLVENCY SYSTEMS, *supra* note 17 at 76.
[187]11 U.S.C. § 364(a); Izak Atiyas, *Bankruptcy: Policy, Law, and Strategy*, 4 *in* CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS 11, 425 (Robert C. Effros ed., 1997).

Indian insolvency regimes do not incorporate a similar DIP model. In England, during administration, an administrator is appointed[188] who acts in a dual capacity as an agent of the insolvent company[189] and an officer of the Court.[190] Once appointed, the administrator takes all the company's property into his custody or control.[191] Similarly, IBC, 2016 provides that once the CIRP has been initiated, the control of the corporate debtor is assumed by an Interim Resolution Professional (IRP).[192] Within 30 days of the initiation of the CIRP, the IRP appoints the Committee of Creditors (CoC).[193] After that, the CoC appoints a Resolution Professional (RP),[194] who assumes the control of the corporate debtor.[195] The RP's control of the corporate debtor's assets is maintained under a strict vigil of the CoC.[196] This difference in the financing model between the American vis a vis the Indian and the English insolvency regimes has no bearing on the rejection of pre-petition transactions. As has been explained in Part 4.2, both these regimes provide for interference with pre-petition contracts. Although, the manner in which the interference is exercised is very different.

The following part of the paper studies the statutory scheme of the Insolvency Act, 1986 and the IBC, 2016 to determine whether a licensor can reject an IP licensing agreement during insolvency proceedings. For the present study, the authors seek to trace statutory mandates comparable to Section 365 in a Chapter 11 proceeding of the American Bankruptcy Code. Therefore, the scope of analysis is limited to insolvency procedures similar to a Chapter 11 proceeding: Administration in the UK and the Corporate Insolvency Resolution Process (CIRP) in India.

4.1. Termination of Contracts: Ipso Facto Clauses

What happens if the licensing agreement stipulates that in the event of either party entering into insolvency proceedings, the licensing agreement stands materially altered/ terminated? If a licensing agreement can be terminated upon insolvency, this would mean that the powers of an insolvency professional shall be subject to the contractual relationship between the parties. Not only does this denude the powers of an insolvency professional, but it also impedes his ability

[188] Paragraph 2, Schedule B1, Insolvency Act, 1986; Also see: Paragraph 14, Schedule B1, Insolvency Act, 1986.
[189] Paragraph 69, Schedule B1, Insolvency Act, 1986.
[190] Paragraph 5, Schedule B1, Insolvency Act, 1986.
[191] Paragraph 67, Schedule B1, Insolvency Act, 1986.
[192] Section 17, Insolvency and Bankruptcy Code, 2016; See: Kamalnath, *supra* note 178.
[193] Section 21, Insolvency and Bankruptcy Code, 2016 read with Regulation 17(1), Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.
[194] Section 22, Insolvency and Bankruptcy Code, 2016.
[195] Section 23, Insolvency and Bankruptcy Code, 2016.
[196] Section 28, Insolvency and Bankruptcy Code, 2016.

to reorganise the debt structure of a company. The Delhi High Court in 1995 ruled in favour of this contractual foresight and permitted the termination of an intellectual property license in terms of the ipso facto clause contained therein.[197] Therefore, before analysing the powers of an insolvency professional, it is crucial to investigate whether the incidence of such powers is subject to the contractual relationship between the parties.

'Ipso facto' clauses are Contractual stipulations that allow termination/ substantial modification of contracts in the event of bankruptcy. An ipso facto clause is defined as "*a non-statutory shorthand label for a category of contractual provisions that, in essence, would provide for the debtor's rights under the contract to terminate upon the filing of bankruptcy or related events.*"[198] As discussed in Part 2, the American Law on the subject invalidates the applicability of such ipso facto clauses.[199] This part of the paper seeks to analyse the treatment afforded to ipso facto clauses during the administration proceedings in the United Kingdom and CIRP in India.

4.1.1. Traditionalist or Proceduralist: Policy Arguments concerning Ipso Facto clauses

Before dealing with the statutory construction of the operative bankruptcy provisions, it is vital to understand the countervailing policy arguments accompanying ipso facto clauses. Prof. Coles-Bjerre has distinguished these countervailing arguments in two camps: proceduralists and traditionalists.[200] In its simplest enunciation, the traditionalist camp believes that bankruptcy law has its own important substantive goals and plays a distinctive role in the legal system.[201] Concerning invalidation of ipso facto clauses, a traditionalist author would argue that it serves the purpose of maximising right holders' recoveries by preserving valuable assets.[202] On the other hand, the proceduralists reduce bankruptcy as only an element that should be well integrated into the rest of the nation's economy and legal systems.[203] They support that contractual autonomy of the parties should be maintained, and ipso facto clauses

[197] Unikol Bottlers v Dhillon Kool Drinks, AIR 1995 Del 25; Gupta and Mehta Kumar, *supra* note 8 at 759.
[198] Coles-Bjerre, *supra* note 66 at 87.
[199] In re Triangle Laboratories, Inc., 663 F.2d 463, 465 (3d Cir. 1981).
[200] Coles-Bjerre, *supra* note 27 at 93; Prof. Baird separated the "world bankruptcy scholarship" in two camps: proceduralists and traditionalists. Prof. Coles-Bjerre builds on Prof. Baird's distinction. See: Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE LAW J. 573 (1998).
[201] Baird, *supra* note 203 at 576.
[202] See: Coles-Bjerre, *supra* note 66 at 92–94.
[203] Baird, *supra* note 203 at 577–578.

should not be invalidated.[204] The proceduralists claim that an ipso facto clause would favour a foresightful non-debtor who would be able to opt-out of his share of pain in a bankruptcy proceeding.[205]

The United Nations Commission on International Trade Law's (UNCITRAL) Legislative Guide to Insolvency underlines concerns similar to Professor Coles-Bjerre's findings.[206] However, the UNCITRAL has not labelled these concerns in proceduralist or traditionalist camps.

The Legislative Guide notes that many arguments, including the desirability of respecting commercial bargains, may support retaining the validity of ipso facto clauses. On the other hand, the guide also notes that while invalidation of ipso facto clauses may interfere with the general principles of contract law, *such interference may be crucial for the success of the proceedings.* The guide explicitly refers to intellectual property licensing agreements and argues that retention of such contracts may be necessary to further the goals of an insolvency proceeding.

Having acknowledged the countervailing arguments, the UNCITRAL concludes that since the continued performance of commercial agreements is necessary for the success of the insolvency process, the ipso facto clause should be invalidated subject to certain exceptions.[207] The European Parliament made a similar suggestion in 2019:

> *"Early termination can endanger the ability of a business to continue operating during restructuring negotiations, especially when contracts for essential supplies such as gas, electricity, water, telecommunication and card payment services are concerned."*[208]

In light of the discussion, Article 7 of the EU Directives recommends invalidation of ipso facto clauses. The European Union argues that solely because of the debtor's restructuring/insolvency, the creditor should not be allowed to amend executory contracts to

---

[204] Charles W. Mooney, *A Normative Theory of Bankruptcy Law: Bankruptcy as (is) Civil Procedure*, 18 FAC. SCHOLARSH. PENN LAW, 1042–44 (2004)"If not offended, procedure theory is at least annoyed that Section 365 overrides ipso facto provisions to which parties have agreed."

[205] Coles-Bjerre, *supra* note 66 at 90–94; Alan Schwarcz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE LAW J. 1807 (1998).

[206] Vereinte Nationen (ed), *Legislative Guide on Insolvency Law* (Vienna: UNCITRAL, United Nations Commission on International Trade Law 2005) 122.

[207] *Id.* at 123.

[208] DIRECTIVE (EU) 2019/1023, OJ L 172 41 (2019), http://data.europa.eu/eli/dir/2019/1023/oj/eng (last visited Mar 30, 2021).

the debtor's detriment. In recent years, many jurisdictions including, Netherlands, Germany and France, have adopted provisions that invalidate ipso facto clauses in bankruptcy.[209]

4.1.2. Legal Position in UK and India

Coming to the position of the law in the UK, the Insolvency Act, 1986 does not invalidate ipso facto clauses. Historically, UK maintained a proceduralist stance and permitted the applicability of ipso facto clauses and retained the freedom of contract. The UK Supreme Court in the *Belmont Park* case confirmed this position.[210] It agreed with the validity of *ipso facto* clauses as long as these provisions do not invalidate the *anti deprivation rule:*[211]

> *"There was no dispute before me as to the efficacy in English law of the provisions in Clause 28.1 of the contract which allow termination by reason of an insolvency event. It was accepted that those provisions are valid in English law. In particular, it was accepted that the Rule of insolvency law, known as the anti-deprivation rule, does not strike down those provisions."*

In 2020, UK enacted the Corporate Insolvency Governance Act (CIGA), which introduced Section 233B to the Insolvency Act, 1986.[212] With the introduction of Section 233B, ipso facto clauses in a specific set of contracts were made unenforceable.[213] The provision invalidates a clause in any contract that terminates it or does "*any other thing*" regarding that contract on the ground that the bankrupt debtor is entering into an insolvency procedure.[214] Interpreting the provision, the England and Wales High Court, on January 20, 2021, noted that the protection afforded by Section 233B does not only covers termination by a supplier but also includes the variance of terms by the supplier.[215] Although, the provision is applicable only when the contract was for the supply of goods and services to the bankrupt debtor.[216] The bar on

---

[209] Ilya Kokorin, *Promotion of group restructuring and cross-entity liability arrangements*, J. CORP. LAW STUD. 1–37, 36 (2021).
[210] Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd, , [2011] UKSC 38; [2012] 1 AC 383 (SC).
[211] Kokorin, *supra* note 212 at 14.
[212] THE CORPORATE INSOLVENCY AND GOVERNANCE ACT, Clause 12 (2020); INSOLVENCY ACT, 233B (1986).; CIGA has now been withdrawn. The temporary provisions introduced vide the Act cease to assume applicability. Although, since Section 233B was a permanent change made to the Insolvency Act, 1986, the withdrawal has no bearing on the present study.
[213] Philip Wood, *Corporate Insolvency and Governance Act 2020 – freezes on contract terminations*, 5 CORP. RESCUE INSOLV. 167 (2020).
[214] Hetal Doshi & Yashasvi Jain, *The Insolvency and Bankruptcy Framework and Principle of Business Efficacy across Different Jurisdictions in the COVID Era*, 42 BUS. LAW REV. 45, 46 (2020).
[215] P&O Princess Cruises International Ltd. v. Demise Charterers of the Columbus, [2021] EWHC 113 (Admity).
[216] Section 233B, Insolvency Act, 1986; Doshi and Jain, *supra* note 217 at 46.

invalidation of clauses would not apply where the bankrupt debtor is the supplying party.[217] The lack of such invalidation can affect the revenue stream of the insolvent company. Therefore, it is safe to say that Section 233B of the UK Insolvency Act, 1986 is narrower than the mandate of Section 365(e) of the American Bankruptcy Code.

The Indian Bankruptcy system does not communicate a clear mandate concerning the treatment of ipso facto clauses in insolvency. Unlike American and English Bankruptcy systems, IBC, 2016 and the Indian Companies Act, 2013 do not include explicit provisions which deal with the legality of ipso facto clauses in insolvency.[218] The requirement of dealing with this question was, however, underlined as far back as 2005. While presiding over a committee set up by the Ministry of Corporate Affairs, Government of India, Dr JJ Irani believed that "*the law should provide for treatment of unperformed contracts. Where the contracts provide for automatic termination on filing of insolvency, its enforcement should be stayed by commencement of insolvency."*[219] The report also acknowledged that such powers should be subject to exceptions where there is *"a compelling commercial, public or social interest in upholding the contractual rights."*[220]

Another report published in 2018 acknowledged that the IBC does not regulate the applicability of ipso facto clauses.[221] The report placed reliance on the compulsory declaration of moratorium by the National Company Law Tribunal (NCLT), which *inter alia* prohibits transferring, alienating or disposing of assets, legal rights and beneficial interests beneficial to the bankrupt debtor.[222] According to the report, Section 14 of IBC, 2016 provides a limited exception from the termination, suspension or interruption of specified "*essential goods and services."*[223] The term "essential supplies" only includes electricity, water, telecommunication services and information technology services.[224] The report suggested inserting a provision in

[217] *Id.* at 46.
[218] Gujarat Urja Vikas Nigam Ltd. v. Amit Gupta and Ors., MANU/SC/0157/2021 (2021).
[219] JAMSHED J. IRANI, *Report of the Expert Committee on Company Law* 146–149 (2005).
[220] *Id.* at 148.
[221] VIDHI CENTRE FOR LEGAL POLICY & ERNST AND YOUNG, *Insolvency and Bankruptcy Code: The journey so far and the road ahead* 34–35 (2018), https://vidhilegalpolicy.in/wp-content/uploads/2019/05/IBC_Thejourneysofarandtheroadahead_Dec18.pdf (last visited Mar 20, 2021).
[222] Section 14(1)(b), Insolvency and Bankruptcy Code, 2016.
[223] Section 14(2), Insolvency and Bankruptcy Code, 2016; VIDHI CENTRE FOR LEGAL POLICY AND ERNST AND YOUNG, *supra* note 224 at 35.
[224] Regulation 32 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

the IBC, 2016 which would conditionally stay the operation of ipso facto clauses until the CIRP proceedings' resolution.

An amendment introduced an explanation to Section 14(1) of the Insolvency and Bankruptcy Code, 2016 in 2020 [225] The explanation clarifies that Section 14, IBC, 2016 invalidates the termination or suspension of Government grants[226] during the moratorium period.[227] The Insolvency Law Committee report, which discussed the legislative intent behind the explanation, admitted that the explanation was geared to regulate termination of contracts by the government authorities only.[228]

Further the Insolvency Law Committee, on two separate occasions,[229] suggested that a new subsection should be introduced to Section 14, IBC, 2016. It was recommended that such introduction was necessary "*to ensure that supplies that are critical to running the corporate debtor as a going concern, and would contribute to the preservation of the corporate debtor's value and success of the resolution plan should not be terminated, suspended or interrupted.*"

These suggestions were taken into account in 2020[230] , and Section 14(2A) was introduced to IBC, 2016.[231] The subsection allows a Resolution Professional to prevent the termination of supply of goods and services, which they consider '*critical to protect and preserve the value of the corporate debtor and manage the operations of such corporate debtor as a going concern*.'[232] However, the amendment witnessed criticism because no legislative guidance was provided to determine which supplies would be '*critical*.' The lack of such guidance renders the amendment ambiguous in its interpretation and creates room for unguided judicial discretion.[233] Further, even after the introduction of Section 14(2A), the validity of ipso facto clauses is contingent on the opinion of the Resolution Applicant. A comparison of this position

[225] Insolvency and Bankruptcy (Amendment) Act, 2020
[226] The word grants include licenses, permits and quotas, concessions, registrations, or other rights.
[227] Gujarat Urja Vikas Nigam Ltd. v. Amit Gupta and Ors., MANU/SC/0157/2021, 135 (2021).
[228] INSOLVENCY LAW COMMITTEE, *Report of the Insolvency Law Committee* 34–36 (2020), https://ibbi.gov.in/uploads/resources/c6cb71c9f69f66858830630da08e45b4.pdf (last visited Mar 20, 2021).
[229] The first time in March 2018, see: INSOLVENCY LAW COMMITTEE, *Report of the Insolvency Law Committee, March 2018* 5.14, 5.15 (2018), http://www.mca.gov.in/Ministry/pdf/ReportInsolvencyLawCommittee_12042019.pdf (last visited Apr 19, 2021); The second time in February 2020, see: INSOLVENCY LAW COMMITTEE, *supra* note 211 at 8.13-8.19.
[230] Although, the amendment was brought into force with effect from December, 28, 2019; See: GUJARAT URJA VIKAS NIGAM LTD. V. AMIT GUPTA AND ORS., *supra* note 214 at 160; Also see: The Insolvency and Bankruptcy Code (Amendment) Act, 2020.
[231] See: Section 5, The Insolvency and Bankruptcy Code (Amendment) Act, 2020.
[232] Amrit Mahal, *Termination of Contracts During the Moratorium: Looking Beyond The 'Going Concern' Status*, 7 NLS BUS. LAW REV. 153, 162–165 (2021).
[233] *Id.* at 163.

with the American Bankruptcy Code reveals a curious distinction. While the Indian Insolvency Law doles the responsibility to suspend ipso facto clauses on the Resolution Professional, the American Law clearly states that all *ipso facto* clauses shall stand suspended during proceedings under the Code.[234]

To summarise the validity of ipso facto clauses in Indian bankruptcy, the paper relies on a judgement of the Supreme Court of India delivered on March 8, 2021:

> *"The position of law in India today invalidates ipso facto clauses in:*
>
> *(i) Government licenses, permits, registrations, quotas, concessions, clearances or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law for the time being in force, in accordance with the Explanation to Section 14(1); and*
>
> *(ii) Contracts where the counter-party supplies essential/critical goods and services to the Corporate Debtor, within the meaning of Sections 14(2) and 14(2A).*
>
> *However, no clear position emerges in relation to the validity of ipso facto clauses in other contracts, from the bare text of the IBC."*[235]

The Supreme Court of India has acknowledged the lacunae of legislative instruction and appealed to the Legislature to provide guidance in the present matter:

> *"Consequently, we hold that question of the validity/invalidity of ipso facto clauses is one which the Court ought not to resolve exhaustively in the present case. Rather, what we can do is appeal in earnest to the Legislature to provide concrete guidance on this issue, since the lack of a legislative voice on the issue will lead to confusion and reduced commercial clarity."*[236]

Therefore, in conclusion, English Law prohibits the validity of ipso facto clauses during bankruptcy in a limited set of circumstances and is qualified by a list of exceptions.[237] Unfortunately, the law in India is not as clear as its English counterpart. The introduction of

[234] 11 U.S.C. § 365(e)(1)(A).
[235] GUJARAT URJA VIKAS NIGAM LTD. V. AMIT GUPTA AND ORS., *supra* note 221 at 135.
[236] *Id.* at 143.
[237] Section 233B, Insolvency Act, 1986; see Doshi and Jain, *supra* note 217.

Section 14(2A) appears to be a step in the right direction, but a lack of legislative guidance plagues the amendment. The Indian courts and administrative bodies have relied on the declaration of a moratorium to regulate the applicability of ipso facto clauses.[238] Neither of these approaches provides a mandate as explicit and exhaustive as the one incorporated in American Law.

Answering the question this part set out to answer: The English Law would invalidate an ipso clause provided that it does not contradict with the exceptions meted in Section 233B, Insolvency Act, 1986. The Indian Law on the subject is unclear. However, it can be argued that if the agreement was between the corporate debtor and the Government or any statutory body, it should not be terminated solely because of the initiation of CIRP proceedings.[239] Similarly, if the licensing agreement was in relation to the provision of essential/ critical services to the corporate debtor, any ipso facto termination clauses shall remain invalid.

Having understood the validity of Ipso Facto clauses in India and the UK, the next part of the paper turns to studies whether an intellectual property license can be rejected during CIRP proceeding in India and Administration in the UK.

4.2. Disclaimer of contracts

The Insolvency Act, 1986 and the IBC, 2016 provide for disclaimer of unprofitable contracts.[240] The power to disclaim unprofitable contracts is the closest enunciation to Section 365[241] of the American Insolvency Code's power to reject executory contracts. While exploring a power similar to Section 365 in English Law, multiple authors and reports have pointed towards the Insolvency Law's ability to disclaim contracts.[242] The intention here is to enable a bankrupt debtor to reject the performance of contracts, the maintenance of which is unprofitable and can potentially result in the acquisition of further obligations, which may diminish the pool of assets available for distribution.[243]

---

[238] GUJARAT URJA VIKAS NIGAM LTD. V. AMIT GUPTA AND ORS., *supra* note 221.
[239] Section 14(1), Insolvency and Bankruptcy Code, 2016.
[240] Section 178, Insolvency Act, 1986; Regulation 10, Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016
[241] David Flint, *Man on a Mission*, 40 BUS. LAW REV. 173, 174 (2019).
[242] *Id.* at 174.; BAKER MCKENZIE, *IP License Agreements in insolvency: Managing licensing arragements in financially turbulent time* (2020); Kubianga Michael Udofia, *The impact of insolvency on corporate contracts: a comparative study of the UK and US insolvency law regimes* (August, 2014)(Ph.D. Dissertation, University of Nottingham), Oksana Koltko et. al. THE PROTECTION OF INTELLECTUAL PROPERTY RIGHTS IN INSOLVENCY PROCEEDINGS, (2017) (INSOL International).
[243] Paul J. Omar, *Disclaiming Onerous Property in Insolvency: A Comparative Study*, 19 INT. INSOLV. REV. 41, 43, 44 (2010).

The statutory enunciation of this intention is similar in the English and the Indian Insolvency Regimes. The two insolvency regimes provide for the disclaimer of onerous property.[244] The definition accorded to '*onerous property'* by the two regimes is also similar and includes '*any unprofitable contracts.*'[245] However, the provisions that determine onerous property's disclaimer explicitly refer to the bankruptcy trustee[246] and the liquidator.[247] In India, the power to disclaim contracts in case of insolvency of corporate debtors is provided within the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016. The Regulations are exclusive to the liquidation process and do not apply to CIRP proceedings.[248]

Such legislative directive raises a pertinent question: Can an administrator or a resolution professional disclaim unprofitable contracts during an administration or CIRP? The simple answer is no. The power of disclaimer is exclusive to the liquidation proceedings and does not extend to other insolvency proceedings. This part of the paper explores the statutory limits of the ability to disclaim onerous property.

During liquidation, in order to disclaim a contract, it is not sufficient to show that the insolvent company can secure a contract at a higher price.[249] What is required to be established is that the contract imposes future obligations, the performance of which shall be detrimental to the creditors.[250] Therefore, an intellectual property license that obliges the licensor to incur any prospective liabilities would ideally be categorised as an unprofitable contract within English [251] and Indian Law.

A disclaimer determines the rights, interests and liabilities of the bankrupt debtor in, or in respect of, the property disclaimed.[252] The disclaimer operates solely to release the debtor from his obligations in a contract and does not affect the rights and liabilities of any other person.[253]

---

[244] Section 178, Insolvency Act, 1986; Regulation 10, Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016; For Indian Law see: INTERNATIONAL FINANCE CORPORATION & INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, *Understanding the IBC: Key Jurisprudence And Practical Consideration* 202–203 (2020), https://www.ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf (last visited Mar 23, 2021).

[245] Section 178(3)(b), Insolvency Act, 1986; Regulation 10(1)(d), Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.

[246] Section 178(1), Insolvency Act, 1986.

[247] Regulation 10(1), Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.

[248] Regulation 1(3), Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.

[249] *Re Blue Sennar Air Pty. Ltd.* [2016] NSWSC 772 as cited in FRANCIS GORE-BROWNE, A. J BOYLE & RICHARD SYKES, GORE-BROWNE ON COMPANIES, FORTY-SECOND EDITION. (1975).

[250] *Id.*

[251] Israel, *supra* note 188.

[252] Section 178(2), Insolvency Act, 1986; Section 160(2), Insolvency and Bankruptcy Code, 2016.

[253] Section 178(4), Insolvency Act, 1986; Regulation 10(4), Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.

Therefore, a licensee will retain the right to use the licensed rights following the disclaimer.[254] Similar to American Law, the English and the Indian insolvency law would require an IP licensee whose contract has been disclaimed to continue to perform the obligations accrued to him vide the licensing agreement.[255] A person who sustains a loss or damage is accorded the status of an unsecured creditor.[256]

Where the UK and Indian regimes differ is the manner in which onerous property is disclaimed. The English Law on the subject allows disclaimer by communicating a notice to the opposite party.[257] On the contrary, the Indian insolvency regime mandates the approval of the adjudicating authority before the power of disclaimer can be exercised.[258] The court approval requirement within the Indian regime would enable a stricter vigil on the liquidator's actions. Furthermore, Section 20(2)(b) IBC, 2016, which empowers the Interim Resolution Professional and the Resolution Professional,[259] to "*amend and modify*" the terms of pre-petition contacts[260], cannot be cited to proffer a power of disclaimer or rejection during CIRP. The NCLT Hyderabad has ratified this position in 2018. Before NCLT, the dispute related to the unilateral modification of the terms of a management agreement. The Applicant, EIH Ltd., Claimed that the agreement was entered into between the Corporate debtor and the applicant before the commencement of the CIRP proceedings and cannot be modified unilaterally.[261] The IRP, on the other hand, claimed that Section 20(2)(b) IBC, 2016 empowers him to modify the Management Agreement.[262] The NCLT sided with EIH Ltd. and explicitly noted that the resolution professional, even with the consent of the Committee of Creditors, cannot unilaterally alter pre-petition contractual arrangements.[263]

Extending the Tribunal's rationale even further, the NCLT Mumbai in 2019 opined that even a resolution plan cannot alter legally valid pre-petition agreements.[264] Such contracts would be governed in the manner they would have been governed had insolvency proceedings not

---

[254] OKSANA KOLTKO, RICK CHESLEY & JOE RICHES, *The Protection of Intellectual Property Rights in Insolvency Proceedings* 26 (2017).
[255] *Id.* at 26.
[256] Section 178(6), Insolvency Act, 1978; Regulation 10(5), Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.
[257] Section 178(4)(a), Insolvency Act, 1986; See: Udofia, *supra* note 245 at 228.
[258] Regulation 10, Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.
[259] Section 20(2)(b) read with Section 23(2), Insolvency and Bankruptcy Code, 2016.
[260] Section 20(2)(b), Insolvency and Bankruptcy Code, 2016.
[261] EIH Ltd. v. Subodh Kumar Agarwal, I.A. No. 73 of 2018 in CP (IB) No. 248/7/HDB/2017, 17, 18 (2018).
[262] *Id.* at 19–21.
[263] *Id.* at 38–45.
[264] DBM Geotechnics and Construction Private Ltd. v. Dighi Port Ltd, , MA 529/2019, MA 761/2019 and MA 1147/2019 in CP 1382/I&BP/NCLT/MAH/2017, 67–70 (2019).

intervened.[265] Hence, it is safe to conclude that the residual powers conferred in Section 20(2)(b), Insolvency and Bankruptcy Code, 2016, cannot be cited to profer a unilateral ability to modify and alter pre-petition contractual agreements.

The power to disclaim onerous property is also unavailable to administrators and administrative receivers within the English Insolvency Law.[266] Unlike a liquidator, an administrator does not have the power to disown onerous contracts.[267] It is clear that the ability to disclaim onerous property is available only in winding up or liquidation. The administrator does not enjoy the power to disclaim contracts. Therefore, it is safe to conclude that that the power to disclaim onerous property is exclusive to liquidation proceedings. The English and Indian insolvency regimes do not provide for disclaimer of contracts during Administration and CIRP. This limitation of the power of disclaimer renders this power beyond the scope of the present study. The powers available during liquidation cannot be used during reorganisation proceedings. Therefore, they cannot act as a corollary to Section 365 of the American Bankruptcy Code, which assumes applicability during a Chapter 11 proceeding.

Having understood that the power to disclaim an IP licencing agreement is exclusive to liquidation, the question arises: Is there any provision that empowers the rejection of an IP licensing agreement during an administration or a CIRP? To answer this question, the next section of the paper investigates the avoidance powers couched in the English Insolvency Law[268] and its Indian counterpart.[269]

4.3. Vulnerable Transactions in Bankruptcy

Avoidance powers or 'claw-back actions' allow the retrospective adjustment of pre-petition transactions.[270] If a pre-petition transaction can be avoided after the initiation of insolvency proceedings, it would be referred to as a 'vulnerable transaction.'[271] Avoidance powers are legislated because there might be a considerable time period between the management of a bankrupt debtor realising that the debtor is heading towards bankruptcy and the debtor actually

[265] DBM GEOTECHNICS AND CONSTRUCTION PRIVATE LTD. V. DIGHI PORT LTD, *supra* note 267.
[266] Israel, *supra* note 188.
[267] 2 L. S SEALY & DAVID MILMAN, ANNOTATED GUIDE TO THE INSOLVENCY LEGISLATION 77 (14 ed. 2011); Camilla Lamont, *Re-structuring leasehold estate under Chapter 11 of the US Bankruptcy Code and in England and Wales- A Comparison*, 31 INSOLV. INTELL. 8, 12 (2018).
[268] Section 238, 239 &, 423, Insolvency Act, 1986.
[269] Section 43, 45, 49, 50, Insolvency and Bankruptcy Code, 2016.
[270] Aurelio Gurrea-Martinez, *The Avoidance of Pre-Bankruptcy Transactions: An Economic and Comparative Approach*, 93 CHIC. -KENT LAW REV. 711 (2018).
[271] VULNERABLE TRANSACTIONS IN CORPORATE INSOLVENCY, (John Armour, Howard N. Bennett, & M. G. Bridge eds., 2003).

initiating insolvency proceedings. During this time, the management may create contractual relationships that strategically place themselves in a comparatively advantageous position to the bankrupt debtor's creditors. [272] To ameliorate such a situation, "*the bankruptcy law allows the ex-post alignment of incentives between factually insolvent debtors and their creditors."*[273]

The power to avoid pre-petition transactions appears in the bankruptcy statutes of multiple jurisdictions and forms an integral part of bankruptcy jurisprudence.[274] The American Bankruptcy Code also empowers a DIP to avoid pre-petition contractual arrangements.[275] The avoidance powers couched in the American Bankruptcy Code are not the same as the power to reject executory contracts as provided in Section 365.[276]

Multiple international organisations, including the UNCITRAL,[277] IMF[278] & World Bank,[279] have recognised the importance of legislating avoidance powers in domestic insolvency laws. The legislative guide prepared by UNCITRAL underlines the importance of the ability to avoid pre-petition arrangements in the following terms:

> "*It is desirable that an insolvency law provide certainty to all parties through clearly defined criteria for avoidance, including the elements that will need to be proved by the insolvency representative and the defences available to the creditors.*"[280]

The Indian Bankruptcy Law Reforms Committee, in its interim report, suggested immediate reforms to improve the corporate insolvency regime in India. Heavily relying on the English Law, the interim report suggested an amendment to the Indian Companies Act, 2013 to strengthen the provisions which regulated vulnerable transactions.[281]

---

[272] ORDERLY & EFFECTIVE INSOLVENCY PROCEDURES: KEY ISSUES, 34 (International Monetary Fund ed., 1999).
[273] Gurrea-Martinez, *supra* note 273 at 713.
[274] Irit Mevorach, *Transaction Avoidance in Bankruptcy of Corporate Groups*, 8 EUR. CO. FINANC. LAW REV., 239 (2011).
[275] 11 U.S.C. § 548, 547, 544(b); RODRIGO OLIVARES-CAMINAL ET AL., DEBT RESTRUCTURING 27–34 (1 ed. 2011).
[276] MISSION PRODUCT HOLDING INC. V. TEMPNOLOGY LLC, *supra* note 9; SUNBEAM PRODUCTS INC. V. CHICAGO AMERICAN MANUFACTURING LLC, *supra* note 157.
[277] LEGISLATIVE GUIDE ON INSOLVENCY LAW, *supra* note 209 at 135–142.
[278] ORDERLY & EFFECTIVE INSOLVENCY PROCEDURES, *supra* note 275 at 34–37.
[279] PRINCIPLES OF EFFECTIVE INSOLVENCY AND CREDITOR/DEBTOR REGIMES, (2016), https://pubdocs.worldbank.org/en/919511468425523509/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2016.pdf (last visited Mar 20, 2021).
[280] LEGISLATIVE GUIDE ON INSOLVENCY LAW, *supra* note 209 at 135–142.
[281] BANKRUPTCY LAW REFORM COMMITTEE, *supra* note 11 at 97–99.

There are essentially four kinds of vulnerable transactions[282] common to both the Indian and the English Insolvency Law.[283] They are preferential transactions,[284] undervalued transactions,[285] extortionate credit transactions[286] and transactions defrauding creditors.[287] As the case may be, a resolution professional or an administrator must apply to the adjudicating authority to avoid a vulnerable transaction.[288] If approved, the adjudicating authority shall pass orders to nullify the effect of the vulnerable transactions. Both the English and the Indian insolvency law enumerate the orders that the adjudicating authority is empowered to pass in order to restore the parties to the position which existed prior to engaging in the vulnerable transaction.

While it may be tempting to conclude that the avoidance powers meted out in the English and Indian insolvency laws are similar to the powers granted to a DIP within Section 365; unfortunately, that is not the case. The rules of procedure that govern the avoidance of vulnerable transactions limit the applicability of the empowering provisions. Simply put, not all transactions entered into by a bankrupt estate qualify as vulnerable transactions. Furthermore, not all vulnerable transactions can be avoided. The following table illustrates the myriad conditions which require compliance before a transaction can be avoided:[289]

[282] See generally: A GLOBAL VIEW OF BUSINESS INSOLVENCY SYSTEMS, *supra* note 17 at 105–117.
[283] For English Law see: Hamish Anderson, *The Nature and Purpose of Transaction Avoidance in English Corporate Insolvency Law*, 2 NOTTM. INSOLV. BUS. LAW EJOURNAL 3, 9 (2014); For Indian Law see: JYOTI SINGH & VISHNU SHRIRAM, INSOLVENCY AND BANKRUPTCY CODE, 2016: CONCEPTS AND PROCEDURE 169–176 (1 ed. 2017).
[284] Section 239, Insolvency Code, 1986; Section 43, Insolvency and Bankruptcy Code, 2016.
[285] Section 238, Insolvency Code, 1986, See: *MacDonald* v. *Carnbroe Estates Lrd.* [2019] UKSC 57; Section 45, Insolvency and Bankruptcy Code, 2016.
[286] Section 244, Insolvency Code, 1986; Section 50, Insolvency and Bankruptcy Code, 2016.
[287] Section 423, Insolvency Code, 1986; Section 49, Insolvency and Bankruptcy Code, 2016.
[288] Regulation 35A, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process For Corporate Persons) Regulations, 2016; In Re: In the matter of Balaknath Bhattacharyya, MANU/BB/0070/2020, 4.1-4.4 (2020).
[289] The table is only indicatory and does not intend to exhaustively delineate the conditions required for the applicability of the avoidance powers.

Type of Transaction	Insolvency Act, 1986	IBC, 2016
Undervalued Transactions	Transactions that were entered into in good faith and for the purpose of carrying on the business of the company cannot be avoided. [290]	Transactions made in the ordinary course of business cannot be avoided.[291]
Preferential Transactions		A preferential transaction can be avoided only when in giving the preference, the bankrupt debtor was influenced by a desire to produce a preferential effect. [292]
Transactions defrauding creditors	The transaction should have been entered into to deprive a person's access to assets he is entitled to make a claim against.[293]	
Extortionate Credit Transactions	Limited to transactions where the terms of the transaction grossly contravene the ordinary principles of fair dealing.[294]	Limited to transactions where the terms of such transactions are unconscionable under the principles of law relating to contracts.[295]

Apart from navigating the statutory puzzle, vulnerable transactions should have been entered into within a "relevant time," else they cannot be avoided. There is a look-back period calculated from the date on which the insolvency proceedings are initiated. Transactions which were entered into before the look-back period are not within the scope of avoidance powers. The following table illustrates the timelines which determine whether or not a vulnerable transaction is avoidable.

[290] Section 238(5)(a), Insolvency Act, 1986.
[291] Section 43(3)(a), 45 Insolvency and Bankruptcy Code, 2016.
[292] Section 239(5), Insolvency Act, 1986.
[293] Section 49(1), Insolvency and Bankruptcy Code, 2016; Section 423(3)(a), Insolvency Act, 1986.
[294] Section 244(3)(b), Insolvency Act, 1986.
[295] Regulation 11, Insolvency and Bankruptcy Board of India (Liquidation Process) Resolutions, 2016.

Type of Transaction	Relevant Time under Insolvency Act, 1986	Relevant Time under IBC, 2016
Undervalued Transactions	2 years[296]	2 years[297]
Preferential Transactions	2 years[298]	2 years[299]
Extortionate Credit Transactions	3 years[300]	2 years[301]
Transactions defrauding creditors	The action can be brought at any time, regardless of debtor's insolvency.[302]	2 years[303]

These tables highlight the time limits and the myriad exceptions which form an integral component of the avoidance powers. The avoidance powers are very narrow in their scope and assume applicability only when a set of conditions are fulfilled and the alleged transactions have been entered into within a specific period of time. On the other hand, as discussed in Part 2, the power enshrined within Section 365 is very far-reaching and is not marred by specific timelines.

Further, the purpose of avoidance powers in the UK and Indian regimes is very different form that of Section 365 of the American Bankruptcy Code. The avoidance powers are set out to avoid two sets of transactions. Firstly, transactions where the bankrupt debtor received a lower consideration, for example, undervalued transactions. Secondly, transactions by virtue of which a particular creditor is put in a comparatively better position by the debtor, for example, preferential transactions.[304] While discussing regulation of vulnerable transactions, the Bankruptcy Reform Committee of India noted, "*These are transactions that fall within the category of wrongful or fraudulent trading by the entity, or unauthorised use of capital by the*

[296] Section 240(1)(a), Insolvency Act, 1986
[297] Section 46(1)(ii), Insolvency and Bankruptcy Code, 2016.
[298] Section 240(1)(a), Insolvency Act, 1986
[299] Section 43(4)(b), Insolvency and Bankruptcy Code, 2016.
[300] Section 244(2), Insolvency Act, 1986.
[301] Section 50(1), Insolvency and Bankruptcy Code, 2016.
[302] VULNERABLE TRANSACTIONS IN CORPORATE INSOLVENCY, *supra* note 274 at 95.
[303] Section 49 r/w 45(2) r/w 46(1)(ii), Insolvency and Bankruptcy Code, 2016.
[304] Gurrea-Martinez, *supra* note 273 at 715–719.

management."[305] The Committee divided the scope of avoidable transactions into fraudulent transfers and fraudulently preferring a specific creditor or class of creditors.[306]

Similarly, the English Law intends to upset transactions "*entered into with the deliberate intention of giving a particular creditor an unfair advantage over others.*"[307] In 2013, the UK Supreme Court opined that the underlying policy of avoiding vulnerable transactions is "*to protect the general body of creditors against a diminution of the assets by a transaction which confers an unfair or improper advantage on the other party.*"[308]

Therefore, we may conclude that the avoidance powers have not been legislated to review and reject commercial obligations resulting from fair and equitable business decisions. The avoidance powers seek to regulate the unfair and fraudulent conduct of the corporate management of the now bankrupt debtor. Hence, owing to the statutory design and the legislative intent, the avoidance powers incorporated in IBC, 2016 and the Insolvency Act, 1986 cannot be comparable to rejection of executory contracts within Section 365 of the American Bankruptcy Code.

5. Lessons for Insolvency and Bankruptcy Code, 2016

The power to reject pre-petition executory contracts is crucial to the American Bankruptcy jurisprudence[309] for two reasons. Primarily, the ability to reject onerous contracts enables the bankrupt debtor to reduce prospective liabilities, therefore increasing the pool of asset available for distribution to the creditors.[310] Secondly, rejection reduces the counter-party's claim to a general unsecured claim, enabling the distribution of the pain felt by the bankrupt debtor amongst its creditors.[311]

5.1. Examining the need for amendment

Comparing the American Bankruptcy Code to the Indian and English Insolvency law reveals a curious deficiency: The Insolvency Act, 1986 and IBC, 2016 do not provide for interference in

[305] BANKRUPTCY LAW REFORMS COMMITTEE, *supra* note 177 at 101–103.
[306] *Id.* at 5.5.7.
[307] A REVISED FRAMEWORK FOR INSOLVENCY LAW: PRESENTED TO THE PARLIAMENT BY THE SECRETARY OF STATE FOR TRADE AND INDUSTRY, 62 (Department of Trade and Industry ed., 1984); as cited in: Anderson, *supra* note 286 at 13–15.
[308] Rubin v. Eurofinance SA, [2012] UKSC 46, 95 (2012).
[309] Roger M Whelan, *An Explanation of, and Guide to, Business Reorganizations under Chapter 11 of the U.S. Bankruptcy Code*, 6 *in* CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS 430, 431 (1997).
[310] Meadows, *supra* note 22.
[311] Jason J. Kilborn, *Technology and Regulatory Black Holes: Issues in Protecting IP Rights in Insolvency for Both Licensors and Licensees*, 18 QUT LAW REV. 290, 293 (2018).

pre-petition contractual arrangements. In this section, the authors address the viability of amending the Indian insolvency regime through IBC, 2016, to incorporate a power similar to Section 365 of the American Bankruptcy Code.

As explained in Part 4, unlike Chapter 11 of the American Bankruptcy Code, IBC 2016 does not incorporate a Debtor-in-possession financing mode.[312] During CIRP, the IRP/RP maintain the commercial affairs of the Corporate Debtor in close coordination with the CoC. The CoC approves a resolution plan which reorganises the corporate debtor's debt structure.[313] However, regardless of the business model followed by the two insolvency regimes, both regimes are geared towards maximising the net value of the debtor's assets.[314] Rejection of onerous contractual obligations in the manner espoused by Section 365 can help achieve this objective.

Within the American regime, the rejection of an onerous IP licensing agreement enables the bankrupt licensor to reduce its prospective liabilities. Such reduction can, in turn, enhance the net value of the underlying IP asset. The JJ Irani Committee report, empowered by the Ministry of Corporate Affairs, Government of India, explicitly aligned with this position while underlining the importance of interfering with pre-petition contracts in 2005:[315]

> *"There should be enabling provisions to interfere with the contractual obligations which are not fulfilled completely. Such interference or overriding powers would assist in achieving the objectives of the insolvency process. The power is necessary to facilitate taking appropriate business and other decisions including those directed at containing rise in liabilities and enhancing value of assets."*

Surprisingly, these recommendations were never acted upon, even when the Bankruptcy Law Reforms Committee prepared a draft of IBC, 2016.[316]

The '*Principles of Effective Insolvency*' published by the World Bank in 2016 explicitly noted that the ability to interfere with the performance of a contract, where both parties have impending obligations, is necessary to achieve the objectives of the insolvency proceedings[317].

---

[312] A GLOBAL VIEW OF BUSINESS INSOLVENCY SYSTEMS, *supra* note 17 at 76.
[313] Section 30, Insolvency and Bankruptcy Code, 2016; SINGH AND SHRIRAM, *supra* note 286 at 145–150.
[314] For American Law see: Robert Bliss & George Kaufman, *A Comparison of US. corporate and bank insolvency resolution*, ECON. PERSPECT. 44–55, 47 (2006); For Indian Law see: BANKRUPTCY LAW REFORMS COMMITTEE, *supra* note 177.
[305] IRANI, *supra* note 222 at 13.5.
[316] The BLRC in its report identified the requirement of regulating 'Treatment of contracts' and 'Treatment of onerous property' while discussing insolvency process for individuals. Although, similar concerns were not highlighted for corporate debtors. See: BANKRUPTCY LAW REFORMS COMMITTEE, *supra* note 177 at 6.5.7.
[317] PRINCIPLES OF EFFECTIVE INSOLVENCY AND CREDITOR/DEBTOR REGIMES, *supra* note 282 at 24.

According to the report, a bankrupt debtor should not be obligated to perform contractual obligations that constitute a net obligation for the estate and can potentially result in accrual of even more liabilities. [318]

Jurisdictions across the globe have identified the importance of regulating pre-petition onerous contractual arrangements. Apart from the American Bankruptcy Code, multiple other jurisdictions provide for the rejection of onerous contractual obligations during insolvency proceedings.[319] Canada recently amended their insolvency regime to incorporate protections to IP licensees similar to the protection pioneered by the IPBPA in 1988.[320] The German Legislature, on the other hand, has recognised the importance of this issue. However, substantial amendments to the German insolvency regime have remained unsuccessful.[321]

Therefore, if a power analogous to Section 365 is drafted within IBC, it can potentially reduce the prospective liabilities of a bankrupt debtor and enhance the value of the debtor's underlying IP assets. Such a provision would prove even more critical in cases where the business model of the corporate debtor heavily relies on licensing of intellectual property or in cases where the financial hardships of the corporate debtor are the result of onerous IP licensing transactions. While this position has seen acceptance,[322] the approach taken by this study is markedly different.

5.2. Proposal to amend IBC, 2016

Having addressed the instrumentality of the power to interfere with pre-petition contractual arrangements, this section comments on the necessary elements of the amendment proposed to IBC, 2016. The present research was limited to addressing the treatment afforded to intellectual property licenses during bankruptcy. Of the numerous exceptions and carve-outs that form part

---

[318] *Id.* at 24.

[319] Canada: Section 65.11, Bankruptcy and Insolvency Act, 1985, see: Alfonso Nocilla, 'National Report for Canada' in Jason Chuah and Eugenio Vaccari (eds), *Executory contracts in insolvency law: a global guide* (Edward Elgar Publishing 2019) 601–616; Switzerland: Article 211 para. 2 SchKG, See: Patrick Keinert, *National Report for Switzerland*, *in* EXECUTORY CONTRACTS IN INSOLVENCY LAW: A GLOBAL GUIDE , 419–435 (Jason Chuah & Eugenio Vaccari eds., 2019).

[320] Bill C-86 Budget Implementation Act, 2018; Also see: Mecek Alan, *Intellectual Property Licenses in Bankruptcy Scenarios*, SLAW, 2019, https://www.slaw.ca/2019/07/17/intellectual-property-licenses-in-bankruptcy-scenarios/ (last visited Apr 15, 2021).

[321] See: Michael A Fammler & Christoph Krieger, *The Fate of a Trademark License in the Case of Bankruptcy of the Licensor – The U.S. Supreme Court Decision Mission Product Holdings Inc. v Tempnology, LLC in the Light of German Law & Practice*, 69 GRUR INT. 35–38, 36 (2020); Also see: Derek I. Hunter, *Nobody Likes Rejection: Protecting IP Licenses in Cross-Border Insolvency Notes*, 47 GEORGET. J. INT. LAW 1167–1196, 1183, 1184 (2015).

[322] Indrajit Dube, *National Report for India*, *in* EXECUTORY CONTRACTS IN INSOLVENCY LAW: A GLOBAL GUIDE , 644 (Jason Chuah & Eugenio Vaccari eds., 2019).

of Section 365, the authors have limited their analysis to Section 365(n). Therefore, given the scope of the research, the suggestions made herein are limited to the treatment of IP licenses during CIRP. The authors submit that a provision analogous to Section 365 should be legislated within IBC, 2016.

Executoriness Requirement: Interference should be warranted only when some prospective obligations remain on the part of the licensor. If the licensor does not owe any prospective obligations, he cannot accrue any liabilities, in which case any interference would be unwarranted, as it would not benefit the corporate debtor. In doing so, the Legislature should acknowledge the controversy surrounding the executory requirement[323] and abandon the executoriness analysis favouring a functional analysis. If rejection of a licensing agreement does not reduce the prospective obligations of the licensor, such rejection should not be allowed. Such an analysis would be in tune with the recommendations of Prof. Westbrook.[324]

General Unsecured Damages Claim: To ensure the licensee, post rejection, shares corporate debtor's misfortune, the licensee should be entitled to pre-petition general unsecured damages claim only. A post-petition claim would accrue a preferential treatment favouring the licensee as opposed to other creditors and should therefore not be provided. Similarly, providing a remedy of specific performance is also unwarranted. A licensee who can require specific performance from the licensor shall essentially recover a 100 payment over its claim. Such a treatment would mean that the licensee has assumed a preferential treatment over other creditors who would recover only a fraction of their original claim.[325] The UNCITRAL has also validated this position in its '*Legislative Guide on Insolvency Law.*'[326]

Although, in order to admit the licensee's claim, the claim approval process during CIRP has to be amended. Presently, a creditor has to submit his claims before the 90th day of the insolvency commencement date.[327] Therefore, in order to ensure that the licensee's claim is admitted, the Legislature can either stipulate that the Resolution Professional has to exercise its powers within 90 days or a suitable amendment should be made in order to admit the licensee's claim past 90 days.

[323] See: Pottow, *supra* note 54.
[324] Westbrook, *supra* note 24.
[325] For details in relation to this position see: A GLOBAL VIEW OF BUSINESS INSOLVENCY SYSTEMS, *supra* note 17 at 94.
[326] LEGISLATIVE GUIDE ON INSOLVENCY LAW, *supra* note 209 at 128.
[327] Regulation 12(2), the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulation, 2016.

The timelines for submission of claim posit a unique problem: What happens if the Resolution Professional decides to breach an intellectual property licensing agreement after 90 days. In order to remedy this situation, the Legislature can take either of two legislative routes. Either, the Resolution Professional's power to breach the licensing transaction should be limited to 90 days from the commencement of the insolvency, or a suitable amendment should be made to provide that an IP licensee whose licensing agreement has been rejected post 90 days shall be allowed to submit a claim thereafter.

Court Approval Requirement: Similar to the American Bankruptcy Code, a court approval requirement should be incorporated in the provision. Where necessary, the Court should require the corporate debtor to establish that the rejection would benefit the bankrupt debtor. When the rejection would cause disproportionate harm to the licensee, as was the case in *In Re Petur,*[328] the Court should be allowed to veto the decision to reject the licensing agreement. Although, it is essential to acknowledge that providing such overwhelming discretionary authority to bankruptcy courts can result in inconsistent results. In order to address this possible inconsistency, the Bankruptcy Courts should be cautioned that the power to veto the business judgement to reject a licensing arrangement should be only in exceptional circumstances. Further, once the amendment is brought into force, the appeallate review of the bankruptcy would eventually ensure that some tests are developed that circumscribe the bankruptcy court's power to veto rejection decisions.

Election to breach: Similar to Section 365, a resolution professional should be entitled to assume and assign an intellectual property license. Unlike Section 365, IBC, 2016 should use the term '*election to breach*' instead of using the term '*rejection.*' The United States National Bankruptcy Review Commission's Report had made a similar suggestion about Section 365 in 1997.[329] The reason for avoiding the term rejection is that the term does not have an obvious contract law counterpart. The term, therefore, becomes difficult to interpret and yields wasteful litigation.[330]

Breach not recession/ termination: Similar to Section 365(n), the Legislature should clarify that the power to interfere with contractual obligations should not be interpreted as rejection/ termination of the license. Interference with a pre-petition agreement should be limited to affect

[328] IN RE PETUR U.S.A. INSTRUMENTS CO., *supra* note 61.
[329] Proposal 2.4.1 of the Report, See: David G. Epstein, *National Bankruptcy Review Commission's Section 365 Recommendations and the Larger Conceptual Issues*, 102 DICKINSON LAW REV. 679, 680 (1998).
[330] Andrew, *supra* note 6.

the terms of the licensor's liabilities and obligations within a license. Such interference should not be interpreted as a unilateral power to rescind a perfectly valid contractual agreement. The onus to terminate the licensing agreement, post rejection, should be on the licensee and not be retained by the licensor.

The reasoning for this position draws from the treatment which would be afforded to a contractual relationship outside bankruptcy. Had insolvency not intervened, the conclusion of a contractual relationship would be determined by reference to the explicit contractual covenants included in the licensing agreement. In the absence of such a covenant, the relationship would have terminated as per the principles of contract law. Under Indian Contract Law, on breach of the contract by the licensor, the licensee would have an option to either put an end to the contract or elect to continue the licensing agreement.[331] A resolution professional who takes charge of the corporate debtor's assets cannot assume a title better than the title enjoyed by the corporate debtor himself.[332] Therefore, it is apposite that insolvency rules proffer an approach similar to the general principles of contract law.

6. Conclusion

The power to interfere with and regulate contractual agreements during an insolvency proceeding fosters a radical departure from the principles of contract law. It is for this reason that the power has been remarked as being *extraordinary and almost superhuman.*[333] When analysed with reference to the Intellectual Property licensing regime, a curious deficiency is highlighted: While the American Bankruptcy Code has incorporated and regulated this power since 1938, the IBC 2016 does not incorporate this power.

Regardless of its interaction with the principles of contract law, the power to regulate and interfere with pre-petition contractual agreements is an essential iteration of the principles of insolvency law. Obligating a financially distressed debtor to perform onerous contractual obligations can potentially result in the acquisition of further liabilities and depletion of the insolvent estate. Any depletion of the insolvent estate would reduce the value of assets available for distribution amongst the creditors. Compelling the insolvent debtor to continue discharging onerous and burdensome contractual obligations is synonymous with giving one of the creditors, i.e. the counter-party to the contract, an unfair preference over the other creditors.

---

[331] Section 39, Indian Contract Act, 1872; 1 CHITTY ON CONTRACTS, Chapter 24 (Hugh Beale ed., 32 ed. 2018).
[332] For a detailed explanation of this argument see: Andrew, *supra* note 6.
[333] Lubben, *supra* note 32 at 61.

Further, Intellectual Property licenses can exponentially increase the rate of depletion of an insolvent debtor's estate. Intellectual property assets can be a significant revenue-generating resource for a company. If onerous and burdensome contractual obligations tie down such a resource, it would impede possible revenue streams for the company and potentially denude the asset's value.

Therefore, to avoid the accrual of prospective liabilities, maintain the underlying IP asset value, and avoid giving an unfair preference to a creditor, the IBC should legislate a power similar to the one incorporated in the American Bankruptcy Code vide Section 365. Although, in doing so, the Indian Parliament should remain conscious of the lessons learned by the American Bankruptcy jurisprudence. That is, the licensee should share the burden of the licensor's insolvency with other creditors of the business. Any interference by the licensor should be in the best interest of the insolvent estate and should be approved by a bankruptcy court. Most importantly, the licensor should not be empowered to rescind an intellectual property license unilaterally. The terms of the interference should be limited to the prospective obligations of the insolvent licensor.