Executory Contracts Defined

- The Term "Executory Contract" Is Not Defined in the Bankruptcy Code
- Courts Generally Use the Countryman Definition: Executory Contract Is a Contract Where Each Side Has Material Remaining Obligations Such That the Default by Either Would Excuse Performance by the Other
- Generally intellectual property licenses are executory contracts
  - Licenses of intellectual property are not assignments of the property interest in such intellectual property, but rather an agreement not to sue the licensee for using the intellectual property(provided that the licensee complies with the terms of the license)
  - The agreement not to sue is sufficient to make such licenses executory under the Bankruptcy Code – See, e.g., In re Access Beyond Technologies, Inc., 237 B.R. 32, 43 (Bankr. D. Del. 1999); see also Everex Systems, Inc. v. Cadtrak Corp. (In re CFLC Inc.), 89 F.3d 673 (9th Cir. 1996); In re Golden Books Family Entm't, Inc., 269 B.R. 311 (Bankr. D. Del. 2001)

Exclusive And Non-Exclusive Licenses

- Generally, licenses of Intellectual Property may be exclusive or non-exclusive
- An exclusive license as the name implies provides the licensee with the right to exclude all others from using the copyright or the patented product or process within the field covered by the license agreement
- A non-exclusive license in contrast gives the licensee the right to use the intellectual property

Exclusive And Non-Exclusive Licenses

- As stated by the United States District Court in Golden Books, "'a nonexclusive licensee . . . has only a personal and not a property interest in the [intellectual property],' which 'cannot be assigned unless the [intellectual property] owner authorizes the assignment.'" In re Golden Books Family Entm't, Inc., 269 B.R. 311, 314 (Bankr. D. Del. 2001) (quoting In re Patient Educ. Media, 210 B.R. 237, 242-43 (Bankr. S.D.N.Y. 1997)).
- In contrast, "an exclusive licensee does acquire property rights and 'may freely transfer his rights, and moreover, the licensor cannot transfer the same rights to anyone else.'" Id.
- The United States District Court for the District of Delaware (sitting as a bankruptcy court) determined in Golden Books that where the license gave a debtor the exclusive right to certain video rights of a children's literary character (Madeline), albeit for a limited time and in a proscribed territory (the United States and its territories and Canada), the license would be deemed exclusive.
- In a related case, the same court determined that an oral license agreement was by its very nature and by applicable copyright law a non-exclusive license. See In re Golden Books Family Entm't, Inc., 269 B.R. 300, 310 (Bankr. D. Del. 2001).

Assumption Or Assumption And Assignment Of Executory Contracts

- Bankruptcy Code section 365(f) (2) provides:

  The trustee may assign an executory contract or unexpired lease of the debtor only if— (A) the trustee assumes such contract or lease in accordance with the provisions of this section; and (B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.

- If challenged in its efforts to assume, or to assume and assign an executory contract, a debtor must establish that (i) any defaults under the executory contract (other than those defaults specified in Bankruptcy Code section 365(b)(2)) have been or will promptly be cured, and (ii) the non-debtor party to the executory contract has been provided "adequate assurance of future performance." 11 U.S.C. § 365(b).
  - In the non-IP context, this generally sets of a series of negotiations concerning the proper cure amount and the proper form and amount of adequate assurance.
  - Adequate assurance is critical because upon assumption and assignment, the debtor is no longer liable under the terms of the executory contract. See 11 U.S.C. § 365(k).

Assumption Or Assumption And Assignment Of Executory Contracts

- Bankruptcy Code section 365(a) permits a debtor to assume, or assume and assign, executory contracts including intellectual property licenses – See 11 U.S.C. § 365(a)
- Similarly, Bankruptcy Code section 365(f) provides:

  (1) Except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection. . . .

  (3) Notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law that terminates or modifies, or permits a party other than the debtor to terminate or modify, such contract or lease or a right or obligation under such contract or lease on account of an assignment of such contract or lease, such contract, lease, right, or obligation may not be terminated or modified under such provision because of the assumption or assignment of such contract or lease by the trustee."

Bankruptcy Code Section 365(c) and Intellectual Property Licenses

- Exclusive intellectual property licenses are generally considered freely transferable under applicable law – See In re Golden Books Fam. Entm't, 269 B.R. 311, 314 (Bankr. D. Del. 2001); but see Gardner v. Nike Inc., 279 F.2d 774 (9th Cir. 2002) (could not transfer exclusive copyright license with consent of licensor); In re Hernandez, 285 B.R. 435 (Bankr. D. Ariz. 2002) (refusing to permit licensee to assume exclusive patent license irrespective of intent to assign such license)
- However, if the executory contract is a non-exclusive license of intellectual property, then the license agreement must contain specific consent to the assignment (and in some jurisdictions, as discussed, to the initial assumption) or the debtor must obtain such consent before any assumption (potentially, depending on jurisdiction) or assumption and assignment of such license – See In re Golden Books Fam. Entm't, 269 B.R. 300, 311 (Bankr. D. Del. 2001); see also Verson Corp. v. Verson International Group PLC, 899 F. Supp. 358, 363 (N.D. Ill. 1995) (cannot assign non-exclusive patent license unless consent to such assignment is in the license agreement)

Assumption of Intellectual Property Licenses – Circuit Split

- Although Courts generally agree that exclusive licenses of intellectual property can be assumed and assigned, while non-exclusive licenses require consent before any such assumption and assignment, a split in the Circuits continues regarding whether consent is required for a debtor licensee to assume (but not assign) a non-exclusive license of intellectual property
- Hypothetical Test – looks to whether, irrespective of the debtor's actual intent, the license could be assumed and assigned
  - Adopted (in order of adoption) by Third, Eleventh, Ninth, and Fourth Circuits
  - See In re West Elecs. Inc., 852 F.2d 79 (3d Cir. 1988); City of Jamestown v. James Cable Partners LP (In re James Cable Partners LP), 27 F.3d 534 (11th Cir. 1994); Perlman v. Catapult Entm't Inc. (In re Catapult Entm't Inc.), 165 F.3d 747 (9th Cir. 1999); RCI Tech. Corp. v. Sunterra (In re Sunterra Corp.), 361 F.3d 257 (4th Cir. 2004)
- Actual Test – looks to intent of debtor; if there is no intent to assign, then assumption is permissible notwithstanding any applicable law prohibiting assignment
  - Adopted by First and Fifth Circuits
  - See Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489 (1st Cir. 1997); Bonneville Power Admin. v. Mirant Corp. (In re Mirant Corp.), 440 F.3d 238 (5th Cir. 2006).
  - See also In re Adelphia Commc'ns Corp., 359 B.R. 65, 72 (Bankr. S.D.N.Y. 2007); In re Footstar, inc., 323 B.R. 566, 573-74 (Bankr. S.D.N.Y. 2005). Cases focus on the use of the word "trustee" in Bankruptcy Code section 365(c) and the statutory assignment that occurs when a "trustee" is appointed as opposed to when a debtor remains in possession of its business

Assumption of Intellectual Property Licenses – Circuit Split

- The argument for the hypothetical test hinges on the disjunctive "or" in Bankruptcy Code section 365(c), requiring courts to ignore both the reference in section 365(c) to "the debtor or the debtor in possession" and Bankruptcy Code section 365(f)(1) entirely
- In Sunterra, the Fourth Circuit reversed the bankruptcy court and compelled a debtor to return valuable intellectual property that the debtor had improved at considerable expense
- In so ruling, the Court stated " only applicable anti-assignment law predicated on the rationale that the identity of the contracting party is material to the agreement is resuscitated by [Bankruptcy Code section] . . . 365(c)(1)" Sunterra, 361 F.3d at 267.
  - In other words, the Court's decision rests on the notion that the debtor in possession (to which the contract is being assigned) is an entity that is in some way different from the pre-bankruptcy debtor
  - But see Bildisco, 465 U.S. 513, 528 (1984) ("For our purposes, it is sensible to view the debtor-in-possession as the same 'entity' which [sic] existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have employed absent the bankruptcy filing.")

Ipso Facto Clauses

- Ipso facto/anti-assignment clauses will generally not be enforced
- Indeed, Bankruptcy Code section 365(e)(1) states:

  "Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—

  (A) the insolvency or financial condition of the debtor at any time before the closing of the case;

  (B) the commencement of a case under this title; or

  (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement."
- Again, there is an exception applicable to intellectual property contracts:
  - Specifically, Bankruptcy Code section 365(e)(2) provides that "[p]aragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if— (A) (i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (ii) such party does not consent to such assumption or assignment . . ."

Rejection Of Executory Contracts

- Courts tend to defer to debtors with respect to decisions to reject executory contracts
- Standard for such rejection is generally whether the rejection is in the best interests of the debtors and their estates
- Moreover, in evaluating the debtors' decision to reject, courts will generally apply the deferential "business judgment" standard – See In re Market Square Inn, Inc., 978 F.2d 116 (3d Cir. 1992); Sharon Steel Corp. v. National Fuel Distrib. Corp., 872 F.2d 36 (3d Cir. 1989); In re HQ Global Holdings, Inc., 290 B.R. 507 (Bankr. D. Del. 2003)
  - Some courts have even stated that absent extraordinary circumstances, a debtor's request to assume or reject an executory contract, "should be granted as a matter of course." Summit Land Co. v. Allen (In re Summit Land Co.), 13 B.R. 310, 315 (Bankr. D. Utah 1981)

Bankruptcy Code Section 365(n)

- License Rejection – Bankruptcy Code section 365(n)
- If a debtor-licensor rejects the IP license the licensee can:
  - Treat the license as terminated or
  - Continue to use the licensed property for the duration of the original contract term and any contractual renewal periods
- Other protections include the right to receive continued performance from the debtor, without interference, and the right to receive the intellectual property itself or its embodiment

Trademarks

- The definition of "Intellectual Property" does not include trademarks
  - This has led to a split in the treatment of trademarks and importantly trademark licenses in bankruptcy
  - The majority of courts do not treat trademarks as intellectual property – See, e.g., In re HQ Global Holdings, Inc., 290 B.R. 507 (Bankr. D. Del. 2003)
  - Other courts that have determined that notwithstanding the omission, trademarks are in the category of "intellectual property" that Congress intended to protect even in bankruptcy proceedings – See e.g. N.C.P. Marketing Group Inc. v. Blanks (In re N.C.P. Marketing Group Inc.), 337 B.R. 230 (D. Nev. 2005)
- Why does this matter?
  - The consequences of property not being "intellectual property" can be quite dramatic in bankruptcy
  - For example, in HQ Global, Judge Walrath decided that because a license of a trademark was not a license of intellectual property, licensees of a debtor licensor could not continue to use such trademark after rejection of the trademark license by the debtor licensor
  - In other words, if the property is not intellectual property, then rejection of the license to use such property gives the licensee a claim for rejection damages
  - The non-debtor licensee does not have the protections afforded by Bankruptcy Code section 365(n).

Bankruptcy Code Section 365(n) Does Not Apply

- Where the debtor is a licensee under a license agreement, the debtor will generally be permitted to reject the license agreement if such rejection is appropriate in the business judgment of the debtor
- Moreover, where the debtor is a licensee, Bankruptcy Code section 365(n) does not apply
- Importantly, Bankruptcy Code section 365(n) provides certain critical protections for non-debtor licensees of intellectual property, including –
  - Allowing a non-debtor licensee to retain its rights under the license (11 U.S.C. § 365(n)(1)(B)); and
  - Pending a decision to reject the license agreement requiring the debtor "to perform such contract." (11 U.S.C. § 365(n)(4)(A)(i))

Consequences Of Rejection Of Intellectual Property License

- If the debtor is a licensee, Bankruptcy Code section 365(n) does not apply and a non-debtor party to a rejected IP license agreement is left with a general unsecured claim for damages
- Specifically, Bankruptcy Code section 365(g) provides –

  . . . the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—

  (1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition; or

  (2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title— (A) if before such rejection the case has not been converted under section 1112, 1208, or 1307 of this title, at the time of such rejection; or (B) if before such rejection the case has been converted under section 1112, 1208, or 1307 of this title— (i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or (ii) at the time of such rejection, if such contract or lease was assumed after such conversion.

Strategies for Debtors

- The most pressing IP issue for debtors is the ability to keep their valuable intellectual property rights
  - Intellectual property licenses can be drafted pre-bankruptcy to provide for consent to the assumption (in the event of bankruptcy) of the license by the debtor and the assignment of such license – See Sunterra, 361 F.2d at 271 (in which the Court determines that no consent existed where licensor consented to assignment of license to successor in interest to substantially all of the debtor's assets, but not to the assumption of the license by the debtor itself)
  - If there is a choice of venue and the IP rights are going to be critical, consider filing in a venue where the actual test will be applied
  - Set up bankruptcy remote entity to hold IP before filing if otherwise permitted to assign IP license.
  - Consider allowing IP license agreements to ride through the bankruptcy case
    - See, e.g., In re Hernandez, 287 B.R. 795 (Bankr. D. Ariz. 2002).
    - Tension between addressing the license in plan or otherwise and need to limit extent to which contract is addressed in bankruptcy case to ride-through
    - May want determination that cured defaults or claims under license not impaired
    - Cannot use ride-through if need to assume and assign to third party as part of restructuring
    - Concern that broad definition of "claim" include executory contract – if not addressed in plan, then may be extinguished or discharged

Strategies for Debtors

- Other issues that may arise:
  - Section 363(m) – moot out any appeal of the transfer of intellectual property by requesting approval of the assumption and assignment in connection with a sale of substantially all of the debtor's assets and getting the purchaser to close over the appeal and quickly.
    - See Regal Ware, Inc. v. Global Home Products, LLC, 369 B.R. 770 (D. Del. 2007).
  - Importantly, if IP is an issue, identify the issue early, get your contracts and get your IP counsel up to speed.
    - Infringement issues will crop up at the most inopportune times.
    - If not resolved early, e.g., in context of sale, open IP issues could significantly decrease value of debtor's assets.
    - Chill bidding if buying a lawsuit, e.g., pending dispute over use of name.
  - Trade Secrets
    - Important to preserve - 11 U.S.C. § 107 provides mechanism.
    - Close sale hearing to protect trade secrets – See In re Global Crossing Ltd., 295 B.R. 720 (Bankr. S.D.N.Y. 2005).
    - Seal customer lists re: creditors – See, e.g., In re Nunn, 49 B.R. 963 (Bankr. E.D. Va. 1985).
    - Open question – are trade secret agreements assumable, or are they akin to personal services contracts?

Strategies For Non-Debtors

- Notwithstanding the protections afforded debtors, non-debtor licensors are not without defenses and remedies
- Draft IP licenses with bankruptcy in mind
  - Attention to consents
  - Attention to defaults and termination
  - Security interest in IP as part of license
  - Place source code in escrow
  - Foreclosure prior to bankruptcy
- Motion to compel assumption or rejection –
  - 11 U.S.C. § 365(d)(2) gives debtors until confirmation of plan to assume or reject executory contracts
  - Court may determine "reasonable amount of time" for assumption/rejection
    - See, e.g., The Sumitomo Trust & Banking Co. v. Holly's Inc. (In re Holly's Inc.), 140 B.R. 643, 682.
  - See also In re Physician Health Corp., 262 B.R. 290, 292 (Bankr. D. Del. 2001) ("permitting the debtor to make its decision as late as the plan confirmation date enables the debtor to carefully evaluate the possible benefits and burdens of an [executory contract.]")

Strategies For Non-Debtors

- Motion for relief from stay
  - See In re El Paso Refinery, L.P., 220 B.R. 37, 44 (Bankr. W.D. Tex. 1998) (lift stay is not proper procedure and contract party must instead move to compel assumption or rejection)
  - But see Wellington Vision v. Pearle Vision, Inc., 364 B.R. 129 (Bankr. S.D. Fla. 2007) (granting lift stay to terminate franchise agreement where franchise agreement encompassed non-exclusive trademark license)
  - Movant must demonstrate that cause exists to support stay relief. See 11 U.S.C. § 362(d)(1); see also In re Stranahan Gear Co., 67 B.R. 834 (Bankr. E.D. Pa. 1986)
  - Movant must also show that it will suffer harm outweighing harm suffered by debtors as a result of lifting the stay to allow contract termination. See W.R. Grace & Co., 2007 WL 1129170 (Bankr. D. Del. Apr. 13, 2007)

Caution
As of: Feb 07, 2012

IN RE: ACCESS BEYOND TECHNOLOGIES, INC., n/k/a HAYES CORPORATION (HONG KONG) LIMITED, et al., Debtors.

Chapter 11, Case Nos. 98-2276 (MFW), 98-2277 (MFW), 98-2278 (MFW), 98-2279 (MFW), 98-2280 (MFW), 98-2281 (MFW) Jointly Administered

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE

237 B.R. 32; 1999 Bankr. LEXIS 878; 34 Bankr. Ct. Dec. 919

July 22, 1999, Decided

DISPOSITION: [**1] Motion of the Debtors for approval of a sale to Xircom Corporation ("Xircom") of certain assets (known as the "EZJack related assets") including the rights under a patent cross license agreement between the Debtors and Megahertz Corporation dated December 31, 1990 ("the License Agreement") DENIED.

CASE SUMMARY:

PROCEDURAL POSTURE: Debtors moved for approval of a sale to a corporation of certain assets, including the rights under a patent cross license agreement between the debtors and another corporation.

OVERVIEW: The debtors were subsidiaries of a microcomputer corporation. The corporation filed for bankruptcy. The debtors determined that the corporation's reorganization plan was not feasible and decided to liquidate their assets. During an auction, a computer corporation was the highest bidder for a portion of the debtor's assets, which included a license agreement. Debtors moved the court to approve the sale. The court held that as subsidiaries of the bankrupt corporation, the debtors had no independent rights under the license agreement. The court further held that the company that had acquired the bankrupt corporation owned the license agreement. The court concluded that the license agreement was an executory contract that was not assignable without the owner's consent. Since the owner did not consent, the debtors could not assume or assign the license agreement. The court also determined that the debtors could not sell the license agreement pursuant to *11 U.S.C.S. § 363*. Since the agreement was not assumable, it could not be sold. Therefore, the debtors' motion was denied.

OUTCOME: The debtors' motion for approval of a sale of certain assets, including a license agreement, was denied. The court found that when the debtors' parent corporation filed for bankruptcy and was acquired by another corporation, the debtors did not retain their rights with respect to the license agreement. Therefore, the debtors could not sell the agreement.

LexisNexis(R) Headnotes

Antitrust & Trade Law > Intellectual Property > Ownership & Transfer of Rights > Assignments
Patent Law > Infringement Actions > Exclusive Rights > Manufacture, Sale & Use
Patent Law > Ownership > Patents as Property
[HN1] A patent holder has the exclusive right to exclude all other persons from practicing the patented inventions

during the effective period of the patent. *35 U.S.C.S. § 154.*

Bankruptcy Law > Estate Property > Content
Contracts Law > Types of Contracts > Executory Contracts
[HN2] A bankruptcy estate is created upon the filing of a bankruptcy petition, which includes all the debtor's legal and equitable interests in property.

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Collateral Estoppel
[HN3] Before a party will be estopped from relitigating an issue, the issue sought to be precluded must be the same as the one involved in the prior action, the issue must have been actually litigated, the issue must have been determined by a valid and final judgment, and the determination must have been essential to the prior judgment.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > General Overview
Contracts Law > Types of Contracts > Executory Contracts
[HN4] In a bankruptcy proceeding, the time for determining whether a contract is executory is when a bankruptcy petition is filed.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
[HN5] See *11 U.S.C.S. § 365(c)(1).*

Contracts Law > Breach > Material Breach
Contracts Law > Breach > Nonperformance
Contracts Law > Types of Contracts > Executory Contracts
[HN6] A contract is executory only where the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.

Patent Law > Infringement Actions > Exclusive Rights > Manufacture, Sale & Use
Patent Law > Ownership > Conveyances > General Overview
[HN7] An agreement is a sale of the patent rights only if it conveys the whole patent, comprising the exclusive right to make, use, and sell the invention, an undivided share of that exclusive right, or an exclusive right to practice the invention within a specified territory.

Patent Law > Infringement Actions > Exclusive Rights > Manufacture, Sale & Use
Patent Law > Ownership > Conveyances > Assignments
Patent Law > Ownership > Conveyances > Licenses
[HN8] Unless a writing conveys some or all of the right to exclude others from practicing the invention, it will not convey an interest in the patent, but is a license.

Patent Law > Ownership > Conveyances > Assignments
Patent Law > Ownership > Conveyances > Licenses
[HN9] Patent license agreements are personal to the licensee and not assignable unless expressly made so in the agreement.

Contracts Law > Contract Interpretation > General Overview
[HN10] The doctrine of expressio unius est exclusio alterius provides that when certain matters are discussed in a contract, other similar matters not mentioned are intended to be excluded.

Patent Law > Ownership > Conveyances > Assignments
Patent Law > Ownership > Conveyances > Licenses
[HN11] Where the provisions of a patent license are silent on the question of assignability, the license is nontransferable.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Powers
Contracts Law > Debtor & Creditor Relations
Contracts Law > Types of Contracts > Executory Contracts
[HN12] An executory contract does not become an asset of the estate until it is assumed pursuant to *11 U.S.C.S. § 365(a).*

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Powers
Contracts Law > Debtor & Creditor Relations
Contracts Law > Types of Contracts > Executory Contracts

[HN13] In the hypothetical test established by the literal language of *11 U.S.C.S. § 365(c)(1)*, a debtor in possession may not assume an executory contract over the nondebtor's objection if applicable law would bar assignment to a hypothetical third party, even where the debtor in possession has no intention of assigning the contract in question to any such third party.

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Jesse [**2] H. Austin, III, Esquire, Paul Hastings Janofsky & Walker, Atlanta, GA, for NationsCredit Commercial Corp.

John D. McLaughlin, Esquire, Office of U.S. Trustee, Philadelphia, PA.

JUDGES: Mary F. Walrath, United States Bankruptcy Judge.

OPINION BY: Mary F. Walrath

OPINION

[*36] ***OPINION***

[1]

1 This Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to *Federal Rules of Bankruptcy Procedure 7052* and *9014*.

I. *PROCEDURAL BACKGROUND*

This matter is before the Court on the Motion of the Debtors for approval of a sale to Xircom Corporation ("Xircom") of certain assets (known as the "EZJack related assets") including the rights under a patent cross license agreement between the Debtors and Megahertz Corporation dated December 31, 1990 ("the License Agreement"). The Sale Motion is supported by the Official Committee of Unsecured Creditors ("the Committee") and the Debtors' secured lender, NationsCredit Commercial Corporation ("NationsCredit"). 3Com Corporation ("3Com"), which asserts it [**3] is the successor by merger to Megahertz, objected to the sale. For the reasons set forth below, we will deny the Motion.

II. *FACTUAL BACKGROUND*

In November 1994, Hayes Microcomputer Products, Inc. ("Hayes") filed a chapter 11 case in the United States Bankruptcy Court for the Northern District of Georgia. In that first bankruptcy case, Hayes filed a plan of reorganization in which certain minority shareholders were cashed out and the debtor merged with the subsidiaries of the new investors ("the Plan"). The Plan expressly called for the assumption of the License Agreement. Megahertz objected. The Bankruptcy Court overruled the objection and entered two orders. The first order found that the License Agreement was executory and authorized its assumption as part of the Plan. The second order confirmed the plan. Megahertz appealed both orders.

In the interim, one of the Plan investors withdrew from the Plan. Hayes filed a Motion for order in aid of confirmation which called for substituting the investor under the Plan. The Bankruptcy Court [*37] entered the order after finding it was authorized by the Plan and did not constitute a modification of the Plan. The Bankruptcy Court, however, [**4] expressly declined to rule on the effect of the order on the assumption of the License Agreement, since that issue was on appeal. The order in aid of confirmation was also appealed.

The District Court affirmed all three orders. The Eleventh Circuit Court of Appeals, while neither affirming nor reversing the orders, remanded the case, because none of the orders expressly dealt with the assumption of the License Agreement in the context of the Plan, as it currently stood. Before the Bankruptcy Court could decide the issue on remand, however, the Debtors, including Hayes, filed chapter 11 cases in this Court on October 9, 1998.

After attempts to reorganize in their second case, the Debtors determined that reorganization was not feasible and announced a decision, with the consent of NationsCredit and the approval of this Court, to liquidate their assets. On February 12, 1999, the Debtors conducted an auction of their assets. One of the auction lots, Lot 15, consisted of the EZJack related assets and included the License Agreement. Xircom was the highest bidder for Lot 15, offering $ 4 million.

The Debtors accepted the Xircom bid and filed a motion for approval of the sale. Xircom's [**5] bid was conditioned on obtaining a final order authorizing the transfer to it of the License Agreement. 3Com filed a timely objection to the sale to Xircom. Testimony was presented at a hearing held on March 19, 1999, and the parties submitted briefs in support of their positions.

Subsequently, a Chapter 11 trustee was appointed in this case. 3Com filed a motion requesting authority to file a supplemental brief on the issue of whether the appointment of a Chapter 11 trustee had any effect on the sale to Xircom. After hearing, we granted the request for supplemental briefing. The Trustee in its pleading has adopted the arguments presented by the Debtors. [2]

> 2 The Trustee also sought to strike portions of 3Com's supplemental pleading as duplicative or impertinent. While some of the arguments may be duplicative, 3Com's pleading does raise issues unique to the Trustee. The impertinent assertion referred to 3Com's argument that the Trustee cannot assume the License Agreement and convey it through a plan of reorganization or by other means. The Trustee asserts that this issue is not yet before the Court since no plan has been filed. However, the issue of the whether the Trustee can assume the License Agreement, a necessary predicate to any plan of reorganization, is before the Court and is decided below.

[**6] III. *DISCUSSION*

Before addressing 3Com's substantive arguments, we must decide two preliminary matters: 3Com's standing and the Trustee's standing.

A. *3Com's Standing*

The Debtors/Trustee assert as a preliminary matter that 3Com has no standing because the License Agreement was with Megahertz, not 3Com. Evidence was presented by 3Com establishing it as the successor, by a three-step merger and acquisition, to Megahertz. [3] The Debtors/Trustee assert that, except for the first merger, Megahertz did not get the Debtors' consent as expressly required by P 7.3 of the License Agreement.

> 3 Megahertz's parent merged into a subsidiary of Vystar Group, Inc., which changed its name to Megahertz Holdings. (This was with consent of Hayes.) Thereafter, U.S. Robotics Corporation acquired Megahertz Holdings. Later, 3Com acquired U.S. Robotics. Following the U.S. Robotics and 3Com acquisitions, Megahertz Holdings remained a separate legal entity though it changed its name to U.S. Robotics Mobile Communications Corporation. Thereafter, it was merged into 3Com in a series of roll-up mergers.

[**7] To resolve this issue, it is necessary to analyze the language of P 7.3, in conjunction with P 7.4 of the License Agreement. [*38] Those provisions (as amended by the Amendment dated June 23, 1993) state:

> 7.3 Neither this Agreement, nor any licenses or rights hereunder, in whole or in part, granted by Hayes to Licensee [Megahertz], shall be assignable or otherwise transferable without Hayes' prior written consent.
>
> 7.4 Neither party to this Agreement nor any Subsidiary of either party may assign any of the Licensed Patents or Licensee's Patents to any third party without making such assignment subject to the terms and conditions of this Agreement.

(License Agreement at pp. 16 & 22.)

3Com asserts that, as a result of the mergers and acquisitions, it is the owner of the Megahertz patented technology. [4] Paragraph 7.4 of the License Agreement does not bar assignment of the Patents, nor does it require consent of the Debtors before the Patents can be assigned, *unless* the assignment is not subject to the terms of the License Agreement.

> 4 Under federal patent law, patents are personal property. *35 U.S.C. § 261.* By operation of state law, the patents became the property of the surviving corporation. *Utah Code Ann. § 16-10a-1106(1)(b)*(1998); *8 Del. C. § 259(a).*

[**8] There is no suggestion that at anytime, even now, 3Com or its predecessors asserted that the transfer of the Patents, by the mergers and acquisitions, affected the terms of the License Agreement. [5] Therefore, the License Agreement did not require Hayes' consent before 3Com obtained the Patents by merger. Consequently, 3Com is the party with standing to assert the patent holder's rights under the License Agreement.

5 In fact, 3Com acknowledges that federal law regarding the assignment of patents makes patent assignments subject to the conditions of any licenses or other rights previously conferred by the patent holders. *Waterman v. Mackenzie, 138 U.S. 252, 258, 34 L. Ed. 923, 11 S. Ct. 334 (1891)*; *American Dirigold Corp. v. Dirigold Metals Corp., 125 F.2d 446, 452 (6th Cir. 1942)*.

One of the rights [HN1] a patent holder has is the exclusive right to exclude all other persons from practicing the patented inventions during the effective period of the patent. *35 U.S.C. § 154*. [**9] This monopoly is the essence of the patent and is the basis for the patent holder's exclusive right to make, use, and sell the patented technology. *Waterman v. Mackenzie, 138 U.S. 252, 255-56, 34 L. Ed. 923, 11 S. Ct. 334 (1891)*(construing prior statute); *Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 135, 23 L. Ed. 2d 129, 89 S. Ct. 1562 (1969)*. Of course, as noted above, 3Com's rights as patent holder are subject to the License Agreement executed by its predecessor in interest.

This interpretation of P 7.4 is not in conflict with P 7.3. The latter provision states that Hayes' consent is required only for an assignment of the License Agreement or the rights granted by Hayes thereunder to Megahertz. 3Com is not seeking to assert the rights as Licensee granted by Hayes to Megahertz under the License Agreement, rather it is seeking to assert the rights it has as patent owner. [6] Thus, we conclude that P 7.4, not P 7.3, is the operative provision and that 3Com has standing as the patent owner to object to the Debtors' assignment of the License Agreement. [7]

6 For example, 3Com is not asserting rights as licensee under *section 365(n)* to continue to use the technology of Hayes granted to Megahertz under the License Agreement.

[**10]

7 3Com also argued that even if the merger transactions somehow affected 3Com's standing to enforce the License Agreement, 3Com's subsidiary, Information Systems Group, Inc. ("ISG") had standing. ISG, which was an original subsidiary of Megahertz Corporation, has remained a separate legal entity. Applying the argument of the Debtors/Trustee that subsidiaries had rights under the License Agreement, 3Com argues that ISG has standing. Because 3Com has standing as the patent owner, it is unnecessary to address this issue.

[*39] B. *Effect of Appointment of Chapter 11 Trustee*

3Com argues that the Chapter 11 Trustee cannot effectuate the transfer of the License Agreement irrespective of whether the Debtors could for two reasons: (1) the Trustee only obtained title to property of the estate as of the time he was appointed which did not include unassumed executory contracts such as the License Agreement, and (2) the Trustee did not succeed to the rights of the Debtors under the License Agreement because it is a personal contract.

1. *Property of the estate*

[HN2] A bankruptcy estate is created upon the [**11] filing of a bankruptcy petition, which includes all the debtor's legal and equitable interests in property. *11 U.S.C. § 541*. Generally, the trustee succeeds to all the debtor's rights in property of the estate. 3Com asserts an exception to this general rule: an executory contract does not become property of the estate until it is assumed. 3Com cites cases which state this general proposition. *See, e.g., In re Qintex Entertainment, Inc., 950 F.2d 1492, 1495 (9th Cir. 1991)* (quoting *In re Tleel, 876 F.2d 769, 770 (9th Cir. 1989)*); *In re Public Service Co. of New Hampshire, 884 F.2d 11 (1st Cir. 1989)*.

The cases cited by 3Com are factually distinguishable [8] and do not stand for the broad proposition that the trustee does not have standing to assume an executory contract. In fact, such a conclusion is directly contrary to the express language of the Bankruptcy Code: "*the trustee*, subject to the court's approval, may assume or reject any executory contract . . . ." *11 U.S.C. § 365(a)* (emphasis added). When the language of a statute is plain, it must be followed. *See, e.g. Patterson v. Shumate, 504 U.S. 753, 757, 119 L. Ed. 2d 519, 112 S. Ct. 2242 (1992)*; [**12] *United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241, 103 L. Ed. 2d 290, 109 S. Ct. 1026 (1989)*.

8 *Public Service* involved a party's attempt to set off amounts it owed to the debtor under one contract against anticipated damages caused by the expected rejection of a separate executory contract. *Qintex* held that an executory contract must be assumed before it can be sold. *See* discussion at Part D2, *infra*. *Tleel* involved the avoidance of an alleged constructive trust on proceeds from the sale of a land sale contract. None held that a trustee does not have standing to seek assumption or rejection of an executory contract.

We conclude, therefore, that the Trustee clearly has standing in this case to ask the Court to approve the assumption and assignment of the License Agreement.

2. *Trustee succeeds to debtors' interests*

3Com asserts that the Trustee did not succeed to the Debtors' interests in the License Agreement because of the personal nature of that agreement. [**13] 3Com cites cases for the proposition that a receiver appointed under state law does not generally succeed to the licensee's rights under a patent license agreement. *See, e.g., Waterman v. Shipman, 55 F. 982, 986 (2d Cir. 1893)*(receiver under New York state law though vested with all legal and equitable property of debtor did not succeed to rights under nonassignable patent license since it was purely personal).

That case, however, involves a receiver appointed under state law, not a trustee appointed under the Bankruptcy Code. The rights of a trustee expressly include the rights the debtor has under executory contracts. *11 U.S.C. §§ 365 & 541.* We conclude that the Trustee succeeded to whatever rights the Debtors had in the License Agreement.

We turn, therefore, to 3Com's substantive arguments. 3Com's objections fall into two general categories: (1) the Debtors lost all rights under the License Agreement as a result of the first bankruptcy case, because it was not properly assumed or assigned in that case; and (2) [*40] even if the Debtors retained some rights under the License Agreement, it cannot be assumed and assigned because applicable non-bankruptcy [**14] law prohibits it.

C. *Assumption and Assignment in the First Bankruptcy Case*

1. *Collateral estoppel/res judicata*

3Com asserts that the decisions of the Georgia Courts are binding on several points: (1) that the License Agreement is an executory contract; (2) that the License Agreement could not be assigned; and (3) that the License Agreement was never assumed in the first bankruptcy case.

The federal doctrine of issue preclusion is well-established in the Third Circuit and requires that [HN3] before a party will be estopped from relitigating an issue:

> (1) the issue sought to be precluded must be the same as the one involved in the prior action; (2) the issue must have been actually litigated; (3) the issue must have been determined by a valid and final judgment; and (4) the determination must have been essential to the prior judgment.

Wolstein v. Docteroff (In re Docteroff), 133 F.3d 210, 214 (3d Cir. 1997) (citations omitted). *See also In re Ross, 602 F.2d 604, 608 (3d Cir. 1979)* (quoting *Haize v. Hanover Insurance Co., 536 F.2d 576, 579 (3d Cir. 1976)).* In determining whether an order should be given preclusive [**15] effect, "the second court should consider whether the parties were fully heard, whether a reasoned opinion was filed, and whether that decision could have been, or actually was, appealed." *First Jersey National Bank v. Brown (In re Brown), 951 F.2d 564, 569 (3d Cir. 1991).*

a. *Only Hayes filed bankruptcy*

The Debtors/Trustee argue that, even if collateral estoppel applies, it is not applicable to the Debtors other than Hayes. Only Hayes was a debtor in the first bankruptcy; none of the subsidiaries were. The subsidiaries are parties to the License Agreement and they retained their rights thereunder, even if Hayes' were lost.

3Com responds that the License Agreement gave the subsidiaries only limited rights which were derivative of, and dependent upon, Hayes having rights. The License Agreement expressly states that it is between Hayes and Megahertz. The License Agreement gives "to Hayes and each of Hayes [sic] Subsidiaries, a non-exclusive royalty-free irrevocable license under all of Licensee's Patents to make, manufacture, use or sell Hayes' Licensed Products, to have Hayes' Licensed Products made for Hayes' use or sale, and for the use of, or sale by, any [**16] of Hayes' Subsidiaries, and to use any process in manufacturing any product of Hayes." (License Agreement at P 2.2.) The definition of Hayes' Licensed Products includes only products made by or for Hayes. The grant is extended to Hayes' subsidiaries only to facilitate its use by Hayes. It was not intended to be an independent grant to the Hayes' subsidiaries to use for themselves to make other, non-Hayes products.

Further, the subsidiaries have rights only so long as they are, in fact, subsidiaries of Hayes. The definition of Hayes' Subsidiary under the License Agreement requires that Hayes own at least 50% of the entity. (*Id.* at P 1.21.) Thus, the transfer to a non-subsidiary would eliminate their rights, unless the purchaser remained a subsidiary of Hayes. Similarly, if the stock in the subsidiary were to be sold by Hayes, the entity would no longer have any rights under the License Agreement. [9]

> 9 The Debtors/Trustee and NationsCredit suggest that even if the sale to Xircom is not approved, the same result could be achieved in a plan of reorganization which transfers the stock of a subsidiary to Xircom. For the reasons stated here and in Part D, we disagree.

[**17] Consequently, we conclude from the express language of the License Agreement [*41] that the subsidiaries' rights are only derivative of Hayes and that they have no independent rights thereunder. Thus, to the extent collateral estoppel bars relitigation of any issue by Hayes, it bars the other Debtors and the Trustee as well.

b. *NationsCredit was not a party*

NationsCredit argues, as well, that preclusion may not arise with respect to it, because it was not a party to the first bankruptcy case or a participant in the litigation that gave rise to the orders issued in that case. *See Kelly v. Armstrong, 141 F.3d 799 (8th Cir. 1998)* (even assuming sufficient similarity of issues, collateral estoppel could not be applied to bar relitigation of such issues by transferees, who were not parties to that litigation); *see also In re Atrium High Point Ltd. Partnership, 189 B.R. 599 (Bankr. M.D.N.C. 1995)* (debtor's pre-petition waiver of rights provided under the Bankruptcy Code are not binding on third party creditors).

However, NationsCredit has no direct interest in the License Agreement; it is not a party to the License Agreement. Rather, its interests are [**18] only derivative of the Debtors: it has a security interest in property of the Debtors, including contract rights. Therefore, NationsCredit's rights can rise no higher than the Debtors' rights and to the extent a decision on the Debtors' rights in the License Agreement is binding on the Debtors, it binds NationsCredit. *See, e.g., In re James Wilson Associates, 965 F.2d 160, 168-70 (7th Cir. 1992)* (secured party had no standing to be heard on issue of enforceability of deadline for assumption or rejection of lease which served as its collateral).

c. *The License Agreement is executory*

Turning to the issue of the preclusive effect of the Georgia Courts' decisions, 3Com asserts that the Georgia Bankruptcy Court, in its order dated February 14, 1996, held that the License Agreement was an executory contract subject to the provisions of *section 365*. (Appendix of Documents filed by 3Com, Tab 3, p. 4.) 3Com asserts that this issue was actually litigated. However, nowhere in the Georgia Bankruptcy Court's opinion is a finding to that effect. It appears that the Court assumed the contract was executory, since it articulated the issue before it as "whether or not the Debtor [**19] in Possession can assume the executory License Agreement with Megahertz . . . ." (*Id.*)

Although 3Com asserts that the issue was actually litigated, we cannot tell that from the Bankruptcy Court's opinion. The briefs filed by the parties in that case were not made part of the record in this case. Further, 3Com's assertion that Hayes argued to the Georgia Bankruptcy Court that the License Agreement was not executory appears to be contradicted by the Schedules filed by Hayes in the Georgia bankruptcy case, where it listed the License Agreement in Schedule G as an Executory Contract. (Appendix of Documents filed by 3Com, Tab 2.) Thus, we cannot conclude from the record before us that the issue was actually litigated in the prior case.

Nor was the issue necessary to the Georgia Bankruptcy Court's ultimate decision that the License Agreement could be assumed by Hayes in its Plan. If the License Agreement were not executory, it would not be subject to the proscriptions on assumption contained in *section 365* and would survive the bankruptcy case unaffected.

Further, the issue before us is different from that decided by the Georgia courts. We must decide whether the License Agreement [**20] was executory on October 9, 1998, the day the second bankruptcy cases were filed. [10] The issue the Georgia Court considered was whether the License Agreement was executory in November, 1994. The four year difference precludes [*42] a decision with respect to the earlier date from being determinative as to the later date. Collateral estoppel does not apply.

10 [HN4] The time for determining whether a contract is executory is when the bankruptcy petition is filed. *See, e.g., In re Columbia Gas Systems, Inc., 50 F.3d 233, 240 (3d Cir. 1995).*

d. *The License Agreement could not be assigned*

3Com asserts that the Georgia Bankruptcy Courts concluded that the License Agreement was not assignable (and that that conclusion was not disturbed on appeal). The Debtors/Trustee respond that that conclusion was mere dicta, unnecessary to the Court's conclusion that Hayes could assume the contract.

We agree with the Debtors/Trustee. Dicta is not covered by the doctrine of collateral estoppel because the latter requires [**21] that the conclusion sought to be given preclusive effect actually formed a necessary part of the ultimate determination reached by the first court. *See, e.g., In re Cassidy, 892 F.2d 637, 640 (7th Cir. 1990); Coleman v. Miller, 117 F.3d 527, 530 n.7 (11th Cir. 1997)*

The Georgia Bankruptcy Court concluded that under its Plan, Hayes was *not* assigning the License Agreement. Therefore, its discussion of *whether* the License Agreement could be assigned was unnecessary to its ruling and constitutes classic dicta. This is evident from the end of the Court's decision where it stated:

> In this case, the post-confirmation debtor under the Debtor's proposed plan

> of reorganization will be one and the same entity as the pre-petition Debtor and the Debtor in Possession. The contemplated performance of the License Agreement by the post-confirmation Debtor will be the same as if no petition had been filed. Therefore, *there will be no assignment* of the License Agreement from the Debtor in Possession to the post-confirmation reorganized Debtor within the meaning of the non-bankruptcy anti-assignment law. *Accordingly, the issue of assignability* of [**22] the License Agreement from the Debtor in Possession to the post-confirmation Debtor *is, in essence, rendered moot.*

(Appendix of Documents, Tab 3 at p. 13 (emphasis added)).

Thus, there can be no preclusive effect to the Georgia Court's discussion of the assignability of the License Agreement.

e. *The License Agreement was never assumed*

3Com asserts that the Debtors/Trustee now have no rights in the License Agreement because that License Agreement was never assumed in the Georgia case.

However, 3Com ignores the effect of the Georgia Courts' rulings. The Bankruptcy Court entered two orders, one holding that the License Agreement could be assumed pursuant to the Plan and the other confirming the Plan. Those orders were appealed. The subsequent order in aid of confirmation did not modify the Plan. (*Id.*, Tab 8 at p. 2.) In fact, the Plan apparently expressly authorized changes to the identity of new investors and the terms of the funding of the Plan. That order also did not *change* the fact of the assumption of the License Agreement. The Bankruptcy Court expressly left that issue as it stood: the order allowing assumption being on appeal. The District Court subsequently [**23] affirmed the assumption order. (*Id.*, Tab 10 at pp. 3-4.) The Eleventh Circuit *remanded* the case for the Bankruptcy Court to decide the effect, if any, of the order in aid of confirmation on the assumption order. (*Id.* at Tab 12.) That remand is pending, having been stayed by this bankruptcy case.

The Georgia Bankruptcy Court on remand may conclude that the order in aid of confirmation did not affect its assumption order. Normally, we would be inclined to wait until the Georgia Bankruptcy Court renders its decision on whether the License Agreement survived the Georgia case. However, because we conclude below that, even if the License Agreement were still viable, the Debtors/Trustee cannot assume the License Agreement now, [*43] we will not direct the parties to obtain a ruling from the Georgia Court first.

D. *Assumption and Assignment in this Case*

1. *The License Agreement is not assignable*

3Com asserts that the Debtors/Trustee may not assume and assign the License Agreement to Xircom under the plain language of *section 365(c)(1)* which provides:

> The trustee may not *assume or assign* any executory contract or unexpired lease of the debtor, whether or not such [**24] contract or lease prohibits or restricts assignment of rights or delegation of duties, if--
>
> (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and
>
> (B) such party does not consent to such assumption or assignment . . . .

[HN5] *11 U.S.C. § 365(c)(1)* (emphasis added).

a. *The License Agreement is executory*

Though we cannot rely on the Georgia Courts' decision on this issue, we readily conclude that the contract is executory. There is performance due on each side: permitting the use of patented technology by the other party.

The traditional test is the "Countryman" definition which provides that [HN6] a contract is executory only where the obligations "of *both* the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Countryman, Executory Contracts in Bankruptcy; [**25] Part I, 57 Minn. L. Rev. 439, 460 (1973) (emphasis added). The Third Circuit has adopted the Countryman definition, *Sharon Steel Corp. v. National Fuel Gas Distribution Corp., 872 F.2d 36, 39 (3d Cir. 1989)*, and has emphasized that it is not a technical definition, but one which requires a court to determine whether the failure to perform an obligation under the contract would constitute a material breach. *In re Columbia Gas Systems, Inc., 50 F.3d 233, 244 n.20 (3d Cir. 1995).*

The Debtors/Trustee assert that the License Agreement is not executory, under the traditional test, [11] because no performance by them was due at the commencement of these cases. Thus, the Debtors/Trustee submit that the License Agreement was, in fact, a sale. We disagree.

> 11 Because we find the contract is executory under the traditional test, asserted by the Debtors/Trustee, we need not consider 3Com's argument that it is executory under the alternative "functional" approach.

Each party [**26] had at least one material duty to perform under the License Agreement: to refrain from suing the other for infringement of any of the patents covered by the license. This performance is material since the licensor's promise to refrain from suing the licensee for infringement is the *raison d'etre* for a patent license. *See, e.g., De Forest Radio Tel. & Tel. Co. v. United States, 273 U.S. 236, 242, 47 S. Ct. 366, 71 L. Ed. 625 (1927)* (a waiver of the right to sue for infringement created a nonexclusive patent license); *Jacob Maxwell, Inc. v. Veeck, 110 F.3d 749, 753 (11th Cir. 1997)* (implied nonexclusive license to use copyrighted material barred suit); *Spindelfabrik Suessen-Schurr Stahlecker & Grill, GmbH v. Schubert & Salzer Maschinenfabrik Aktiengesellschaft, 829 F.2d 1075, 1081 (Fed. Cir. 1987)* (a patent license agreement is nothing more than a promise by licensor not to sue licensee).

Further, each party was required to grant the other party sub-licenses under [*44] third parties' patents, a duty which is co-extensive with the terms of the License Agreement. (License Agreement at P 2.3.) While the Debtors/Trustee dispute Hayes' obligation to grant additional licenses [**27] under patents owned by Hayes, the Debtors/Trustee do not argue that these sub-license obligations did not exist. We agree with 3Com that even though these sub-licensing obligations may be remote, that does not render the obligations non-executory. *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers, Inc.), 756 F.2d 1043, 1046 (4th Cir. 1985)* (the "contingency of an obligation does not prevent its being executory").

In *Everex Systems, Inc. v. Cadtrak Corp. (In re CFLC, Inc.), 89 F.3d 673 (9th Cir. 1996)*, the Ninth Circuit found that a licensor's obligation to forbear from suing the license (and to mark all products made under the license) was both a significant and continuing performance obligation that made the contract executory as to the licensor. *89 F.3d at 677*. Similarly, we conclude that the License Agreement was executory at the commencement of these cases.

The Debtors/Trustee seek to avoid this conclusion by arguing that the License Agreement was, in fact, a sale. They point to the fact that it was irrevocable and royalty free. The Debtors/Trustee cite *In re DAK Industries, Inc., 66 F.3d 1091 (9th Cir. 1995)* [**28] in support of their position. The agreement in *DAK* permitted the debtor nonexclusive rights to sell Microsoft's Word for Windows software to its customers, who were the ultimate users. In *DAK*, the Court concluded that the software "license" was, in fact, a sale because (1) the pricing, and timing of payments, suggested a sale not a lease, (2) the debtor received all its rights at the commencement of the agreement, and (3) the debtor had the right to sell the technology, not simply use it. *Id. at 1095-96.* [12]

> 12 *DAK* is further distinguishable because it dealt, not with the assumption and assignment of an executory contract, but with a request for a payment of an administrative claim under a prepetition contract which the Court found provided no benefit to the estate post-petition. *66 F.3d at 1096.*

We find the latter element to be missing here: under the License Agreement the Debtors do *not* have the right to sell the Megahertz technology. This is significant. [HN7] An agreement [**29] is a sale of the patent rights only if it conveys: (1) the whole patent, comprising the exclusive right to make, use, and sell the invention; (2) an undivided share of that exclusive right; or (3) an exclusive right to practice the invention within a specified territory. *Waterman v. Mackenzie, 138 U.S. at 255.* [HN8] Unless the writing conveys some or all of the right to exclude others from practicing the invention, it will not convey an interest in the patent, but is a mere license. *138 U.S. at 256.* Therefore, a "non-exclusive" grant of the rights to make, use, and sell the patented invention, by its very terms, is not an assignment, but a mere naked license. *Preload Enterprises, Inc. v. Pacific Bridge Co., 86 F. Supp. 976, 979 (D. Del. 1949)* ("if the rights conferred upon the alienee are not exclusive rights investing in him alone or him jointly with the alienor, the monopoly is not transferred and the conveyance is a license"). [13]

> 13 The other authority cited by the Debtors/Trustee is similarly distinguishable. In *Chesapeake Fiber Package Corp. v. Sebro Packaging Corp., 143 B.R. 360 (D. Md. 1992) aff'd, 8 F.3d 817 (4th Cir. 1993)*, the agreement in dispute contained language of conveyance: "[patent holder] hereby sells, assigns, transfers and sets over to [alienee] its entire right, title and interest in, to, and under the aforesaid Invention(s) and any and all Letters Patent. . ." *Id. at 363.* Because

> of that language, the Court concluded it was a sale not an executory contract or license. There is no similar language in the License Agreement at issue here.

[**30] In this case, the License Agreement, by its very terms, is a "non-exclusive" right only to make, use, and sell Megahertz's [*45] patented technology in Hayes' licensed products. (License Agreement at P 2.2). In other words, the License Agreement did *not* convey to the Debtors the exclusive right or some part of the exclusive right to practice the invention and did not grant any right to exclude others from practicing the patents. Thus, the License Agreement did not convey any part of the patent monopoly or the underlying patents. We conclude, therefore, that it was not a sale but a license which was executory at the time of the filing of the bankruptcy cases.

b. *Applicable law excuses 3Com from accepting performance from a third party*

The "long standing federal rule of law with respect to the assignability of [HN9] patent license agreements provides that these agreements are personal to the licensee *and not assignable unless expressly made so in the agreement." Unarco Industries, Inc. v. Kelley Co., Inc., 465 F.2d 1303, 1306 (7th Cir. 1972), cert. denied, 410 U.S. 929, 35 L. Ed. 2d 590, 93 S. Ct. 1365 (1973)* (citations omitted) (emphasis added). This [**31] federal rule in favor of allowing a patent holder to choose who, if anyone, may use the patented invention promotes the important federal policy underlying patent law:

> to "foster and reward invention" [which] is primarily accomplished by granting a 17 year monopoly for the patent holder to exploit. Limiting assignability to licenses in which the patent holder expressly agrees to assignment aids the patent holder in exploiting the patent and thus "rewards" the patent holder. Free assignability of a non-exclusive patent license without the consent of the patent holder is inconsistent with patent monopoly and thus inconsistent with federal policy.

In re CFLC, Inc., 174 B.R. 119, 123 (N.D. Cal. 1994), aff'd sub nom., Everex Systems, Inc. v. Cadtrak Corp. (In re CFLC, Inc.), 89 F.3d 673 (9th Cir. 1996).

c. *3Com does not consent*

3Com clearly does not consent to the sale to Xircom in this case. 3Com's objection to Xircom is very basic: Xircom is a direct competitor of 3Com and allowing Xircom to use 3Com's technology will eliminate any competitive advantage in the market which 3Com may have as a result of that technology. [14] This [**32] is exactly what the patent laws are designed to prevent.

> 14 The testimony presented at trial by 3Com was that there are effectively three types of products on the market which allow a laptop computer to connect to communications devices: the basic dongle which many manufacturers produce, the 3Com XJack technology (which the Debtors use in the EZJack products) and Xircom's Real Port technology. (N.T. at pp. 25-27.) Thus, allowing Xircom access to 3Com's technology has a significant effect. (*Id. at pp. 27-28, 51.*)

The Debtors/Trustee argue that 3Com (by its predecessor Megahertz) has agreed to the assignment. They point to the language of the License Agreement at P 7.3 which states that Megahertz cannot assign the License Agreement without Hayes' consent. There is no similar provision barring assignment by the Debtors.

The Debtors/Trustee rely on [HN10] the doctrine of *expressio unius est exclusio alterius* which provides that when certain matters are discussed in a contract, other similar matters not mentioned [**33] are intended to be excluded. *See, e.g., Plumbers & Steamfitters Local No. 150 Pension Fund v. Vertex Construction Co., Inc., 932 F.2d 1443, 1449 (11th Cir. 1991)* (collective bargaining agreement which incorporated certain agreements, but did not mention others, held not to incorporate those not mentioned); *Macon Auto Auction, Inc. v. Georgia Cas. & Sur. Co., 104 Ga. App. 245, 251, 121 S.E.2d 400 (1961)* (because indemnity agreement expressly stated that one provision was a condition precedent, all other provisions were necessarily not conditions precedent).

[*46] This rule of construction is well-recognized black-letter law. 3 CORBIN ON CONTRACTS § 552 (1998) ("If one subject is specifically named, . . . and there are no general words to show that other subjects of that class are included, it may reasonably be inferred that the subjects not specifically named were intended to be excluded."); 11 WILLISTON ON CONTRACTS § 1295 (1998) ("Covenants are implied in two situations, one where the covenant is so clearly within the contemplation of the parties that they deemed it unnecessary to express it, and the other where the covenant was probably beyond the pale [**34] of conscious thought of the parties but is necessary in order to give effect to and effectuate the purpose of the contract as a whole.")

The Debtors/Trustee seek to apply the doctrine of *expressio unius est exclusio alterius* to this case as follows. The License Agreement provides at P 7.3, which relates solely to Megahertz:

> Neither this Agreement, nor any licenses or rights hereunder, in whole or in part, granted by Hayes to Licensee [Megahertz], shall be assignable or otherwise transferable without Hayes' prior written consent.

(License Agreement at P 7.3.) The License Agreement contains no corresponding prohibition with respect to Hayes. Under the *expressio unius* doctrine, the Debtors/Trustee argue that such a deliberate omission is tantamount to an express grant of permission and, thus, this Court may find that the License Agreement expressly provides that Hayes and its subsidiaries may freely assign their rights under the License Agreement.

However, we cannot conclude in this case that silence is express consent to the assignment, particularly where federal law holds the opposite: that silence, i.e., lack of express agreement, means the agreement is [**35] *not* assignable. As noted above, license agreements are personal to the licensee and not assignable *unless expressly made so in the agreement. Unarco, 465 F.2d at 1306.* "Under well-established law the holder of a nonexclusive patent license may not assign its license *unless the right to assign is expressly provided for in the license agreement." Verson Corp. v. Verson Int'l Group PLC, 899 F. Supp. 358, 363 (N.D. Ill. 1995)* (emphasis added).

The argument of the Debtors/Trustee is based on a faulty legal premise -- that under applicable law a patent license *is* assignable in the absence of an express provision *prohibiting* assignment. But this is exactly backwards: "patent licenses are personal and not assignable unless expressly made so . . . [and this] has been the rule at least since 1852 when the Supreme Court decided *Troy Iron & Nail v. Corning, 55 U.S. (14 How.) 193, 14 L. Ed. 383 (1852)." PPG Industries, Inc. v. Guardian Industries Corp., 597 F.2d 1090, 1093* (6th Cir.), *cert. denied, 444 U.S. 930, 62 L. Ed. 2d 187, 100 S. Ct. 272 (1979).* Rather, "express" authorization means just that [**36] -- precise language granting, in black and white, the exact authority that is sought.

Here, the License Agreement is at best silent with respect to Hayes' entitlement to assign its rights under the contract. [HN11] Where the provisions of a patent license are silent on the question of assignability, the license is nontransferable. *Walter A. Wood Harvester Co. v. Minneapolis-Esterly Harvester Co., 61 F. 256, 258 (8th Cir. 1894)* (patent license that did not contain the words "heirs," "successors" or "assigns" or words of similar import was not assignable). Thus, under federal law, the rights of Hayes as licensee under Megahertz's patents are clearly non-assignable.

This finding is bolstered by the language of P 7.1 of the License Agreement which provides:

> Nothing contained in this Agreement shall be construed as . . . conferring by *implication, estoppel or otherwise* upon any grantee any license or other right [*47] under any Patent, except the licenses and rights *expressly* granted to such grantee.

(License Agreement at P 7.1 (emphasis added).)

The instant case is distinguishable from the case cited by the Debtors/Trustee in support of their position. [**37] *See Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489 (1st Cir. 1997).* In the *Pasteur* case, the written provision was contrary to patent law, while the provision presumed by the contract's silence was consistent with patent law. *104 F.3d at 494.* Thus, the application of the *expressio unius est exclusio alterius* doctrine in *Pasteur* did not result in the creation of an unwritten contract in contravention of patent law. Rather, the *Pasteur* court gave effect to the parties' election to deviate from the law where that election was in writing.

Here, the opposite is true. The written provision (P 7.3) is consistent with patent law and the provision which the Debtors/Trustee wish us to create by the contract's silence is directly contrary to patent law. In the face of patent law which requires an express undertaking before it is assignable, we will not presume such consent by mere silence. [15]

> 15 We are also cognizant of the general doctrine that we should not construe a contract to render one of its provisions meaningless. *See, e.g., Chemical Bank v. Affiliated FM Ins. Co., 815 F. Supp. 115 (S.D.N.Y. 1993).* That is not the result here. Our conclusion simply means that P 7.3 is redundant; it mirrors existing law.

[**38] Because the License Agreement is executory, non-assignable under applicable nonbankruptcy law, and 3Com does not consent to its assignment, the Debtors/Trustee may not assign it under the express language of *section 365.*

2. *The License Agreement cannot be sold pursuant to § 363*

The Debtors/Trustee seek to avoid this result by asserting that they are not seeking to assume and assign the License Agreement under *section 365.* Rather, they argue

they are "selling" the License Agreement pursuant to *section 363*. However, the courts have held that, with respect to an executory contract, until it is assumed under *section 365*, the debtor has nothing to sell under *section 363*. *See, e.g., Qintex, 950 F.2d 1492*; *Tleel, 876 F.2d at 770-71* (treating motion to sell executory contract as motion to assume and assign).

In *Qintex*, the Court stated:

> *Section 363* of the Code allows a debtor to sell assets of the estate, after notice and a hearing, including a sale of substantially all the assets of the estate. *11 U.S.C. § 363(b)(1)*. [HN12] An executory contract does not become an asset of the estate until it is assumed pursuant to *§ 365(a)* [**39] of the Code. *See § 365(a)*; *In re Tleel, 876 F.2d 769, 770 (9th Cir. 1989)* ("Unless and until rights under an executory contract are timely and affirmatively assumed by the trustee, they do not become property of the debtor's estate"). Therefore, the sale of Qintex's assets will not include any contract that is executory unless Qintex first assumes the contract.

950 F.2d at 1495.

We agree with the *Qintex* conclusion. A debtor cannot avoid the requirements of *section 365* by saying it is "selling" a lease or executory contract, rather than assuming and assigning it.

To hold otherwise would lead to ludicrous results. If the debtor does not assume an executory contract, it is deemed rejected. *See, e.g., James Wilson Associates, 965 F.2d at 169*; *Sea Harvest Corp. v. Riviera Land Co., 868 F.2d 1077, 1079 (9th Cir. 1989)* (the statutory presumption of rejection, unless the debtor or trustee acts affirmatively to assume a lease, protects the estate from unexpected liability). Thus, if a debtor does not assume an executory contract before he sells it (as the Debtors/Trustee argue they can here), the buyer may [**40] be purchasing an illusion: the [*48] executory contract will disappear on conclusion of the bankruptcy case.

Thus, for the Debtors/Trustee to "sell" the License Agreement to Xircom, they must first assume it under *section 365*.

3. *The License Agreement is not assumable*

The language of *section 365(c)(1)* also clearly and unambiguously prohibits the assumption of the License Agreement. That section states a debtor in possession "*may not assume or assign* any executory contract or unexpired lease of the debtor," if applicable nonbankruptcy law precludes it. *11 U.S.C. § 365(c)(1)* (emphasis added).

Some federal courts have rejected the plain language of the statute and applied an "actual test" to allow assumption of contracts that are non-assignable and non-delegable under applicable law. *See, e.g., Pasteur, 104 F.3d at 493*. Those federal courts reason that where the contract is merely being assumed by the debtor, the policy behind the nonbankruptcy law which prohibits assignment is still upheld. [16]

16 The Georgia Bankruptcy Court adopted this reasoning, even though the Eleventh Circuit had articulated the hypothetical test. (Appendix of Documents, Tab 3 at pp. 7-12.)

[**41] The "actual test" approach, however, has been criticized as ignoring the plain language of the statute. The majority of the Circuit Courts that have addressed this issue have concluded that the plain language [17] of *section 365(c)(1)* requires application of a hypothetical test:

> [HN13] The literal language of *§ 365(c)(1)* is thus said to establish a "hypothetical test": a debtor in possession *may not assume* an executory contract over the nondebtor's objection if applicable law would bar assignment to a hypothetical third party, *even where the debtor in possession has no intention of assigning* the contract in question to any such third party. *See In re James Cable, 27 F.3d [534] at 537* (characterizing *§ 365(c)(1)(A)* as presenting "a hypothetical question"); *In re West Elecs., 852 F.2d [79] at 83* (same).

Perlman v. Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.), 165 F.3d 747, 750 (9th Cir. 1999) (emphasis added). *See also, City of Jamestown v. James Cable Partners, L.P. (In re James Cable Partners, L.P.), 27 F.3d 534, 537, reh'g denied, 38 F.3d 575 (11th Cir. 1994).*

17 When a statute is clear and unambiguous on its face, recourse to legislative history is inappropriate. *See, e.g., Toibb v. Radloff, 501 U.S. 157, 162, 115 L. Ed. 2d 145, 111 S. Ct. 2197 (1991)* ("this Court has repeated with some frequency:

> 'Where, as here, the resolution of a question of federal law turns on a statute and the intention of Congress, we look first to the statutory language and then to the legislative history if the statutory language is unclear.'"); *United States v. Rush, 874 F.2d 1513, 1514 (11th Cir. 1989).*

[**42] Of particular significance in this case, the Third Circuit Court of Appeals has followed the express language of the statute and adopted the hypothetical test. *In re West Electronics, Inc., 852 F.2d 79 (3d Cir. 1988).* In *West Electronics*, the Third Circuit held that a debtor could not assume a defense contract because the federal Anti-Assignment Act prohibited the assignment of that contract. Because the debtor could not assume the contract, the Court held that relief from the stay should be granted to permit the government to terminate the contract. *852 F.2d at 82.*

Although the *West Electronics* case dealt with a federal statute which barred assignment, the Third Circuit held that *section 365(c)(1)* similarly applied in other instances:

> Thus, if non-bankruptcy law provides that the government would have to consent to an assignment of the West contract to a third party, *i.e.*, someone "other than the debtor or the debtor in possession," then West, as the debtor in possession, cannot assume that contract. *This provision limiting assumption of* [*49] *contracts is applicable to any contract subject to a legal prohibition against assignment.* [**43] *See In re Pioneer Ford Sales, Inc., 729 F.2d 27 (1st Cir. 1984); In re Braniff Airways, Inc., 700 F.2d 935, 943 (5th Cir. 1983).*

Id. (emphasis added).

Like the language of the statute, the decision in *West Electronics* is clear and unequivocal. We are bound by Third Circuit law on this point. The Debtors/Trustee may not assume the contract with 3Com. [18]

18 The Debtors/Trustee, and NationsCredit, assert that even if they cannot assume and assign the License Agreement to Xircom under *section 365*, they can still accomplish the same result through a plan. They argue that they can formulate a plan by which the stock of one or more of the Debtors/Trustee is conveyed to Xircom, thereby giving it rights in the License Agreement. Since the Debtors/Trustee cannot assume the License Agreement, we do not see how this can be accomplished.

IV. *CONCLUSION*

For the foregoing reasons, we conclude that the License Agreement is an executory contract which under its terms [**44] and applicable nonbankruptcy law is not assignable without 3Com's consent. Since 3Com does not consent, the Debtors/Trustee may not assume or assign the License Agreement under *section 365* or sell it under *section 363.*

An appropriate order is attached.

BY THE COURT:

July *22*, 1999

Mary F. Walrath

United States Bankruptcy Judge

ORDER

AND NOW, this day of **JULY, 1999**, upon consideration of the Motion of the Debtors/Trustee for approval of the sale of Lot 15 (the EZJack related assets) to Xircom Corporation and the objection of 3Com Corporation thereto, it is hereby

ORDERED that the Motion be, and the same hereby is, **DENIED**.

BY THE COURT:

July *22*, 1999

Mary F. Walrath

United States Bankruptcy Judge

Caution
As of: Feb 07, 2012

IN RE: GOLDEN BOOKS FAMILY ENTERTAINMENT, INC., GOLDEN BOOKS PUBLISHING COMPANY, INC., GOLDEN BOOKS HOME VIDEO, INC., LRM ACQUISITION CORP., SHARI LEWIS ENTERPRISES, INC., and SLE PRODUCTIONS, INC. Debtors.

Chapter 11, Case No. 01-1920 through 01-1925 (RRM), Jointly Administered

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE

269 B.R. 300*; *2001 Bankr. LEXIS 1439

November 8, 2001, Decided

DISPOSITION: Warner Bros. Consumer Products' objections were sustained.

CASE SUMMARY:

PROCEDURAL POSTURE: Chapter 11 debtors had obtained approval from the court to sale and assign various publishing license agreements issued by a third-party licensor. Subsequently, the licensor challenged the debtors' right to sale and assign the license.

OVERVIEW: The debtors, who published, licensed, and marketed children's media products, owned an array of film copyrights, distribution rights, trademarks, and licenses relating to characters, television programs, and motion pictures. The debtors obtained court approval to sale their various publishing license agreements which were obtained from the licensor. In ruling on the licensor's challenge to the sale of its grant of the licenses, the court held that the notice of assignment documents sent to the licensor were deficient because, among other things, they failed to address any of the copies of the notice to a person of authority or to a person authorized to accept service. Further, although the sale had been completed, the debtor had sufficient notice of the licensor's objection before the closing date such that the debtors could not now claim that there was undue prejudice against them. As to the merits of the licensor's objections, the third party's licenses were executory contracts within the meaning of *11 U.S.C.S. § 365(c)*. Further, the licenses had not conferred exclusive rights to the debtors. Hence, the licenses were nonexclusive, and non-assignable.

OUTCOME: The court held that the four licenses were nonexclusive licenses. Hence, they could not be transferred by the debtors without the licensor's permission.

LexisNexis(R) Headnotes

Bankruptcy Law > Case Administration > Notice
Bankruptcy Law > Practice & Proceedings > Contested Matters
Business & Corporate Law > Agency Relationships > Agents Distinguished > General Overview
[HN1] *Fed. R. Bankr. P. 6006* governs the assumption, rejection, or assignment of executory contracts. *Fed. R. Bankr. P. 6006(c)* requires notice of a proceeding to assume, reject, or assign an executory contract be given to the other party to an executory contract. *Fed. R. Bankr. P. 6006(a)* provides that a proceeding to assume, reject, or assign an executory contract, other than as part of a plan, is a contested matter, governed by *Fed. R. Bankr.*

P. 9014. Rule 9014, states that motions in contested matters must be served in the same manner provided for service of a summons and complaint in *Fed. R. Bankr. P. 7004. Fed. R. Bankr. P. 7004(b)(3)* provides for service by mail: upon a domestic or foreign corporation or upon a partnership or other unincorporated association, by mailing a copy of the notice to the attention of an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process. Although bankruptcy courts have differed when addressing the issue of how strictly to interpret this provision, certain courts have found that these notice requirements are to be strictly adhered to. Due process of law, which is to be accorded finality, requires notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and to afford them an opportunity to present their objections.

Bankruptcy Law > Claims > Proof > Effects & Procedures
Civil Procedure > Pleading & Practice > Pleadings > Time Limitations > Extensions
[HN2] *Fed. R. Bankr. P. 9006(b)(1)* permits the court for cause to enlarge the time within which an act is required to be done, before or after the expiration of the time, based on excusable neglect. The doctrine of "excusable neglect" includes the danger of prejudice to the debtor, the length of the delay, the reason for the delay, and whether the moving party acted in good faith.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Powers
Contracts Law > Types of Contracts > Executory Contracts
[HN3] Under *11 U.S.C.S. § 365(c)*, when an executory contract can not be assigned under applicable non-bankruptcy law, it may not be assumed or assigned by the bankruptcy trustee without permission of the other contracting party.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
Contracts Law > Types of Contracts > Executory Contracts
[HN4] See *11 U.S.C.S. § 365(c)*.

Bankruptcy Law > Case Administration > Administrative Powers > General Overview
Contracts Law > Breach > Material Breach
Contracts Law > Types of Contracts > Executory Contracts
[HN5] The United States Court of Appeals for the Third Circuit holds that the test to be applied to determine whether a contract is executory is the "Countryman" test, which provides that a contract is executory when the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other. Applying the Countryman definition of executory contracts, courts generally have found intellectual property licenses to be "executory" within the meaning of *11 U.S.C.S. § 365(c)* because each party to the license had the material duty of refraining from suing the other for infringement of any of the intellectual property covered by the license.

Copyright Law > Conveyances > General Overview
[HN6] Whether copyright law precludes the free assignment of licenses depends on whether a particular license is exclusive or nonexclusive.

Copyright Law > Conveyances > Licenses > General Overview
Copyright Law > Conveyances > State Regulation
[HN7] Under copyright law, a nonexclusive licensee has only a personal and not a property interest in the intellectual property, which cannot be assigned unless the intellectual property owner authorizes the assignment. By contrast, however, an exclusive licensee does acquire property rights and may freely transfer his rights, and moreover, the licensor cannot transfer the same rights to anyone else. Licensees cannot freely transfer rights even under exclusive license.

Contracts Law > Negotiable Instruments > Transfers
Copyright Law > Conveyances > Formalities > Writing Requirement
Copyright Law > Conveyances > Licenses > Exclusive Licenses
[HN8] According to the Copyright Act, specifically, *17 U.S.C.S. § 204(a)*, while a non-exclusive license may be oral, an exclusive license is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights conveyed. A transfer of copyright ownership, other than by operation of law, is not valid unless an instrument of conveyance, or a note or memorandum of the

transfer, is in writing and signed by the owner of the rights conveyed or such owner's duly authorized agent.

COUNSEL: [**1] For debtors: Edmon L. Morton, Esquire, Young Conaway Stargatt & Taylor, LLP, Wilmington, Delaware.

For debtors: Jennifer Harding, Esquire, Willkie Farr & Gallagher, New York, New York.

For Random House: Kevin Mangan, Esquire, Walsh Monzack and Monaco, Wilmington, Delaware.

For Random House: Bruce Nathan, Esquire, Ralph Berman, Esquire, Davidoff & Malito, New York, New York.

For Warner Bros. Consumer Products: Jeffrey C. Wisler, Esquire, Michelle McMahon, Esquire, Connolly Bove Lodge & Hutz LLP, Wilmington, Delaware.

For Warner Bros. Consumer Products: Jon L.R. Dalberg, Esquire, Andrews & Kurth, Los Angeles, California.

OPINION

[*302] **MEMORANDUM OPINION**

Wilmington, Delaware

November 8, 2001

McKELVIE, District Judge

This is a bankruptcy case. Golden Books Family Entertainment, Inc. is a debtor before this court. Golden Books publishes, produces, licenses, and markets a host of children's and family-related media and entertainment products. It owns an array of film copyrights, distribution rights, trademarks, and licenses relating to characters, television programs, and motion pictures. Moreover, through a number of license agreements, Golden Books publishes [**2] children's books featuring characters owned by other companies.

Golden Books, as part of the sale of its assets to Random House and Classic Media, Inc. ("the Buyers"), is proposing to assume and assign various executory contracts. Among the contracts that Golden Books is seeking to assume and assign are various publishing license agreements in which Warner Bros. Consumer Products ("WBCP"), a division of Time Warner Entertainment, L.P., licenses to Golden Books a sub-set of WBCP's copyright and trademark rights with respect to certain animated children's characters.

There are seven agreements at issue. Three of the agreements pertain respectively to the animated character "Frosty the Snowman," a set of animated characters designated as "Cartoon Network [*303] Originals," and another set of animated characters designated as "Cartoon Network Classics -- Hanna Barbera." Two agreements relate to the cartoon character "Scooby Doo." The remaining two agreements relate to a set of cartoon characters from the animated television show, the "Power Puff Girls."

I. FACTUAL AND PROCEDURAL BACKGROUND

Pursuant to an order from this court, dated June 28, 2001 entitled "Bid Procedures Order," Golden [**3] Books held an auction to sell its assets to the highest and best bidder. The auction was held on July 27, 2001 at the offices of Wilkie Farr & Gallagher in New York. After determining that the Buyers submitted the highest and best bid for the assets, Golden Books entered into an asset purchase agreement with the Buyers. On August 15, 2001, the date that was designated as the sale hearing date by the court's August 1, 2001 order, this court conducted a sale hearing and signed a sale order approving the asset purchase agreement between Golden Books and the Buyers. Those parties formally consummated the sale transaction at a closing on August 28, 2001.

On August 6, 2001, after the auction but before the court approved the asset purchase agreement, Golden Books sent a Notice of Hearing to Consider Objections to Debtors' Motion to Sell All or Substantially All of the Debtors Assets Free and Clear of All Liens, Claims, Encumbrances, and Other Interests to a number of interested parties, such as licensors of Golden Books, who might have objections to portions of the sale. WBCP was among the parties to which notices were sent.

In response to the notice, several parties filed objections prior [**4] to the August 15, 2001 sale hearing contesting the assumption and assignment of certain executory contracts pursuant to the terms of the asset purchase agreement. Paragraph 12 of the sale order for the sale to the Buyers provides that:

> all parties [who have failed to object are] deemed to have given the consent contemplated by the *Bankruptcy Code Sections 365(c)(1)* and *(f)(1)* to the assumption of such Executory Contract by the relevant Debtors and the assignment of such Executory Contract to the [Buyers].

The deadline for filing such objections was August 13, 2001.

WBCP did not file an objection prior to the August 15, 2001 hearing. On August 17, 2001, WBCP filed its

Objection To Debtor's Notice of Intent To Assume and Assign Executory Contracts, arguing that certain of the notices were defective because they were either addressed to a general studio lot address at Warner Bros. Inc., instead of being addressed to the specified address that each of its license agreements require notice to be sent to: Warner Bros. Consumer Products, a Division of Time Warner Entertainment Company, L.P., 4000 Warner Blvd., Burbank, CA 91522. Despite the fact that each of the license [**5] agreements was executed by Gary Simon, a Senior Vice President of Warner Bros. Consumer Products, none of the notices were addressed to a particular individual within Warner Bros. Consumer Products. Certain of the notices that were addressed to the proper address, were addressed to the attention of the "Asst. Controller." These notices, however, incorrectly included references to license numbers that did not correspond to any WBCP licenses. Consequently, WBCP asserts that its general counsel, Wayne M. Smith, did not receive actual notice of the debtors' intent to assume and assign to the Buyers the specific license agreements at issue until August 14, 2001.

WBCP argues that the notices were additionally deficient because the schedule of [*304] license agreements to be assumed and assigned failed to designate each of the specific license agreements referred to by its specific license number, which is assigned by WBCP and printed in the upper right hand corner of the face of each of the agreements. WBCP supplemented this objection on August 18, 2001, explaining that it had learned that fourteen of the notices were incorrectly sent to another address specified in the license agreements, the [**6] check-processing center in Chicago, Illinois to which the payments and royalty statements must be sent according to each of the agreements. In the ordinary course, these notices were forwarded by the processing center to WBCP in Burbank, California, but did not arrive at the legal department until August 14, 2001.

In its August 17 objection motion, WBCP also objected to the assumption and assignment of the seven WBCP licenses and requested that, in light of the defective notice, the court consider its objection to be timely filed.

Also on August 17, 2001, WBCP filed a conditional objection, which again it asked the court to consider as timely filed. The conditional objection states that if the court overrules its objection with respect to the assumption and assignment of the license agreements, then the court must order the cure payment of $ 89,000 that it alleges is due and owing under four of the license agreements.

On August 20, 2001, WBCP amended its objection to the assumption and assignment of the seven licenses. In its amended objection, WBCP argued that three of the seven licenses were non-executed draft agreements and that the other four agreements were not assignable because [**7] they contained non-assignment clauses. On September 4, 2001, WBCP filed its Supplemental Memorandum of Points and Authorities in Support of its Filed Objections to Debtors' Notice of Intent to Assume and Assign Executory Contracts. In its memorandum, WBCP supplements its earlier arguments regarding the defectiveness of the notice and goes on to substantively argue that the agreements at issue are either non-assignable drafts or nonexclusive personal licenses, and that, under *§ 365(c) of the Bankruptcy Code*, copyright law prohibits the transfer of nonexclusive personal licenses without the permission of the licensor. The September 4 memorandum is the first objection that properly characterizes WBCP's objection as one under *§ 365(c) of the Bankruptcy Code.*

On September 12, 2001, WBCP withdrew its earlier filed objection to the assumption and assignment of one of the seven agreements, the Frosty License Agreement, a Merchandise and Promotional License Letter Agreement, dated April 1, 2001, by and between WBCP as licensor and Golden Books as licensee, pertaining to the character "Frosty the Snowman." WBCP maintains its objection regarding the assumption and assignment of the six remaining [**8] agreements.

On October 5, 2001, Random House filed its response to WBCP's objections to the debtor's assumption of the WBCP contracts and the subsequent assignment to Random House, Inc. In its brief, Random House argues that the WBCP objections are untimely and without substantive merit.

The court heard oral argument on WBCP's objections at an omnibus hearing for Golden Books bankruptcy matters on October 10, 2001. This is the court's decision on WBCP's objections.

II. DISCUSSION

A. Should the Court Entertain WBCP's Late-filed Objections

As stated above, WBCP contends that the court should consider the merits of its [*305] untimely filed objection to the assumption and assignment of certain license agreements, because the notice that was meant to inform them of the deadline for filing objections was defective.

Golden Books and one of the Buyers, Random House, argue in response that there is no equitable reason for the court to allow WBCP to withdraw its implied consent to the assignment and assumption of the license agreements at issue, which, they argue, occurred by vir-

tue of its own failure to register any timely objection with the court.

[HN1] *Rule 6006 of the Federal Rules of Bankruptcy Procedure* [**9] governs the assumption, rejection, or assignment of executory contracts. *Rule 6006(c)* requires notice of a proceeding to assume, reject, or assign an executory contract to be given to the other party to that executory contract. *Rule 6006(a)* provides that a proceeding to assume, reject, or assign an executory contract, other than as part of a plan, is a contested matter, governed by *Rule 9014*. *Rule 9014*, in turn, states that motions in contested matters must be served in the same manner provided for service of a summons and complaint in *Rule 7004*. *Rule 7004(b)(3)* provides for service by mail:

> Upon a domestic or foreign corporation or upon a partnership or other unincorporated association, by mailing a copy of the [notice] to the attention of an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process . . . .

Although bankruptcy courts have differed when addressing the issue of how strictly to interpret this provision, certain courts have found that these notice requirements are to be strictly adhered to. See, e.g., *In re Schoon, 153 B.R. 48 (Bankr. N.D. Cal. 1993)* [**10] (holding that by addressing an envelope Attn: President, the debtors did not serve an officer, they served an office, and finding that such service was invalid and "makes a joke of the requirement that an officer be served"); but see *In re C.V.H. Transp., Inc., 254 B.R. 331, 333 (Bankr. M.D. Pa. 2000)* (rejecting the strict interpretation of *Rule 7004(b)(3)* set forth in Schoon). Indeed, the Supreme Court has stated that strict fulfillment of notice requirements are central to our system of jurisprudence: "due process of law in any proceeding which is to be accorded finality [requires] notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and to afford them an opportunity to present their objections." *Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314, 94 L. Ed. 865, 70 S. Ct. 652 (1950).*

The court agrees with WBCP that the August 6, 2001 notice documents were deficient because, among other things, they failed to address any of the copies of the notice to a person of authority or to a person authorized to accept service. The person at Warner who is responsible for these contracts, Gary Simon, was well-known, [**11] or at least easily identifiable, to Golden Books, because he was the WBCP signatory on each of the signed contracts. In this case, it does not seem too onerous to require the notice to comply with the literal requirement that it be addressed to an officer or to the known person responsible for such licensing matters, in order for the notice to be considered "reasonably calculated" to afford WBCP an opportunity to object in this particular circumstance, especially given the extremely short period in which those receiving notice were given to file objections. Parties receiving the notice, which was dated August 6, 2001, were required to respond with objections by August 13, 2001; that is six business [*306] days. This short time period causes the impact of the asserted deficiencies in the notice to be more severe. Given that WBCP's general counsel did not receive actual notice until August 14, 2001, the court will consider the late filed objections as timely filed.

At the oral argument, counsel for Random House argued that even if such notice were found to be insufficient, the court should nonetheless refuse to entertain WBCP's objections either because (1) Random House should have already [**12] been on notice prior to August 6, 2001 due to its being on notice about the bid procedures, or (2) Random House's filings after the closing date of the sale were in bad faith and unduly prejudice the Buyers. The court will consider these equitable arguments in turn.

Random House first argues that prior to August 6, when notice of the assumption and assignment and of the August 15, 2001 sale hearing was sent out, WBCP had received on July 2, 2001 an earlier notice dated June 29, 2001 that its contracts were subject to assumption and assignment to the winning bidder of Golden Books's assets. At that point in time, the then-contemplated purchaser was another company, DIC GB Acquisition Corp. Golden Books ultimately sold the assets to the Buyers, Random House and Classic Media, Inc., who entered the bidding process after DIC and submitted the highest and best offer for the Golden Books assets at the July 27, 2001 auction. Random House argues that this earlier notice was sufficient to put WBCP on notice that its contracts would be assumed and assigned to Random House and Classic Media, and that to the extent WBCP had any objection to the assumption and assignment of its contracts, WBCP [**13] was required to file its objection at that time.

The court finds the argument that WBCP had adequate notice of these events by virtue of its notice of the prior sale procedures to be unpersuasive. WBCP has stated that while it did not object to its licenses being assigned to the original purchaser, DIC, it does object for valid business reasons to the assignment of these licenses to Random House. Random House and WBCP are competitors in the publishing industry, and Random House has a relationship with one of WBCP's largest competi-

tors, Disney. Therefore, notice of an earlier sale to which it would not object cannot be said to put WBCP on notice of the sale to Random House and Classic Media, Inc. This was the purpose of the August 6, 2001 notice.

Random House next notes that the WBCP's memorandum filed on September 4, 2001 to supplement its earlier objection was filed one week after the August 28, 2001 closing date of the sale of the Golden Books assets in which Random House and Classic Media, Inc. purchased assets from Golden Books that included these very contracts. Random House argues that although letters from WBCP's counsel demonstrate that WBCP knew the closing was happening, [**14] WBCP took no action to seek relief from the court to stop the sale. It concludes that WBCP's failure to act should preclude it from filing a post-sale objection. Random House contends that WBCP's September 4, 2001 request for relief is too late because it would unduly prejudice the Buyers now that the sale has gone through and the Buyers have paid a purchase price that includes the benefit of these contracts. Random House also contends that the earlier objections, standing alone, do not state any valid objection.

After reviewing the August 23, 2001, letter from WBCP's counsel to Golden Book's counsel, the court finds that WBCP's memorandum supplementing its [*307] objection, which was filed post-closing, was not filed in bad faith and was not filed after it waived its right to object. The letter states:

> In the course of our discussion, you indicated to me that the Debtor intends to close the Sale tomorrow, Friday, August 24, 2001, but that it is the Debtor's position that, pursuant to Paragraph 16 of the Order of the Bankruptcy Court approving the Sale, because the WBCP Objections have been filed and not withdrawn, the WBCP Agreements will not be affected by that closing. This letter [**15] will confirm that, based on this representation, WBCP will not file its motion with the Bankruptcy Court seeking a stay of the Order and tomorrow's proposed closing as to the WBCP Agreements. WBCP does, however, reserve its rights in all other respects, including (without limitation) its right to file such additional or supplemental pleadings in connection with the WBCP Objections as WBCP may deem appropriate.

Letter from Jon L.R. Dalberg, Esq., Andrews & Kurth L.L.P., to Jennifer Harding, Esq., Wilkie Farr & Gallagher (Aug. 23, 2001).

Random House argues that it was unaware of this letter and that the agreement reflected within was inconsistent with Golden Books' communicated position to Random House that the WBCP contracts were assigned to Random House at the closing. Random House also argues that WBCP should have taken action with the court instead of by private letter. The court finds that, based on the substance of the letter, action of the court would have been unnecessary at that time because WBCP believed that its objections would be preserved. Because WBCP believed that its objections were preserved under paragraph 16 of the Sale Order, in which the court reserved [**16] for decision all filed objections to the assumption and assignment of executory contracts, it, in good faith, did not seek to interfere with the consummation of the larger sale transaction. Although at this point the sale has already been consummated, Golden Books and the Buyers both knew of WBCP's objections to these six contracts before closing the deal. While the debtor and the Buyers argue that considering WBCP's objections at this point would prejudice them, the court finds that they have not proven the severe degree of prejudice necessary to convince this court that it must ignore WBCP's objections as a matter of equity.

It appears to the court that WBCP has acted in good faith throughout this process. Upon receiving the notice, WBCP acted quickly to file its objection with the court and later more fully fleshed out the substance of that objection through supplemental briefing. Although the sale has now been completed, the debtor and Buyers had sufficient notice of WBCP's objection before the closing date such that they cannot now claim that there is undue prejudice against them. Moreover, it should be noted that if the court were to consider and grant WBCP's objections, this [**17] would not undo the entire sale transaction. It would mean that, to the extent Golden Books sold assets that it did not own as a matter of law, the portions of the sale transaction relating to those assets would need to be adjusted.

The court therefore elects to treat WBCP's objections as timely filed and will address the merits of those objections. See [HN2] *Bankruptcy Rule 9006(b)(1)* (court may for cause enlarge the time within which an act is required to be done, before or after the expiration of the time, based on "excusable neglect"); *Chemetron Corp. v. Jones, 72 F.3d 341, 349 (3d Cir. 1995)* (discussing factors for equitable doctrine of [*308] "excusable neglect," which include the danger of prejudice to the debtor, the length of the delay, the reason for the delay, and whether the moving party acted in good faith); *Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship,*

507 U.S. 380, 123 L. Ed. 2d 74, 113 S. Ct. 1489 (1993). The objections, taken together, state that WBCP believes that Golden Books cannot transfer the agreements at issue without its consent.

B. Should the Court Sustain WBCP's Objections?

1. Does *§ 365(c)* prevent Golden Books from assuming and assigning the Scooby [**18] Doo and Power Puff Girl licenses with the consent of WBCP?

[HN3] Under *§ 365(c) of the Bankruptcy Code*, when an executory contract can not be assigned under applicable non-bankruptcy law, it may not be assumed or assigned by the bankruptcy trustee without permission of the other contracting party. Lawrence P. King et al., 3 *Collier on Bankruptcy P 365.06[1]* (15th ed. 1997). The relevant portion [HN4] of *§ 365(c)* states:

> Trustees may not assume or assign any executory contract . . . of the debtor, whether or not such contract . . . prohibits or restricts assignment of rights if, . . .
>
> 1)
>
> > A) applicable law excuses a party, other than the debtor, to such contract from accepting performance from or rendering performance to an entity other than the debtor or debtor in possession. . . . whether or not such contract . . . prohibits or restricts assignment of rights or delegation of duties; and
> >
> > B) such party does not consent to such assumption or assignment.

11 U.S.C. § 365(c). In this case, Golden Books is operating as the trustee because it is a debtor in possession pursuant to *11 U.S.C. § 1107(a).*

The issue [**19] before the court is whether Golden Books, as debtor in possession, can freely assign the license agreements at issue to the Buyers without the permission of WBCP. To resolve this issue, the court must first determine whether the copyright licenses are "executory contracts" within the meaning of *11 U.S.C. § 365(c).* If they are, the court must then determine whether under the "applicable law" of copyright, the licenses are not freely transferable. *11 U.S.C. § 365(c)(1)(A).*

Golden Books and the Buyers first argue that the six license agreements at issue are not "executory contracts" within the meaning of *section 365(c).* [HN5] The Third Circuit test to be applied to determine whether a contract is executory is the "Countryman" test, which provides that a contract is executory when the obligations of "both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Countryman, Executory Contracts in Bankruptcy; Part I, 57 Minn. L. Rev. 439, 460 (1973); *In re Columbia Gas Sys., 50 F.3d 233, 239 (3d Cir. 1995)* [**20] (citing *Sharon Steel Corp. v. Nat'l Fuel Gas Distrib. Corp., 872 F.2d 36, 38-39 (3d Cir. 1989)).* Applying the Countryman definition of executory contracts, courts generally have found intellectual property licenses to be "executory" within the meaning of *section 365(c)* because each party to the license had the material duty of "refraining from suing the other for infringement of any of the [intellectual property] covered by the license." *In re Access Beyond Tech., Inc., 237 B.R. 32 (Bankr. D. Del. 1999)*; see generally, [*309] Bradley N. Raderman and John Walshe Murray, Assumption and Assignment of Patent Licenses under Chapter 11 of the Bankruptcy Code, 6 J. Bankr. L. & Prac. 513, 514-15 (1997). The court thus finds that the WBCP's licenses are executory contracts within the meaning of *§ 365(c).*

The issue under *§ 365(c)* thus becomes a question of copyright law: Does copyright law preclude the free assignment of the licenses at issue? Courts have generally found that the answer to this question turns on [HN6] whether each particular license is exclusive or nonexclusive. See generally *In re Patient Educ. Media, Inc., 210 B.R. 237 (Bankr. S.D.N.Y. 1997)*; [**21] See *Perlman v. Catapult Entm't Inc. (In re Catapult Entm't, Inc.), 165 F.3d 747 (9th Cir. 1999)*; see also Aleta A. Mills, Note: The Impact of Bankruptcy on Patent and Copyright Licenses, *17 Bankr. Dev. J. 575, 585-86 (2001)* (collecting and summarizing cases).

[HN7] Under copyright law, "a nonexclusive licensee . . . has only a personal and not a property interest in the [intellectual property]," which "cannot be assigned unless the [intellectual property] owner authorizes the assignment . . . ." *In re Patient Educ. Media, 201 B.R. 234, 242-43* (citing references omitted); see also 3 Melvin B. Nimmer & David Nimmer, *Nimmer on Copyright § 10.02[A]* at 10-23 (1996) (hereinafter "Nimmer"). By contrast, however, an exclusive licensee does acquire property rights and "may freely transfer his rights, and moreover, the licensor cannot transfer the same rights to anyone else." *In re Patient Educ. Media, 201 B.R. at*

240; see also 3 *Nimmer § 10.02[A]* at 10-23; but see *Gardner v. Nike, Inc., 110 F. Supp. 2d 1282, 1287 (C.D. Cal. 2000)* (analyzing the Copyright Act and holding that licensees cannot freely [**22] transfer rights even under exclusive license).

To determine whether the agreements are exclusive or nonexclusive licenses, the court must examine the terms of the agreements. Two of the agreements at issue, the March 6, 2000 publishing license relating to Scooby-Doo [*310] and the March 6, 2000 publishing license relating to the Power Puff Girls contain the following language in Section 3(b), which is labeled "Reservation of Rights; Premiums:"

> Notwithstanding anything to the contrary stated herein, Licensor, for itself and its affiliates, specifically reserves the right, without limitation throughout the world, to use, or license any third party(s) of its or their choice to use the Licensed Property . . . . Further, Licensor reserves the right to use, or license others to use, and/or manufacture products similar or identical to those licensed herein for use as premiums.

Moreover, both agreements include the following language in Section 19 of the Agreements' Standard Terms and Conditions:

> This Agreement is personal to the Licensee. Licensee shall not sublicense, franchise, or delegate to third parties its rights hereunder (except as set forth in Paragraph 10(b) hereof). [**23]

Last, Section 20 of both agreements expressly states, that the parties

> acknowledge and agree that in a bankruptcy context this Agreement is a license of the type described by *Section 365(c)(1) of the Bankruptcy Code* and may not be assigned without prior written consent of the Licensor.

In light of all of this language, it is clear that these two licenses do not confer exclusive rights to Golden Books. Both licenses are therefore nonexclusive.

The other two publishing license agreements have an effective date of July 12, 2001 and also respectively relate to Scooby-Doo and the Power Puff Girls. These two license agreements contain even clearer language than March 6, 2000 agreements, which indicates that they are nonexclusive license agreements. The two licenses, contain identical "Grant of Rights" sections which state that "subject to these Standard Terms and Conditions, Licensor [WBCP] grants Publisher [Golden Books] the non-exclusive right during the Term and in the Territory to utilize the Property and the Licensed Materials . . . ." No other language within these two licenses indicates that they are exclusive licenses or that, as Random House argues, [**24] the quoted language above means that the licenses are limited in duration and geographic scope, but are nonetheless exclusive with respect to those limited rights.

Accordingly, the court finds that the four license agreements relating to Scooby-Doo and the Power Puff Girls are nonexclusive licenses and are therefore non-assignable under the copyright law. It is evident from the language of these four licenses that WBCP meant to exercise a considerable degree control over these licenses as a matter of business policy. As stated above, prevailing case law holds that nonexclusive intellectual property licenses do not give rise to ownership rights and cannot, as a matter of law, be assigned without the consent of the licensor. See In re Catapult Entertainment, 165 F.3d at 750 (holding nonexclusive licenses do not give rise to ownership rights and are not assignable over the objection of the licensor); *In re Patient Educ. Media, 210 B.R. at 240* (same); *In re Access Beyond Tech., 237 B.R. at 44* (finding that patent license agreement at issue was nonexclusive because it did not convey the exclusive right or some part of the exclusive right [**25] to practice the invention and did not grant any right to exclude others from practicing the patents and holding that nonexclusive license is not assignable).

2. Can Golden Books assume and assign the two Cartoon Network licenses

WBCP next contends that the two agreements pertaining to the "Cartoon Network Originals" and "Cartoon Network Classics -- Hanna Barbera" are unexecuted drafts that do not constitute contracts at all and that, therefore, Golden Books has no rights to assume and assign them. Golden Books' own listing of these two contracts on page S-21 of the contract assignment schedule that was appended as an exhibit to the Notice and entitled "Section 2.1(e) Licenses" describes the two Cartoon Networks licenses as "drafts."

WBCP argues that, as a matter of law, only executory contracts that are in existence as of the time of the commencement of the bankruptcy may be assumed or assigned, because if no contract exists, there is nothing to assume or assign. See Lawrence P. King et al., 3 *Collier on Bankruptcy P 365.02[2]* (15th ed. 1997) (contract terminated pre-petition cannot be assumed or assigned

because "there is nothing left . . . to assume or assign"). [**26] In response, Golden Books and the Buyers claim that both parties were operating under these two agreements and that, at minimum, they were oral contracts that were being honored by Warner and not merely drafts.

It is clear that even according to WBCP, the parties were operating under both of these contracts. WBCP, in its conditional objection seeking cure amounts, claims that "according to WBCP's internal accounting records, the following Guaranteed Payments are past due and owing:" (1) for the "96724 TOON license" covering "Various Cartoon Network," Golden Books owes WBCP $ 10,000; (2) for the "12546 [*311] CNHBD license" covering Various Cartoon Network-- Hanna Barbera," Golden Books owes WBCP is $ 50,000. Thus, these agreements were not drafts, but binding oral agreements that are demonstrated by the parties' course of conduct.

The only question that remains for the court to resolve is whether such oral agreements can confer exclusive rights to a licensee that are freely transferable under copyright law. This question has already been answered by other courts and by the Copyright Act itself. [HN8] According to the Copyright Act, *17 U.S.C. § 204(a)*, while a non-exclusive [**27] license may be oral, an exclusive license "is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights conveyed . . . ." *Eden Toys, Inc. v. Florelee Undergarment Co., Inc., 697 F.2d 27, 36 (2d Cir. 1982)*; *17 U.S.C. § 204(a)* ("A transfer of copyright ownership, other than by operation of law, is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights conveyed or such owner's duly authorized agent"). The purpose of the provision is to protect copyright holders from persons mistakenly or fraudulently claiming oral licenses. See *Eden Toys, Inc., 697 F.2d at 36*. Because the court concludes that such oral licenses must, as a matter of law, be nonexclusive, the court finds that Golden Books may not assume and assign these two licenses without the permission of WBCP. See *supra*, § II.B.1.

III. CONCLUSION

The court finds that the four licenses relating to Scooby-Doo and the Power Puff Girls are nonexclusive licenses. The court also finds that the two licenses [**28] relating to Cartoon Network are nonexclusive licenses. Because under applicable copyright law, nonexclusive licenses are personal and do not convey an ownership interest to the licensee that allows that licensee to freely transfer its rights, the court finds that copyright law prevents the free assumption and assignment of these agreements.

Accordingly, WBCP' objection will be upheld. The court will enter an order in accordance with this memorandum opinion.

Analysis
As of: Feb 07, 2012

IN RE: GOLDEN BOOKS FAMILY ENTERTAINMENT, INC., GOLDEN BOOKS PUBLISHING COMPANY, INC., GOLDEN BOOKS HOME VIDEO, INC., LRM ACQUISITION CORP., SHARI LEWIS ENTERPRISES, INC., and SLE PRODUCTIONS, INC., Debtors.

Chapter 11, Case No. 01-1920 through 01-1925 (RRM) Jointly Administered

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE

269 B.R. 311*; *2001 Bankr. LEXIS 1442

November 8, 2001, Decided

PRIOR HISTORY: *In re Golden Books Family Entm't, Inc., 2001 Bankr. LEXIS 1439 (Bankr. D. Del. Nov. 8, 2001)*

DISPOSITION: [**1] DIC's objection was denied.

CASE SUMMARY:

PROCEDURAL POSTURE: Debtor sought to assume and assign various executory contracts. Among the contracts was an agreement with company, in which debtor licensed certain of company's copyright and trademark rights with respect to a children's character. The company objected to the transfer of the rights to the character.

OVERVIEW: The company argued that the agreement in question was an executory contract within the meaning of *11 U.S.C.S. § 365(c)*, that the agreement was a nonexclusive personal license, and that copyright law prohibited the transfer of nonexclusive personal licenses without the permission of the licensor. The company set forth an alternative argument that even if the court disagreed with the company's characterization of the agreement as a nonexclusive license and found that the agreement was an exclusive license, copyright law also prohibited the free transfer of exclusive licenses. Based on the licenses terms, the court found that the agreement was an exclusive license. The court also found that, under applicable copyright law, exclusive licenses convey an ownership interest to the licensee that allows that licensee to freely transfer its rights. Therefore, in this case, copyright law did not prevent the assumption and assignment of the agreement.

OUTCOME: The company's objection was denied.

LexisNexis(R) Headnotes

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Powers
Contracts Law > Types of Contracts > Executory Contracts
[HN1] Under *11 U.S.C.S. § 365(c)*, when an executory contract can not be assigned under applicable non-bankruptcy law, it may not be assumed or assigned by the bankruptcy trustee without permission of the other contracting party.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
Contracts Law > Types of Contracts > Executory Contracts
[HN2] See *11 U.S.C.S. § 365(c).*

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
Contracts Law > Breach > Material Breach
Contracts Law > Types of Contracts > Executory Contracts
[HN3] The test to be applied to determine whether a contract is executory is the "Countryman" definition, which provides that a contract is executory when the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other. Applying the Countryman definition of executory contracts, courts generally have found intellectual property licenses to be "executory" within the meaning of *11 U.S.C.S. § 365(c)* because each party to the license had the material duty of refraining from suing the other for infringement of any of the intellectual property covered by the license.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > General Overview
Copyright Law > Conveyances > General Overview
[HN4] To determine whether copyright law precludes free assignment turns on whether the license is exclusive or nonexclusive.

Copyright Law > Conveyances > Licenses > General Overview
Copyright Law > Conveyances > State Regulation
[HN5] Under copyright law, a nonexclusive licensee has only a personal and not a property interest in the intellectual property, which cannot be assigned unless the intellectual property owner authorizes the assignment. By contrast, however, an exclusive licensee does acquire property rights and may freely transfer his rights, and moreover, the licensor cannot transfer the same rights to anyone else.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Assignments

Copyright Law > Conveyances > General Overview
[HN6] Copyright law clearly distinguishes between the legal effect of a nonexclusive license and an exclusive license. Contract clauses restricting assignment do not change this calculus under the copyright law.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Assignments
Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
Contracts Law > Types of Contracts > Executory Contracts
[HN7] See *11 U.S.C.S. § 365(f)(1).*

Commercial Law (UCC) > Sales (Article 2) > Form, Formation & Readjustment > Third Party Contracts
Copyright Law > Conveyances > Licenses > Nonexclusive Licenses
Patent Law > Ownership > Conveyances > Licenses
[HN8] Nonexclusive intellectual property licenses do not give rise to ownership rights and are not assignable over the objection of the licensor.

Copyright Law > Owner Rights > General Overview
[HN9] See *17 U.S.C.S. § 106.*

Copyright Law > Conveyances > Divisibility of Rights
Copyright Law > Conveyances > Licenses > Exclusive Licenses
Copyright Law > Ownership Interests > Initial Ownership
[HN10] See *17 U.S.C.S. § 201(d).*

Copyright Law > Conveyances > Divisibility of Rights
Copyright Law > Conveyances > Licenses > Exclusive Licenses
Copyright Law > Conveyances > Licenses > Nonexclusive Licenses
[HN11] Ownership is the sine qua non of the right to transfer, and the copyright law distinguishes between exclusive and nonexclusive licenses. A transfer of copyright ownership includes the grant of an exclusive license, but not a nonexclusive license. *17 U.S.C.S. § 101.* The holder of the exclusive license is entitled to all of the rights and protections of the copyright owner to the extent of the license. *17 U.S.C.S. § 201(d).* Accordingly, the licensee under an exclusive license may free-

ly transfer his rights, and moreover, the licensor cannot transfer the same rights to anyone else.

Contracts Law > Types of Contracts > Executory Contracts
Copyright Law > Conveyances > Licenses > Exclusive Licenses
Copyright Law > Owner Rights > General Overview
[HN12] Pursuant to *17 U.S.C.S. § 201(d)(2)* of the Copyright Act, the holder of an exclusive copyright is entitled, to the extend of such right, to all of the rights and remedies accorded to a copyright owner. Such rights include the exclusive right to transfer. A licensee under an exclusive copyright license would, therefore, have the right to transfer its exclusive right to do and to authorize the designated uses of the copyright. Based on the foregoing, an e-commerce debtor-licensee's exclusive license is not implicated by *11 U.S.C.S. § 365(c)*.

Copyright Law > Conveyances > Licenses > Exclusive Licenses
Copyright Law > Conveyances > State Regulation
[HN13] See *17 U.S.C.S. § 101*.

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Rachel B. Mersky, Esquire, Walsh Monzack and Monaco, Wilmington, Delaware, for Classic Media and Random House.

Leslie A. Cohen, Esquire, Liner, Yankelevitz, Sunshine & Regenstreif, Santa Monica, California, for Classic Media and Random House.

JUDGES: McKELVIE, District Judge.

OPINION BY: McKELVIE

OPINION

[*312] **MEMORANDUM OPINION**

Wilmington, Delaware

November 8, 2001

McKELVIE, District Judge

This is a bankruptcy case. Golden Books Family Entertainment, Inc. is a debtor before this court. Golden Books publishes, produces, licenses, and markets a host of children's and family-related media and entertainment products. It owns an array of film copyrights, distribution rights, trademarks, and licenses relating to characters, television programs, and motion pictures. Moreover, through [**2] a number of license agreements, Golden Books publishes children's books featuring characters owned by other companies.

Golden Books, as part of its sale of its assets to Random House and Classic Media, Inc. ("the Buyers"), is proposing to assume and assign various executory contracts. Among the contracts that Golden Books is seeking to assume and assign is an Agreement, dated April 20, 1998, with DIC Entertainment, L.P., in which Golden Books licenses certain of DIC's copyright and trademark rights with respect to the children's character, Madeline (the "Madeline Agreement").

This court approved Golden Books' proposed asset sale to the Buyers in a sale [*313] order dated August 15, 2001. Golden Books and the Buyers formally consummated the sale transaction at a closing on August 28, 2001. On or before the August 15, 2001, sale hearing, several parties filed objections contesting the assumption and assignment of certain executory contracts pursuant to the terms of the Buyers purchase agreement. The court was not asked to rule on the merits of those objections at the sale hearing and the these rights were preserved for later argument and ruling. Paragraph 12 of the sale order for the sale [**3] to the Buyers provides that:

> all parties [who have failed to object are] deemed to have given the consent contemplated by the *Bankruptcy Code Sections 365(c)(1)* and *(f)(1)* to the assumption of such Executory Contract by the relevant Debtors and the assignment of such Executory Contract to the [Buyers].

After being notified of the sale, DIC filed a motion with the court on August 13, 2001, objecting to the transfer of the rights to Madeline from Golden Books to the Buyers under *§ 365(c)* of the bankruptcy code, which prohibits a bankruptcy trustee from assuming and assigning executory contracts where applicable non-bankruptcy law operates to prohibit such transfers. In its objection brief, DIC argues that the Madeline Agreement is an executory contract within the meaning

of *§ 365(c) of the Bankruptcy Code*, that the Madeline Agreement is a nonexclusive personal license, and that copyright law prohibits the transfer of nonexclusive personal licenses without the permission of the licensor. At an oral argument before the court on September 28, 2001, DIC set forth an alternative argument that even if the court disagrees with DIC's characterization of the Madeline Agreement [**4] as a nonexclusive license and finds that the Madeline Agreement is an exclusive license, copyright law also prohibits the free transfer of exclusive licenses. DIC found support for this proposition of law in the recent Central District of California case, *Gardner v. Nike, Inc., 110 F. Supp. 2d 1282 (C.D. Cal. 2000)*.

The objection motion has been fully briefed and argued by both parties. This is the court's decision on DIC's motion.

I. DISCUSSION

[HN1] Under *§ 365(c) of the Bankruptcy Code*, when an executory contract can not be assigned under applicable non-bankruptcy law, it may not be assumed or assigned by the bankruptcy trustee without permission of the other contracting party. Lawrence P. King et al., 3 *Collier on Bankruptcy P 365.06[1]* (15th ed. 1997). The relevant portion of *section 365(c)* states:

> [HN2] Trustees may not assume or assign any executory contract . . . of the debtor, whether or not such contract . . . prohibits or restricts assignment of rights if, . . .
>
> 1)
>
> A) applicable law excuses a party, other than the debtor, to such contract from accepting performance from or rendering performance to an entity other than the debtor [**5] or debtor in possession. . . .whether or not such contract . . . prohibits or restricts assignment of rights or delegation of duties; and
>
> B) such party does not consent to such assumption or assignment.

11 U.S.C. § 365(c). In this case, Golden Books is operating as the trustee because it is a debtor in possession pursuant to *11 U.S.C. § 1107(a)*.

The issue before the court is whether Golden Books, as debtor in possession, can freely assign the Madeline Agreement to the Buyers without the permission of DIC. [*314] To resolve this issue, the court must first determine whether a copyright license is an "executory contract" within the meaning of *11 U.S.C. § 365(c)*. If it is, the court must then determine whether under the "applicable law" of copyright, the license is one that is not freely transferable. *11 U.S.C. § 365(c)(1)(A)*.

The parties do not dispute that the Madeline Agreement is an "executory contract" within the meaning of *section 365(c)*. Courts, including the Third Circuit, have widely held that [HN3] the test to be applied to determine whether a contract is executory is the "Countryman" definition, which [**6] provides that a contract is executory when the obligations of "both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Countryman, Executory Contracts in Bankruptcy; Part I, 57 Minn. L. Rev. 439, 460 (1973); see also *Everex Systems. Inc. v. Cadtrak Corp (In re CFLC, Inc.), 89 F.3d 673, 677 (9th Cir. 1996)* (an executory contract is "a contract . . . on which performance is due to some extent on both sides"); *Sharon Steel Corp. v. Nat'l Fuel Gas Distrib. Corp., 872 F.2d 36, 39 (3d Cir. 1989)*. Applying the Countryman definition of executory contracts, courts generally have found intellectual property licenses to be "executory" within the meaning of *section 365(c)* because each party to the license had the material duty of "refraining from suing the other for infringement of any of the [intellectual property] covered by the license." *In re Access Beyond Tech., Inc., 237 B.R. 32 (Bankr. D. Del. 1999)*; see generally, Bradley N. Raderman and John Walshe Murray, Assumption and [**7] Assignment of Patent Licenses under Chapter 11 of the Bankruptcy Code, 6 J. Bankr. L. & Prac. 513, 514-15 (1997).

The issue thus becomes a question of copyright law: [HN4] Does copyright law preclude the free assignment of the Madeline Agreement? Courts have generally found that the answer to this question turns on whether the license is exclusive or nonexclusive. See generally *In re Patient Educ. Media, Inc., 210 B.R. 237 (Bankr. S.D.N.Y. 1997)*; *Perlman v. Catapult Entm't, Inc. (In re Catapult Entm't, Inc.), 165 F.3d 747 (9th Cir. 1999)*; see also Aleta A. Mills, Note: The Impact of Bankruptcy on Patent and Copyright Licenses, *17 Bankr. Dev. J. 575, 585-86 (2001)* (collecting and summarizing cases). [HN5] Under copyright law, "a nonexclusive licensee . . . has only a personal and not a property interest in the [intellectual property]," which "cannot be assigned unless

the [intellectual property] owner authorizes the assignment . . . ." *In re Patient Educ. Media, 210 B.R. at 242-43* (citing references omitted); see also 3 Melvin B. Nimmer & David Nimmer, *Nimmer on Copyright § 10.02[A]* at 10-23 (1996) (hereinafter "Nimmer"). [**8] By contrast, however, an exclusive licensee does acquire property rights and "may freely transfer his rights, and moreover, the licensor cannot transfer the same rights to anyone else." *In re Patient Educ. Media, 210 B.R. at 240*; see also 3 *Nimmer § 10.02[A]* at 10-23; but see *Gardner, 110 F. Supp. 2d at 1287* (analyzing the Copyright Act and holding that licensees cannot freely transfer rights even under exclusive license).

To determine whether the Madeline Agreement is an exclusive or nonexclusive license, the court must examine the terms of the agreement itself.

A. The Madeline Agreement

In the Madeline Agreement, DIC granted to Golden Books certain rights in Madeline cartoons that were owned by DIC. Section 2(a) of the Agreement, which sets [*315] forth the parties "Basic Rights," states that, with respect to 25 specified currently existing half-hour animated programs based on the [Madeline Property],

> DIC hereby grants to Golden, throughout the Territory, the sole, exclusive, and irrevocable right, license, and privilege to (i) manufacture, sell, rent, and otherwise distribute "Videograms" of the Programs in any and all formats and [**9] configurations; (ii) publicize, advertise, exploit, promote, market and turn to account copies of such Videograms ("Copies") in connection with any or all of the foregoing rights, and (iii) license, lease, and authorize others to do any or all of foregoing during the Term.

As set forth in section 3, the "Term" of the license agreement runs from April 20, 1998 until June 1, 2004. The "Territory" is defined, in section 4 of the Agreement, as including the United States and its territories and Canada. "Videograms" is defined in section 2(a) as "a cassette, disc, or other device now known or hereafter devised and designed to be used in conjunction with a reproduction apparatus which causes a visual image . . . to be seen on the screen of a television receiver or any comparable device . . . ."

At oral argument, Golden Books and the Buyers pointed to a number of relevant provisions of the Agreement that they believe demonstrate that the Madeline Agreement is an exclusive and not a nonexclusive license. Specifically, Buyers counsel directed the court to:

> section 2(a), set forth above;
>
> section 2(c), which states that "Golden Books shall have the sole, full, and complete [**10] discretion concerning the manufacture, distribution, marketing, and other exploitation of all Videograms and Copies" and that the judgment of Golden Books as to all matters affecting exploitation shall be binding on DIC;
>
> section 2(d), which states that Golden Books shall have the sole and exclusive right to negotiate and enter into contracts with respect to the property, "including the right to sublicense its rights hereunder";
>
> section 2(e), which states that "Golden Books shall have the right to use and authorize others to use the name, physical likeness . . . biographies, and voice of any person rendering services in connection with the Programs";
>
> section 9, which obligates DIC to provide further assurances in the event that there is a question as to the grant that has been given to Golden Books in the agreement; and,
>
> section 12(d), which states that none of the rights granted to Golden Books in the Agreement has been or will be transferred by DIC to any third party.

Each of these rights seems to indicate that Golden Books did hold exclusive rights with respect to the licensed property.

In apparent contradiction to section 2(a), which gives Golden Books [**11] the exclusive right to sub-license the Madeline Properties to others, the Agreement also includes among its miscellaneous provisions a section labeled Assignments/Sublicense (section 18(e)), which states that subject to certain exceptions: "Neither party shall have the right to assign its rights and obligations hereunder without the other party's prior consent, which consent shall not be unreasonably withheld."

B. Is the Madeline Agreement Exclusive or Nonexclusive

It is clear from the above listed terms that the Madeline Agreement grants to Golden Books certain exclusive rights with respect to a sub-set of the copyright relating to the Madeline video properties that DIC owns. Golden Books and the Buyers [*316] argue that the Madeline Agreement is an exclusive license simply because it grants to Golden Books certain exclusive rights. They also argue that limitations in the license as to territory and term do not undercut the exclusivity of the license, because rights conferred under exclusive licenses can and often do encompass less than the whole right to the property. DIC argues, however, that because the exclusive rights only cover a sub-set of the rights that DIC owns (e.g., they [**12] are in a limited territory and for a limited time), the license must be a nonexclusive license.

DIC's position that the license is necessarily nonexclusive because it only grants exclusive rights to a set of rights that are limited in temporal and geographical scope is incorrect as a matter of law. Intellectual property rights are recognized as bundles of rights, portions of which may be exclusively or nonexclusively licensed. The fact that only certain rights are exclusively licensed does not convert the license to a nonexclusive license. Under copyright law, even if one licenses a right that is limited in geographic or temporal scope, if that right is nonetheless exclusive within those parameters, it is an exclusive grant of a copyright. Therefore, based on the licenses terms, the court finds that the Madeline Agreement is an exclusive license.

DIC's only plausible textual argument in support of nonexclusivity is that section 18(e) detracts from the exclusivity of the license in the sense that Golden Books cannot have a freely transferable property interest if they need DIC's permission to sub-license it. Given the many provisions in the Agreement that indicate that this license [**13] was indeed meant to be exclusive, the court declines to accept this argument.

[HN6] Copyright law clearly distinguishes between the legal effect of a nonexclusive license and an exclusive license. Contract clauses restricting assignment do not change this calculus under the copyright law. The court therefore finds that the non-assignment clause of section 18(e) is exactly the type of boilerplate restriction of assignment that *section 365(f)* states should have no bearing on this matter. See *11 U.S.C. § 365(f)(1)* ("[HN7] Except as provided in subsection (c) of this section, *notwithstanding a provision in an executory contract . . . that prohibits, restricts, or conditions the assignment of such a contract* . . . the trustee may assign such contract . . .") (emphasis added); see also *11 U.S.C. § 365(c)* ("Trustees may not assume or assign any executory contract . . . of the debtor, whether or not such contract . . . prohibits or restricts assignment of rights if . . ." excused by applicable law).

Accordingly, the court finds that the Madeline Agreement is an exclusive license.

C. Under Copyright Law, Does Golden Books Need DIC's Consent [**14] to Transfer the Madeline Agreement

DIC's objection as filed asserts that the Madeline Agreement is a nonexclusive license and is therefore non-assignable under the copyright law. Prevailing case law holds that [HN8] nonexclusive intellectual property licenses do not give rise to ownership rights and are not assignable over the objection of the licensor. See In re Catapult Entertainment, 165 F.3d at 750 (holding nonexclusive licenses do not give rise to ownership rights and are not assignable over the objection of the licensor); *In re Patient Educ. Media, 210 B.R. at 240* (same); *In re Access Beyond Tech., 237 B.R. at 44* (finding that patent license agreement at issue was nonexclusive because it did not convey the exclusive right or some part of the exclusive right to practice the invention and did not grant any right to exclude others from practicing the patents and holding that nonexclusive [*317] license is not assignable). Having now found that the Madeline Agreement is an exclusive license, the court must now determine whether copyright law allows an exclusive licensee to freely transfer such a license.

At oral argument, DIC alternatively [**15] contended that if the court determined that the Madeline Agreement was an exclusive license that, as a matter of copyright law, even an exclusive license cannot be assigned without the licensor's consent. To support this argument, DIC relies on *Gardner v. Nike, 110 F. Supp. 2d 1282 (C.D. Cal. 2000)*.

In Gardner, Nike and Sony entered into an exclusive licensing agreement for the use of a cartoon character created by Nike. Sony subsequently transferred its rights under the license to Gardner, who started using the character on various products. In response to threatened legal action from Nike, Gardner brought an action for declaratory relief against Nike seeking a declaration of his right to use the character. Gardner argued that under the Copyright Act, Sony, the original licensee, was allowed to transfer its rights to him without the consent of the original licensor, because the exclusive license made the original licensee an "owner" under the Copyright Act. As an "owner," Gardner asserted, the original licensee was able to transfer whatever rights it had (including the right to assign, as set forth in *§ 106* of the Copyright Act [1]) under *§ 201(d)* of the Copyright [**16] Act. [2] *Gardner, 110 F. Supp. 2d at 1284*. In opposition, Nike argued that, according to the text of *§ 201(d)*, the original licensee was not an "owner" who has all the rights of ownership

(including the right to assign); rather, *§ 201(d)* only conferred upon the original licensee the "protections and remedies" of a copyright owner, which the court held includes only the right to sue and defend suits in its own name, but not the right to assign. Id. The Gardner court agreed with Nike and held that exclusive licensees do not have the right to assign under *§ 201(d)* of the Copyright Act. *Id. at 1286.*

> 1 *Section 106* of the Copyright Act provides in relevant part that [HN9] "the owner of [the] copyright . . . has the exclusive rights to do and to authorize" the designated uses of the copyrighted work. *17 U.S.C. § 106.*
> 2 *Section 201(d)* of the Copyright Act provides as follows:
>
> [HN10] (d) Transfer of Ownership.
>
> The ownership of a copyright may be transferred in whole or in part by any means of conveyance or by operation of law . . .
>
> Any of the exclusive rights comprised in a copyright, including any subdivision of any of the rights specified by *section 106*, may be transferred as provided by the clause (1) and owned separately. The owner of any particular exclusive right is entitled, to the extent of that right, to all of the protection and remedies afforded to the copyright owner by this title. *17 U.S.C. § 201(d).*

[**17] Commentators have noted that the holding in Gardner flatly contradicts the leading treatise on copyright law, Nimmer on Copyright, and leading bankruptcy cases such as In re Patient Educ. Media that state that under the Copyright Act exclusive licenses are freely assignable. See, e.g., Ronald Leibow, Ashleigh Danker & Keith Murphy, Transfer of Intellectual Property Rights in Bankruptcy, 820 PLI/Comm 1141, 1154-1163 (2001).

In re Patient Education Media is a bankruptcy case. The issue presented in Patient Education Media was whether the debtor could transfer its nonexclusive license to use the copyrighted work over the objection of the copyright owner. Although the court did not need to address exclusive licenses in its holding, in dicta the court referred to the distinction in the [*318] copyright law between nonexclusive and exclusive licenses, and concluded that, in contrast to nonexclusive licenses, exclusive licenses are freely assignable. The court reasoned that:

> [HN11] Ownership is the sine qua non of the right to transfer, and the copyright law distinguishes between exclusive and nonexclusive licenses. A "transfer of copyright ownership" includes the grant of an [**18] exclusive license, but not a nonexclusive license. *17 U.S.C. § 101.* The holder of the exclusive license is entitled to all of the rights and protections of the copyright owner to the extent of the license. *17 U.S.C. § 201(d).* See generally 3 *[Nimmer] § 10.02[A]* at 10-23 (1996) []. Accordingly, the licensee under an exclusive license may freely transfer his rights, and moreover, the licensor cannot transfer the same rights to anyone else.

In re Patient Educ. Media, 210 B.R. at 240. The proposition that exclusive licenses are freely assignable by the licensee is echoed in the Nimmer on Copyright treatise (which is cited in the above quote from Patient Education Media) and in other bankruptcy treatises that address this issue. See, e.g., Primoff and Weinberger, E-Commerce and Dot-Com Bankruptcies: Assumption, Assignment, and Rejection of Executory Contracts, Including Intellectual Property Agreements, and Related Issues Under *Sections 365(c), 365(e),* and *365(n)* of the Bankruptcy Code, 8 American Bankruptcy Institute Law Review 307, 326 (2000) ("[HN12] Pursuant to *section 201(d)(2)* of the Copyright Act, [**19] the holder of an exclusive copyright is entitled, to the extend of such right, to all of the rights and remedies accorded to a copyright owner. Such rights include the exclusive right to transfer. A licensee under an exclusive copyright license would, therefore, have the right to transfer its exclusive right to do and to authorize the designated uses of the copyright. Based on the foregoing, an e-commerce debtor-licensee's exclusive license is not implicated by *section 365(c) of the Bankruptcy Code*").

This court finds the reasoning of Gardner to be unpersuasive. The Copyright Act clearly states that there is a key distinction between exclusive and nonexclusive licenses. *Section 101* of the Copyright Act defines a "Transfer of Copyright Ownership" as the:

> [HN13] assignment, mortgage, *exclusive license,* or any other conveyance, alienation, or hypothecation of a copyright or any of the exclusive rights comprised in a copyright, whether or not it is limited in time or place of effect, but not including a nonexclusive license.

17 U.S.C. § 101 (emphasis added). The court in Gardner held that conferring "protections and remedies" on an exclusive [**20] licensee is distinct from conferring ownership rights. In so doing, the Gardner court effec-

tively interpreted *§ 201(d)* to limit the meaning of "ownership" as set forth in *§ 101*. According to the Gardner court's construction of the phrase "protections and remedies" in *§ 201 (d)*, granting exclusive licensees "protections" does not necessarily grant them the right to assign. Rather, it only confers on the licensee the right to sue for infringement and to defend suits in its own name. This right is set forth for copyright owners in § 501(b). It is difficult to understand why the Gardner court held that the phrase "protections and remedies" confers on exclusive licensees the particular rights of copyright owners that are set forth in § 501(b), but does not confer to exclusive licensees the rights of copyright owners, such as the right to freely assign, that are set forth in *§ 106*.

The more natural reading of *§ 201(d)* is that Congress intended exclusive licensees to have all of the rights of an owner to the extent the license is intended to cover each of these rights. The court therefore declines to adopt the holding of [*319] the Gardner court and instead finds, in accordance [**21] with Patient Educ. Media and Nimmer, that exclusive licensees have the right to freely assign their rights.

II. CONCLUSION

The court finds that Madeline Agreement is an exclusive license. The court also finds that, under applicable copyright law, exclusive licenses convey an ownership interest to the licensee that allows that licensee to freely transfer its rights. Therefore, in this case, copyright law does not prevent the assumption and assignment of the Madeline Agreement. The court thus has authority to permit the Golden Books to assume and assign the Madeline Agreement as part of their sale to Random House and Classic Media, Inc. Accordingly, DIC's objection will be denied.

The court will enter an order in accordance with this memorandum opinion.


Questioned
As of: Feb 07, 2012

IN THE MATTER OF WEST ELECTRONICS INC.; United States Of America, by the United States Air Force, Appellant

No. 87-5782

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

852 F.2d 79; 1988 U.S. App. LEXIS 9689; Bankr. L. Rep. (CCH) P72,351; 18 Bankr. Ct. Dec. 287; 34 Cont. Cas. Fed. (CCH) P75,526

May 5, 1988, Argued
July 19, 1988, Filed

PRIOR HISTORY: [**1] On Appeal from the United States District Court for the District of New Jersey, D.C. Civil No. 87-1875.

CASE SUMMARY:

PROCEDURAL POSTURE: The United States appealed an order of the United States District Court for the District of New Jersey refusing the government's request for lifting of an automatic stay pursuant to *11 U.S.C.S. § 362* in a Chapter 11 bankruptcy filing. Relief from the stay was sought so that the United States could terminate a contract entered into with the bankruptcy debtor, a defense contractor, before it sought relief under Chapter 11 of the Bankruptcy Code.

OVERVIEW: The United States entered into a contract for manufacturing services with a defense contractor, before it filed for Chapter 11 bankruptcy and became a debtor in possession. When the bankruptcy petition was filed, an automatic stay went into effect under *11 U.S.C.S. § 362*, and the government was barred from terminating the contract. The government applied for relief from the automatic stay, asserting that the Nonassignment Act, *41 U.S.C.S. § 15*, barred the debtor in possession from assuming the contract without the government's consent, and that the government had the right to terminate the contract. The bankruptcy court denied the government's request, and the district court affirmed. On appeal, the court ordered the lifting of the automatic stay so that the contract could be terminated, holding that the Nonassignment Act applied. The court ruled that the relevant inquiry was not whether the Nonassignment Act would preclude an assignment from the company as a debtor to the same company in its role as a debtor in possession, but whether it would foreclose an assignment by the debtor to another defense contractor.

OUTCOME: The court reversed and remanded with instructions to lift the stay as it related to the government so that the contract could be terminated, holding that a contract for services of a third party could not be assigned without government consent, regardless of whether the assignment was from a defense contractor to the same contractor, once its status changed to debtor in possession as a result of a bankruptcy filing.

LexisNexis(R) Headnotes

Bankruptcy Law > Case Administration > Administrative Powers > Stays > Appeals
Bankruptcy Law > Case Administration > Administrative Powers > Stays > Relief From Stays > General Overview
Bankruptcy Law > Practice & Proceedings > Appeals > Standards of Review > De Novo Review

[HN1] When the facts germane to the disposition of an appeal are not in dispute, the appellate court review is of legal precepts and is plenary.

Bankruptcy Law > Practice & Proceedings > Appeals > Jurisdiction
Civil Procedure > Appeals > Appellate Jurisdiction > Final Judgment Rule
Civil Procedure > Appeals > Appellate Jurisdiction > Interlocutory Orders
[HN2] Under *28 U.S.C.S. § 158(a)*, United States district courts have jurisdiction to hear appeals from final judgments, orders and decrees and, with leave of court, interlocutory orders and decrees of bankruptcy judges.

Bankruptcy Law > Practice & Proceedings > Appeals > Jurisdiction
Civil Procedure > Judicial Officers > Judges > General Overview
Civil Procedure > Appeals > Appellate Jurisdiction > Final Judgment Rule
[HN3] Federal courts of appeal have jurisdiction over appeals from final decisions, judgments, orders, and decrees of district judges under *28 U.S.C.S. § 158(d)*.

Bankruptcy Law > Case Administration > Administrative Powers > Stays > Appeals
Bankruptcy Law > Case Administration > Administrative Powers > Stays > Relief From Stays > General Overview
Civil Procedure > Judgments > Entry of Judgments > Stays of Proceedings > Automatic Stays
[HN4] In some instances, an order denying relief from the automatic stay may not be final and thus may not be appealable as of right to the district court. Accordingly, if the order is affirmed on interlocutory appeal, a subsequent appeal to the court of appeals will not then be permitted under *28 U.S.C.S. § 158(d)*.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
Contracts Law > Debtor & Creditor Relations
Contracts Law > Types of Contracts > Executory Contracts
[HN5] See *11 U.S.C.S. § 365(c)(1)*.

Contracts Law > Debtor & Creditor Relations
Contracts Law > Performance > Assignment > Consent
Contracts Law > Performance > Novation
[HN6] If non-bankruptcy law provides that the government would have to consent to an assignment of a contract to a third party, i.e., someone other than the debtor or the debtor in possession, then the debtor in possession cannot assume that contract. This provision limiting assumption of contracts is applicable to any contract subject to a legal prohibition against assignment.

Contracts Law > Performance > Assignment > Consent
Public Contracts Law > Performance > Assignment & Novation
[HN7] *41 U.S.C.S. § 15* requires the government's consent to assignment of a contract. It provides in relevant part that no government contract, or any interest therein, shall be transferred by the party to whom such contract is given to any other party, and any such transfer shall cause the annulment of the contract transferred, so far as the United States are concerned.

Contracts Law > Debtor & Creditor Relations
Contracts Law > Types of Contracts > Executory Contracts
Healthcare Law > Business Administration & Organization > Peer Review > Organizations
[HN8] In the context of the assumption and assignment of executory contracts, a solvent contractor and an insolvent debtor in possession going through bankruptcy are materially distinct entities.

COUNSEL: Dorothy Donnelly, Assistant U.S. Attorney, Trenton, New Jersey, Dwight G. Rabuse (Argued), Washington, District of Columbia, Attorneys, for Appellant.

Kathryn Ferguson (Argued, Michael Zindler, Markowitz and Zindler, Lawrenceville, New Jersey, Attorneys, for Appellee West Electronics, Inc.

JUDGES: Higginbotham, Stapleton, and Greenberg, Circuit Judges. Higginbotham, J., concurring in part and dissenting in Part.

OPINION BY: GREENBERG

OPINION

[*80] **OPINION OF THE COURT**

GREENBERG, Circuit Judge.

This matter before the court on appeal from an order of the district court entered September 8, 1987 in a bankruptcy case presents the question of whether the automatic stay provisions of *11 U.S.C. § 362* should be lifted so that the government may terminate a contract

entered into with a defense contractor before it sought relief under Chapter 11 of the Bankruptcy Code. [HN1] The facts germane to the disposition of this appeal are not in dispute and thus our review is of legal precepts and is plenary. *United States v. Adams, 759 F.2d 1099, 1106 (3d Cir. 1985), cert. denied, 474 U.S. 906, 971, 106 S. Ct. 275, 336, 88 L. Ed. 2d 236 (1985).* For the reasons stated below, we hold that the automatic stay should have been [**2] lifted so that the contract could be terminated.

I

In 1986 the United States entered into a contract with West Electronics, Inc., under which West was to supply a substantial number of AIM-9 missile launcher power supply units to the Air Force. While West expected this contract to be very profitable, it contends that its ability to perform was impaired by the government's failure to make inspectors available. Nevertheless, West did from time to time receive progress payments under the contract.

In October 1986 West suffered a computer malfunction which destroyed its accounting records, a misfortune which it does not attribute to the government. On November 14, 1986 the government suspended progress payments on the contract pending a review of West's financial status. At that time West had not made its first deliveries under the contract, though it asserts that in late November its first delivery of 60 units passed final inspection. West indicates that the suspension of the progress payments compelled it to deliver some of the power units to another customer willing to pay cash immediately.

The government's review revealed what it considered to be serious irregularities in West's accounting [**3] procedures. Overall the contracting officer concluded that because of West's delinquency in delivering the power supply units, the failure of its accounting systems, its delinquency in paying costs attributable to the contract and the excess of unliquidated progress payments to work in progress, the contract should be suspended.

On December 9, 1986 the government served an administrative notice on West requiring it to show cause why the contract should not be terminated. West responded on December 19, 1986 by explaining the impact of the limited availability of government inspectors. On December 18, 1986 the Internal Revenue Service seized West's assets to satisfy a lien of $ 779,449.40.

On December 19, 1986 West filed a petition for relief under Chapter 11 of the Bankruptcy Code and became a debtor in possession. At that time it obtained an order from the bankruptcy court temporarily restraining the Internal Revenue Service from seizing or removing property from its premises. At a subsequent hearing a consent order was entered which permitted West to regain possession of its premises. Of course, the automatic stay provisions of *11 U.S.C. § 362* were triggered when the petition was [**4] filed.

On January 9, 1987 West moved in the bankruptcy court for an order compelling the government to make progress payments on the contract. On February 5, 1987 the government filed a cross-motion seeking an order permitting it to terminate the contract either by the court lifting the automatic stay or in some other appropriate [*81] manner. In addition, the government sought an order permitting it to take absolute possession of the parts and work in progress identifiable to the contract.

The bankruptcy judge denied both motions as premature. The judge concluded that he should not compel progress payments until West had first applied for the payments in accordance with the terms of the contract. The judge also indicated that West had the capacity to cure the default and should be given the opportunity to establish it could perform. The judge further ruled that there were no exigent circumstances arising from national defense considerations requiring lifting of the stay. An order reflecting this decision was entered April 9, 1987. The government appealed to the district court. The district judge in a memorandum opinion dated July 20, 1987 affirmed the bankruptcy judge's order. He reasoned [**5] that the contract, while executory, could be assumed by West and that because West represented that it had the capacity and intention to cure the default, the bankruptcy court had not erred. On September 8, 1987 the district judge entered an order reflecting this decision. The government has appealed from that order.

II

As happens often in bankruptcy cases, we are preliminarily presented with a significant jurisdictional question. [HN2] Under *28 U.S.C. § 158(a)* the district courts have jurisdiction to hear appeals from final judgments, orders and decrees and, with leave of court, interlocutory orders and decrees of bankruptcy judges. [HN3] The courts of appeal have jurisdiction over appeals from final decisions, judgments, orders, and decrees of district judges under *28 U.S.C. § 158(d).* Here the government appealed from the bankruptcy judge's order to the district court without leave and the district judge apparently ruled on the case without making any statement as to the finality of the order he was reviewing. Thus, it is obvious that the parties and the district judge treated the bankruptcy order as final.

It is therefore not surprising that on the appeal to us neither party originally questioned [**6] our jurisdiction. Nevertheless the possibly tentative nature of the

bankruptcy judge's order which denied the government's motion as premature and the conceivably interlocutory character of an order denying relief from a stay raised jurisdictional problems which we cannot overlook. *See In re White Beauty View, Inc., 841 F.2d 524 (3d Cir. 1988).*

The general approach to finality in bankruptcy matters was set forth in *In re Meyertech Corp., 831 F.2d 410, 414 (3d Cir. 1987)*, In which we indicated that:

> In the context of bankruptcy cases, the definition of a final order is less than crystalline. Analysis of finality in these proceedings differs from litigation in an ordinary civil matter. In bankruptcy matters we have consistently considered finality in a more pragmatic and less technical sense than in other matters and the concept, for purposes of appellate jurisdiction, should be viewed functionally. *Matter of Marin Oil, Inc., 689 F.2d 445 (3d Cir. 1982), In re Amatex, 755 F.2d 1034 (3d Cir. 1985).*
>
> In *Universal Minerals, Inc. v. C.A. Hughes & Co., 669 F.2d 98 (3d Cir. 1981)*, we enunciated a finding of finality in bankruptcy matters when 'nothing remains for the district [**7] court to do.' *Also, Cox Broadcasting Corp. v. Cohn, 420 U.S. 469, 95 S. Ct. 1029, 43 L. Ed. 2d 328 (1975).*

There have been a substantial number of cases dealing with the finality of orders granting or denying motions to lift stays. In *In re Comer, 716 F.2d 168 (3d Cir. 1983)*, we held that an order lifting a stay blocking foreclosure of a debtor's property was final because litigation on the question was completed and the property was subject to foreclosure in a state court. Thus the particular matter in controversy was ended. *Id. at 172.* We indicated, however, that it was conceivable that an order denying relief from the automatic stay might be interlocutory. *Id. at 174 n. 11.* In *In re American Mariner Industries, Inc., 734 F.2d 426, 429*, (9th Cir. 1984), the court broadly [*82] held that an order denying relief from the automatic stay is final. *See also In re Kemble, 776 F.2d 802, 805 (9th Cir. 1985).* In *In re Leimer, 724 F.2d 744 (8th Cir. 1984)*, the court held that an appeal from a bankruptcy court to a district court was from a final order when the order denied a creditor relief from the automatic stay and in so doing conclusively established that the creditor [**8] was not the owner of property which it claimed adversely to the debtor's estate. The court pointed out that from the perspective of the creditor there was nothing further for the bankruptcy court to do. *Id. at 745.*

From our study of the cases we are satisfied that [HN4] in some instances an order denying relief from the automatic stay may not be final and thus may not be appealable as of right to the district court. Accordingly, if the order is affirmed on interlocutory appeal, a subsequent appeal to the court of appeals will not then be permitted under *28 U.S.C. § 158(d).* Further, we recognize that the bankruptcy court denied the government's application to lift the stay without prejudice, thus suggesting that its order was not final.

Nevertheless on the unusual facts here we are convinced that the pragmatic approach of *Meyertech* requires that we hold that the bankruptcy judge's order was final and that we thus have jurisdiction. The government's asserted bases for relief are that the Nonassignment Act, *41 U.S.C. § 15*, bars West as a debtor in possession from assuming the contract without its consent and that as a matter of contract and administrative regulation the government has [**9] the right to terminate the contract for its convenience. *See 48 C.F.R. § 52.249-1, et seq.*; *48 C.F.R. § 217.7104(a)*; 48 C.F.R. § 252.217-7120. If the government is correct West should not be permitted to cure its default even if it is capable of doing so. Thus, the consequence of the bankruptcy court's decision was to reject the government's legal positions as the passage of time would not have made them more tenable.

By filing the petition under Chapter 11 West became a debtor in possession and this change in its status either did or did not entitle the government to relief by reason of *41 U.S.C. § 15*. Further, the circumstances which the government believed justified terminating the contract for convenience existed when the government filed its motion to lift the stay. Thus, this is not a case in which an application for relief from the stay was denied without prejudice because the record was incomplete, discovery was ongoing or the court required further research on the issue before it. The government was denied relief because in the bankruptcy court's view it was not entitled to it when it filed its motion. In these circumstances we regard the bankruptcy court as having rejected [**10] the government's legal positions. Accordingly, we hold that the district court had jurisdiction in this matter as an appeal from a final order under *28 U.S.C. § 158(a)* and we have jurisdiction under *28 U.S.C. § 158(d).*

III

We hold that the bankruptcy and district court should have lifted the stay and allowed the government to terminate the contract. In this regard we will assume without deciding that the government was barred by *11*

U.S.C. § 362(a) from terminating the contract without obtaining an order pursuant to *11 U.S.C. § 362(d). See 11 U.S.C. § 541(a)(1)*; *In re Computer Communications, Inc., 824 F.2d 725, 728-31 (9th Cir. 1987)*; *In re Minoco Group of Companies, Ltd., 799 F.2d 517 (9th Cir. 1986).* Further, we acknowledge in general that under *11 U.S.C. § 365* West as a debtor in possession could assume an executory contract with court approval. But *11 U.S.C. § 365(c)(1)* provides that:

> (c) [HN5] The trustee [which includes the debtor in possession [1]] may not assume . . . any executory contract . . . if . . . (1)(A) applicable law excuses a party, other than the debtor, to such contract . . . from accepting performance from . . . an entity other than the debtor or the debtor [**11] [*83] in possession . . . and (B) such party does not consent to such assumption. . . .

1 *See 11 U.S.C. § 1107*; *In re Pioneer Ford Sales, Inc., 729 F.2d 27, 28 (1st Cir. 1984).*

Thus, [HN6] if non-bankruptcy law provides that the government would have to consent to an assignment of the West contract to a third party, *i.e.*, someone "other than the debtor or the debtor in possession," then West, as the debtor in possession, cannot assume that contract. This provision limiting assumption of contracts is applicable to any contract subject to a legal prohibition against assignment. *See In re Pioneer Ford Sales, Inc., 729 F.2d 27 (1st Cir. 1984)*; *In re Braniff Airways, Inc., 700 F.2d 935, 943 (5th Cir. 1983).*

Section 15 of Title 41 of the United States Code [HN7] is a law requiring the government's consent to the assignment. It provides in relevant part:

> No [government] contract . . . or any Interest therein, shall be transferred by the party to whom such contract is given to any other party and any such transfer shall cause the annulment of the contract . . . transferred, so far as the United States are concerned.

As this court noted in *Thompson v. Comm'r of Internal Revenue, 205 F.2d* [**12] *73 (3d Cir. 1953)*:

> It has been held that the statute was meant to secure to the government the personal attention and services of the contractor; to render him liable to punishment for fraud or neglect of duty; and to prevent parties from acquiring mere speculative interests. . . . [*Id. at 76*].

We conclude that assignment of a contract calling for the production of military equipment is precisely what Congress intended to prevent when it prohibited assignments in *41 U.S.C. § 15*. Thus, West could not force the government to accept the "personal attention and services" of a third party without its consent. It therefore necessarily follows that under *11 U.S.C. § 365(c)(1)* West, as a debtor in possession, cannot assume this contract.

West argues that *41 U.S.C. § 15* should not be construed to foreclose an assignment of a contract from a debtor to a debtor in possession since they are such closely related entities. West's argument misses the point, however, for *11 U.S.C. § 365 (c)(1)* creates a hypothetical test -- *i.e.*, under the applicable law, could the government refuse performance from "an entity *other* than the debtor or the debtor in possession." [Emphasis added]. Thus, the [**13] relevant inquiry is not whether *41 U.S.C. § 15* would preclude an assignment from West as a debtor to West as a debtor in possession, but whether it would foreclose an assignment by West to another defense contractor.

The literal meaning of the words chosen by Congress clearly requires the analysis and conclusion we have just articulated and we are confident that it is what Congress intended. We think that by including the words "or the debtor in possession" in *11 U.S.C. § 365(c)(1)* Congress anticipated an argument like the one here made and wanted that section to reflect its judgment that [HN8] in the context of the assumption and assignment of executory contracts, a solvent contractor and an insolvent debtor in possession going through bankruptcy are materially distinct entities. [2] While the relevant case law is very sparse, it supports our understanding of the interplay between *11 U.S.C. § 365(c)(1)* and *41 U.S.C. § 15. See In re Adana Mortgage Bankers, Inc., 12 Bankr. 977 (Bankr. N.D. Ga. 1980)*; *see also In re Pennsylvania Peer Review Organization, Inc., 50 Bankr. 640 (Bankr. M.D. Pa. 1985).*

2 *11 U.S.C. § 365(c)(1)* was amended by Congress and given its current wording in 1986. *See* Pub.L. 99-554, § 283, 100 Stat. 3088, 3117 (1986). While the section previously was arguably somewhat ambiguous on the point decided herein, we are persuaded that the 1986 amend-

> ment merely clarified Congress' original intent and that, in any event, there can be no doubt about the meaning of the section in the present form.

[**14] The bankruptcy court was, therefore, confronted with a situation in which the debtor in possession was not entitled to assume the contract without the government's consent and the government was unwilling to give that consent. In that situation, the debtor in possession did not [*84] have a legally cognizable interest in the contract and it was an abuse of discretion for the court to decline to lift the stay. In view of our conclusion we need not address the government's contention that it has the right as a matter of contract and administrative regulation to terminate the contract for its convenience.

IV

We will reverse the judgment of the district court and will remand with instructions to lift the stay imposed pursuant to *11 U.S.C. § 362* as it relates to the government and this contract.

CONCUR BY: HIGGINBOTHAM, Jr., (In Part)

DISSENT BY: HIGGINBOTHAM, Jr., (In Part)

DISSENT

HIGGINBOTHAM, J., Concurring In Part and Dissenting in Part.

I join in all parts of Judge Greenberg's thoughtful opinion except as to Part III because I do not believe that a "solvent contractor and an insolvent debtor in possession going through bankruptcy," at 83, are *different* entities for the purposes of the Non-Assignment Clause. The [**15] interpretation of the *Adana* court notwithstanding, I think that that provision really meant to avoid having the U.S. government contractually bound to a wholly separate entity that received an assignment from the actual contracting party. I do not believe that when it enacted *Section 15* of Title 41, Congress considered the issue of whether a debtor in possession should be viewed as a party different than the debtor.

The government may well have the right to terminate the contract in issue on other grounds, but I am not convinced that *41 U.S.C. § 15* is the appropriate vehicle for the severance of West Electronics' rights under the contract.

Caution
As of: Feb 07, 2012

In re: SUNTERRA CORPORATION, Debtor. RCI TECHNOLOGY CORPORATION, formerly known as Resort Computer Corporation, Plaintiff- Appellant, v. SUNTERRA CORPORATION, Defendant-Appellee.

No. 03-1193

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

361 F.3d 257*; *2004 U.S. App. LEXIS 5131*; *Bankr. L. Rep. (CCH) P80,068*; *51 Collier Bankr. Cas. 2d (MB) 1276*; *42 Bankr. Ct. Dec. 222

December 4, 2003, Argued
March 18, 2004, Decided

PRIOR HISTORY: [**1] Appeal from the United States District Court for the District of Maryland, at Baltimore. (CA-02-2539). J. Frederick Motz, District Judge. *RCC Tech. Corp. v. Sunterra Corp., 287 B.R. 864, 2003 U.S. Dist. LEXIS 1055 (D. Md., 2003)*

DISPOSITION: Reversed and remanded.

CASE SUMMARY:

PROCEDURAL POSTURE: Appellant challenged a decision entered by the United States District Court for the District of Maryland that affirmed the bankruptcy court's ruling in favor of appellee, a debtor.

OVERVIEW: Appellant contended that the district court erred in ruling that appellee, as the Chapter 11 debtor in possession, was entitled to assume a non-exclusive license of copyrighted software. On appeal, the court was called upon to decide whether, pursuant to *11 U.S.C.S. § 365(c)*, such a debtor in possession could assume, over the licensor's objection, a non-exclusive software license. The court had to resolve the issue of whether the disjunctive term "or," as used in the "assume or assign" language of *11 U.S.C.S. § 365(c)*, should have been construed in the conjunctive as "and." The court found that appellant had consented to appellee's assignment of the license to a successor in interest under certain circumstances. However, the transfer provision did not apply to an assumption of the agreement by a Chapter 11 debtor in possession. Because the terms assumption and assignment described two conceptually distinct events, appellant did not consent to appellee's assumption of the agreement. Without the consent, appellee was precluded from assuming the agreement.

OUTCOME: The court reversed and remanded the district court's decision.

LexisNexis(R) Headnotes

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
[HN1] See *11 U.S.C.S. § 365(c)*.

Bankruptcy Law > Practice & Proceedings > Appeals > Standards of Review > De Novo Review
Civil Procedure > Appeals > Standards of Review > De Novo Review
[HN2] The appellate court reviews de novo the judgment of a district court sitting in review of a bankruptcy court, applying the same standards of review that were applied in the district court.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > General Overview
Contracts Law > Breach > Material Breach
Contracts Law > Types of Contracts > Executory Contracts
[HN3] In assessing whether a contract is executory, the court is obliged, under Lubrizol, to apply what courts have referred to as the Countryman Test. Under the Countryman Test, a contract is executory if the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other.

Contracts Law > Defenses > Ambiguity & Mistake > General Overview
Governments > Legislation > Interpretation
[HN4] As a settled principle, unless there is some ambiguity in the language of a statute, a court's analysis must end with the statute's plain language.

Governments > Legislation > Interpretation
[HN5] There are two narrow exceptions to application of a statute's plain language. The first such exception, premised on absurdity, exists when literal application of the statutory language at issue results in an outcome that can truly be characterized as absurd, i.e., that is so gross as to shock the general moral or common sense. The second exception is premised on legislative intent, and it exists only when literal application of the statutory language at issue produces an outcome that is demonstrably at odds with clearly expressed congressional intent. A reviewing court may look beyond the plain language of an unambiguous statute only when one of these exceptions is implicated. And the instances in which either of these exceptions to the Plain Meaning Rule apply 'are, and should be, exceptionally rare.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Assignments
Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
Contracts Law > Types of Contracts > Executory Contracts
[HN6] *11 U.S.C.S. § 365(f)(1)* lays out the broad rule - a law that, as a general matter, prohibits, restricts, or conditions the assignment' of executory contracts is trumped by the provisions of *11 U.S.C.S. § 365(f)(1)*. 11 U.S.C.S. § 265(c)(1), in contrast, creates a carefully crafted exception to the broad rule, under which applicable law does not merely recite a general ban on assignment, but instead more specifically excuses a party from accepting performance from or rendering performance to an entity' different from the one with which the party originally contracted. Therefore, under the broad rule of *11 U.S.C.S. § 365(f)(1)*, the "applicable law" is the law prohibiting or restricting assignments as such; whereas the "applicable law" under *11 U.S.C.S. § 365(c)(1)* embraces legal excuses for refusing to render or accept performance, regardless of the contract's status as assignable.

Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Assignments
Bankruptcy Law > Case Administration > Administrative Powers > Executory Contracts & Unexpired Leases > Nonassumable Contracts
[HN7] In order to determine whether a law is overridden by *11 U.S.C.S. § 365(f)(1)* under the foregoing interpretation of *11 U.S.C.S. § 365(f)(1)* and *11 U.S.C.S. § 365(c)(1)*, a court must ask why "applicable law" prohibits assignment. And only applicable anti-assignment law predicated on the rationale that the identity of the contracting party is material to the agreement is resuscitated by *11 U.S.C.S. § 365(c)(1)*. Premised on this interpretation, the Fourth Circuit agrees with those Circuits that apply *11 U.S.C.S. § 365(c)(1)* literally - the provisions of *11 U.S.C.S. § 365(c)(1)* are not inevitably set at odds with the provisions of *§ 365(f)(1)*.

Contracts Law > Debtor & Creditor Relations
Contracts Law > Performance > Assignment > Consent
Contracts Law > Types of Contracts > Executory Contracts
[HN8] By its plain language, *11 U.S.C.S. § 365(c)(1)* addresses both assumption and assignment. An assumption and an assignment are two conceptually distinct events, and the non-debtor must consent to each independently. Under the plain language of *11 U.S.C.S. § 365(c)(1)*, therefore, two independent events must occur before a Chapter 11 debtor in possession is entitled to assign an executory contract. The debtor in possession must first obtain the non-debtor's consent to assume the contract, and it must thereafter obtain the non-debtor's consent to assign the contract. Therefore, where a non-debtor consents to the assumption of an executory contract, *11 U.S.C.S. § 365(c)(1)* will have to be applied a second time if the debtor in possession wishes to assign the contract in question. And in the second application of *11 U.S.C.S. § 365(c)(1)*, the issue is whether applicable

law excuses a party from accepting performance from or rendering performance to an entity other than the debtor in possession. *11 U.S.C.S. § 365(c)(1)(A).*

Governments > Legislation > Interpretation
[HN9] In assessing whether a plain reading of a statute implicates the absurdity exception, however, the issue is not whether the result would be "unreasonable," or even "quite unreasonable," but whether the result would be absurd.

Governments > Legislation > Interpretation
[HN10] A federal court must determine the meaning of the statute passed by Congress, not whether wisdom or logic suggests that Congress could have done better.

COUNSEL: ARGUED: Jay Alan Shulman, SAUL EWING, L.L.P., Baltimore, Maryland, for Appellant.

Kenneth Oestreicher, WHITEFORD, TAYLOR & PRESTON, L.L.P., Baltimore, Maryland, for Appellee.

ON BRIEF: Irving E. Walker, SAUL EWING, L.L.P., Baltimore, Maryland, for Appellant. John F. Carlton, WHITEFORD, TAYLOR & PRESTON, L.L.P., Baltimore, Maryland, for Appellee.

JUDGES: Before WIDENER, LUTTIG, and KING, Circuit Judges.

OPINION BY: KING

OPINION

[*260] KING, Circuit Judge:

RCI Technology Corporation appeals from an order entered in the District of Maryland affirming the bankruptcy court's ruling in favor of Sunterra Corporation. *RCC Tech. Corp. v. Sunterra Corp., 287 B.R. 864 (D. Md. 2003).* [1] RCI contends that the district court erred in ruling that Sunterra, as the Chapter 11 debtor in possession, was entitled to assume a nonexclusive license of copyrighted software. [2] On appeal, we are called upon to decide whether, pursuant to *11 U.S.C. § 365(c)*, such a debtor in possession may assume, over the licensor's [**2] objection, a nonexclusive software license. In so deciding, we must resolve the issue of whether the disjunctive term "or," as used in the "assume or assign" language of *§ 365(c)*, should be construed in the conjunctive as "and." Because we are unable to so construe *§ 365(c)*, Sunterra was precluded from assuming the nonexclusive software license, and we reverse and remand.

1 RCI Technology Corporation was formerly known as Resort Computer Corporation, or RCC.

2 Pursuant to Chapter 11 of the Bankruptcy Code, a debtor in possession remains in possession of the pre-petition assets and administers them for the benefit of its creditors. *In re Southeast Hotel Prop. Ltd. P'ship, 99 F.3d 151, 152 n. 1 (4th Cir. 1996)* (citing *11 U.S.C. §§ 322, 1101(1), 1104, 1107*).

I.

A.

At all times material to this appeal, RCI conducted business as a software development company for the resort and hospitality industry. RCI's software products were used by entities in this industry, [**3] such as Sunterra, for functions such as recording reservations, managing resort properties, and marketing and financing timeshares. [3] Sunterra owns or controls more than 150 subsidiaries and related entities, constituting one of the world's largest resort management businesses.

3 A timeshare has been defined as "a share in a property under a timesharing scheme." *Oxford English Dictionary* 879 (Vol. 4 & Supp. 1986). The term time-sharing has been described as "the ownership or right of a property (esp. as a holiday home) for a fixed limited time each year." *Id.*

In the 1990s, Sunterra launched a program called Club Sunterra. Membership in the Club allowed timeshare owners at Sunterra resorts to trade their timeshare rights for such rights at other Sunterra resorts. Because tens of thousands of timeshare owners and units were involved in the Club, Sunterra needed to develop an integrated computer system to assist its management of the Club. For this purpose, Sunterra decided to acquire RCI's Premier Software [**4] [4] and modify it into a unique computer program, the SWORD System.

4 It is uncontested that RCI's Premier Software is a copyrighted computer program registered with the United States Copyright Office.

In 1997, RCI and Sunterra entered into a software license agreement (the "Agreement"), pursuant to which RCI granted Sunterra a nonexclusive license to use Premier Software (the "Software"). Under the Agreement, effective December 31, 1997, RCI was required to provide Sunterra a "non-exclusive, worldwide, perpetual, irrevocable, royalty-free license to ...use, copy, modify, and distribute" the Software (the "License"). Agreement § 3.1. Sunterra [*261] paid RCI $ 3.5 million for the License. Because the Software, as marketed, did not meet Sunterra's requirements, the Agreement authorized

Sunterra to utilize the Software to develop its own software system. Under the Agreement, Sunterra owned any enhancements it made to the Software (the "Sunterra Enhancements"). *Id.* §§ 2.15, 3.6.3. Sunterra, in turn, granted RCI [**5] a license to use the Sunterra Enhancements. *Id.* § 3.2.2. Sunterra thereafter invested approximately $ 38 million in developing the SWORD System.

B.

On May 31, 2000, Sunterra filed a Chapter 11 bankruptcy petition in the District of Maryland. Two years later, on June 21, 2002, the bankruptcy court confirmed Sunterra's Plan of Reorganization, effective July 29, 2002. Prior to the Plan's confirmation, on March 28, 2002, RCI filed a motion to have the court deem the Agreement rejected (the "Motion"). RCI claimed that the Agreement was an executory contract and that Sunterra, as debtor in possession, was precluded by *11 U.S.C. § 365(c)* (hereinafter " *§ 365(c)*" or the "Statute") from assuming the Agreement without RCI's consent. [5] RCI maintained that, because it had refused to consent to assumption of the Agreement, the court was required by law to deem the Agreement rejected.

> 5 [HN1] *Section 365(c) of Title 11* provides, in pertinent part:
>
> > (c) *The trustee may not assume or assign any executory contract* ...of the debtor, whether or not such contract ...prohibits or restricts assignment of rights or delegation of duties, if -
> >
> > (1)(A) applicable law excuses a party, other than the debtor, to such contract ...from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract ...prohibits or restricts assignment of rights or delegation of duties; and
> >
> > (B) such party does not consent to such assumption or assignment ....
>
> *11 U.S.C. § 365(c)* (emphasis added). The term "trustee," as used in the Statute, includes a Chapter 11 debtor in possession. *See, e. g., Perlman v. Catapult Entertainment (In re Catapult Entertainment), 165 F.3d 747, 750 (9th Cir. 1999).* And the term "applicable law" means "applicable non-bankruptcy law." *In re Pioneer Ford Sales, Inc., 729 F.2d 27, 28 (1st Cir. 1984).*

[**6] Sunterra opposed the Motion, asserting that the Statute was inapplicable because the Agreement was not an executory contract. [6] Sunterra also maintained that it was not precluded from assuming the Agreement because the Statute should be interpreted as prohibiting a debtor in possession from assuming *and* assigning a contract, and it intended only to assume - not to assign. Finally, Sunterra contended that the Statute did not prohibit assumption of the Agreement because RCI had agreed to permit reasonable assignments thereof.

> 6 In the context of the Statute, "a contract is executory if performance is due to some extent on both sides." *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1045 (4th Cir. 1985).*

On June 6, 2002, the bankruptcy court relied on *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985)*, and held, in a bench ruling, that the Statute did not prohibit Sunterra, as debtor in possession, from [**7] assuming the Agreement. It decided that the Agreement was not an executory contract and that, if it were, the Statute did not preclude assumption because Sunterra did not intend to assign the Agreement. The court concluded that prohibiting Sunterra from assuming the Agreement was nonsensical because RCI would not be damaged if Sunterra, as debtor in possession, assumed the very contract rights it [*262] had possessed prior to bankruptcy. The following day, on June 7, 2002, the court entered an order denying the Motion. *In re Sunterra Corp.*, No. 00-5-6931-JS (Bankr. D. Md.).

On June 14, 2002, RCI appealed the bankruptcy court's decision to the district court, which, on January 10, 2003, affirmed. *RCC Tech. Corp. v. Sunterra Corp., 287 B.R. 864 (D. Md. 2003)* (the "Opinion"). The district court disagreed with the bankruptcy court's finding that the Agreement was not executory, but concluded that the Statute did not preclude Sunterra, as debtor in possession, from assuming it.

In its Opinion, the district court acknowledged that the Statute, read literally, precluded Sunterra, as debtor in possession, from assuming the Agreement because: (1) copyright law excused [**8] RCI from accepting performance from a party other than Sunterra, [7] and (2) RCI did not consent to Sunterra's assumption of the Agreement. *Id.* at 865. In explaining its ruling, the court recognized the existence of a circuit split on the issue of whether the Statute should be applied literally. It acknowledged that at least three circuits, the Third, Ninth,

and Eleventh, as well as several bankruptcy courts, have followed a "literal test" (generally called the "hypothetical test") in applying the Statute to the assumption of executory contracts. [8] *See In re West Elecs., Inc., 852 F.2d 79, 83 (3d Cir. 1988)* (characterizing *§ 365(c)(1)(A)* as posing "a hypothetical question"); *In re Catapult Entm't, Inc., 165 F.3d 747, 750 (9th Cir. 1999)* (same); *In re James Cable Partners, 27 F.3d 534, 537 (11th Cir. 1994)* (same); *In re Catron, 158 B.R. 629, 633-38 (E.D. Va. 1993)* (same), *aff'd without op., 25 F.3d 1038 (4th Cir. 1994)*. On the other hand, the First Circuit, along with a majority of the bankruptcy courts, have applied the "actual test" in such circumstances. [9] *See Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 493 (1st Cir. 1997)* [**9] (rejecting the literal test in favor of the actual test); *see also In re Catapult, 165 F.3d at 749 n. 2* (collecting bankruptcy court decisions adopting actual test).

7 Because the Software is a duly registered copyrighted computer program, copyright law is the applicable nonbankruptcy law that would excuse RCI from accepting performance under the Agreement from an entity other than Sunterra. *See, e. g., Everex Sys. v. Cadtrak Corp. (In re CFLC, Inc),89 F.3d 673, 679 (9th Cir. 1996)*; *In re Golden Books Family Entm't, Inc., 269 B.R. 300, 309 (Bankr. D. Del. 2001)*.

8 The term literal test is derived from a literal interpretation of the Statute, under which the disjunctive "or" in *§ 365(c)* is construed to mean what it says. If *§ 365(c)* is construed literally, "a debtor in possession may not assume an executory contract over the nondebtor's objection if applicable law would bar assignment to a *hypothetical* third party, even where the debtor in possession has no intention of assigning the contract in question to any such third party." *In re Access Beyond Techs., Inc., 237 B.R. 32, 48 (Bankr. D. Del. 1999)* (original emphasis omitted and emphasis added) (citing *In re James Cable Partners, 27 F.3d 534, 537 (11th Cir. 1994)*; *In re West Elecs., Inc., 852 F.2d 79, 83 (3d Cir. 1988))*. Although generally called the hypothetical test, the test is premised on a literal interpretation of the Statute, and it is more aptly referred to as the "literal test."

[**10]

9 Under the actual test, the disjunctive "or" in *§ 365(c)* is construed as the conjunctive "and." In applying the actual test, therefore, a court must make a case-by-case inquiry into whether the nondebtor party would be compelled to accept performance from someone other than the party with whom it had originally contracted, and a debtor would not be precluded from assuming a contract unless it *actually* intended to assign the contract to a third party. *Summit Invest. & Dev. Corp. v. Leroux, 69 F.3d 608, 612 (1st Cir. 1995)*.

In its Opinion, the district court recognized that resolution of the dispute turned on which of the two tests applied. If the [*263] literal test applied, Sunterra could not assume the Agreement because RCI was excused, pursuant to applicable copyright law, from accepting performance from a *hypothetical* third party. On the other hand, if the actual test applied, Sunterra, as debtor in possession, was entitled to assume the Agreement because it did not intend to assign, and RCI would not *actually* be forced to accept performance from a party other than [**11] Sunterra. The court then adopted the actual test, interpreting the disjunctive "or" in the conjunctive as "and," and holding that, because RCI would not, in the circumstances, be forced to accept performance from a party other than Sunterra, the Statute did not preclude it from assuming the Agreement. [10]

10 As the district court explained, the literal test has the "obvious virtue of being consistent with the dictate of the Supreme Court that the plain meaning of a statute must be enforced when its terms are unambiguous." Opinion at 865 (citing *Patterson v. Shumate, 504 U.S. 753, 757-59, 119 L. Ed. 2d 519, 112 S. Ct. 2242 (1992))*. The court adopted the actual test, however, declaring that, although it "has the weakness of reading the statutory language 'assume *or* assign' to mean 'assume *and* assign,' ....it has the virtue of being consistent with the general goals of Chapter 11 because it allows licensees to benefit from the protections of the bankruptcy law while encouraging the maximization of the economic value of the debtor's estate." *Id. at 866* (emphasis added) (citing *In re Cardinal Indus., Inc., 116 B.R. 964, 981 (Bankr. S.D. Ohio 1990))*.

[**12] Finally, the district court addressed Sunterra's contention that, because RCI had agreed that it would not unreasonably withhold its consent regarding future assignments of the License by Sunterra, RCI had impliedly consented for Sunterra, as debtor in possession, to assume the Agreement. The court deemed unpersuasive Sunterra's contention that RCI consented to assumption of the Agreement. It determined, however, that its adoption and application of the actual test rendered the consent issue moot. It thus affirmed the bankruptcy court's ruling that the Statute did not bar Sunterra, as debtor in possession, from assuming the Agreement. RCI has filed a timely appeal, and we possess jurisdiction pursuant to *28 U.S.C. § 158(d)*.

II.

[HN2] We review de novo the judgment of a district court sitting in review of a bankruptcy court, "applying the same standards of review that were applied in the district court." *Three Sisters Partners, L.L.C. v. Harden (In re Shangra-La, Inc.),167 F.3d 843, 847 (4th Cir. 1999)*. Accordingly, we review de novo the issue of whether the Agreement was an executory contract. *Lubrizol, 756 F.2d at 1045* (observing that issue of whether contract is executory [**13] is one of law); *Bose Corp. v. Consumers Union of the United States, Inc., 466 U.S. 485, 80 L. Ed. 2d 502, 104 S. Ct. 1949 (1984)* (observing that issues of law are reviewed de novo). We also review de novo an issue of statutory construction. *United States v. Childress, 104 F.3d 47, 50 (4th Cir. 1996)* (observing that issues of statutory construction are reviewed de novo).

III.

In its appeal, RCI contends that we should reverse for several reasons. First, it maintains that, because the plain meaning of the Statute can be applied without producing a result that is patently absurd, the court erred in failing to do so. Second, RCI contends that general bankruptcy policy cannot be relied upon to support the decision not to apply the plain meaning of the Statute. Third, RCI maintains that the Statute is unambiguous and that use of legislative history to construe the Statute was inappropriate. Finally, RCI contends [*264] that, if legislative history can be utilized, it does not support the Opinion.

On the other hand, Sunterra maintains that, for multiple reasons, we should affirm. First, it asserts that the Statute applies only to executory contracts, and that the Agreement [**14] was not executory. Second, it contends that, if the Agreement was executory, we should affirm because courts need not apply the plain meaning of a statute to produce an absurd result or be inconsistent with clearly established legislative intent. On this point, Sunterra maintains that the literal test - interpreting the disjunctive "or" in the Statute to mean what it says - would have produced an absurd result *and* been inconsistent with legislative intent. Finally, Sunterra contends that the Statute does not preclude assumption of an executory contract if the nondebtor party, i. e., RCI, consents to the assignment, and RCI, in section 5.11 of the Agreement, *impliedly* consented to reasonable assignments. Sunterra asserts that assumption was "automatically reasonable" because it would leave undisturbed the identity of Sunterra as the licensee. Sunterra contends, therefore, that we should affirm because RCI had consented to assumption of the Agreement by Sunterra as debtor in possession. We address these issues in turn.

A.

First, Sunterra contends that the Statute does not prohibit assumption of the Agreement because the Statute applies only to executory contracts and the [**15] Agreement was not executory. [11] [HN3] In assessing whether a contract is executory, we are obliged, under *Lubrizol, 756 F.2d at 1045*, to apply what courts have referred to as the Countryman Test. Under the Countryman Test, a contract is executory if the "' obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other.'" *Gloria Mfg. Corp. v. Int'l Ladies' Garment Workers' Union, 734 F.2d 1020, 1022 (4th Cir. 1984)* (quoting Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973)). Applying the Countryman Test, the Agreement was not executory unless it was executory as to *both* Sunterra and RCI when Sunterra petitioned for bankruptcy. [12] We must therefore assess whether, at the time of the Chapter 11 filing, the obligations of both Sunterra and RCI were so unperformed that the failure of either to complete performance would constitute a material breach of the Agreement.

11 If the Agreement was not executory, it was not subject to the Statute, and it would have survived the bankruptcy filing unaffected. *See In re Access, 237 B.R. at 41.*

[**16]

12 The date a bankruptcy petition is filed is the critical time for determining whether a contract is executory. *See, e. g., In re Columbia Gas Sys. Inc., 50 F.3d 233, 240 (3d Cir. 1995)*; *In re Access, 237 B.R. at 41 n. 10.*

On this point, we agree with the district court that the Agreement was executory when Sunterra petitioned for bankruptcy. When the bankruptcy petition was filed, each party owed at least one continuing material duty to the other under the Agreement - they each possessed an ongoing obligation to maintain the confidentiality of the source code of the software developed by the other, i. e., the Software and the Sunterra Enhancements. [13] Agreement §§ 3.1.3, 3.2.2, 3.10, 3.11.

13 The term source code, as used in the Agreement, means the humanreadable form of the Software and the Sunterra Enhancements. Agreement § 2.19.

[*265] B.

If the Agreement was executory, Sunterra agrees [**17] that a straightforward application of the Statute prohibits it from assuming the Agreement without RCI's