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Another U.S. Court of Appeals Decision Protects U.S. Creditors from the Effects of Foreign Bankruptcy Law

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One of the effects of commercial globalization is that the bankruptcy filing of a debtor with transnational business relationships will sometimes result in a clash between the substantive bankruptcy laws of different countries. A frequent question is whether the bankruptcy laws of a foreign country should be brought to bear upon creditors located in the United States, even where foreign bankruptcy law is at odds with the laws of the United States.

On December 3, 2013, the **United States Court of Appeals for the Fourth Circuit,** in an appeal stemming from the Chapter 15 bankruptcy case of **Qimonda AG** ("Qimonda"), issued a decision that allowed U.S. licensees to continue performing under patent license agreements, even though the German administrator for Qimonda sought to terminate or renegotiate those license agreements under German bankruptcy law.[1] The Fourth Circuit embraced a Chapter 15 balancing test for relief under Chapter 15 similar to that of the Fifth Circuit in *In re Vitro S.A.B. de CV*, 701 F.3d 1031 (5th Cir. 2012) and, like the Fifth Circuit in *Vitro*, reached a conclusion that protected creditors in the United States from the effects of foreign bankruptcy law and proceedings.

A company that is in an insolvency proceeding in a foreign country may seek protection in the United States under **Chapter 15 of the U.S. Bankruptcy Code**. Under Chapter 15, a representative of the debtor applies for recognition in a United States bankruptcy court. If recognition is granted, the foreign representative can then seek an order to assist him in administering assets located in the United States and to protect those assets from creditors.

Qimonda, a German-based manufacturer of semiconductor memory devices, filed an insolvency proceeding in Munich, Germany, in January 2009. Shortly thereafter, the German court-appointed insolvency administrator filed a petition for recognition under Chapter 15 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Eastern District of Virginia and the bankruptcy court recognized the German proceeding as a "foreign main proceeding." The Bankruptcy Court also issued a separate order in accordance with Section 1521(a) of the U.S. Bankruptcy Code, making Section 365 applicable in the Chapter 15 proceeding.

Qimonda owned approximately 4,000 U.S. patents, many of which were subject to cross-license agreements with other seminconductor manufacturers. The German administrator planned to monetize Qimonda's patents by relicensing them for new royalties. In connection with that plan, the administrator sent letters to Qimonda's patent licensees, including U.S. patent licensees, declaring that under German insolvency law the licenses were no longer enforceable. Under Section 365(n) of the U.S. Bankruptcy Code, licensees of intellectual property enjoy significant protection in the event of a bankruptcy by the licensor. In short, the licensee can elect to continue to exercise its rights under the license agreement to use the patented technology, even over the objection of the licensor or the bankruptcy trustee. On the other hand, German bankruptcy law terminates the licensee's right under the license agreement unless the insolvency administrator elects to perform under the agreement. Certain U.S. patent licensees responded by asserting that their rights in Qimonda's patents were shielded by Section 365(n), notwithstanding the U.S. bankruptcy court's recognition of Qimonda's bankruptcy case in Germany.[2]

Under **Section 1522(a) of the U.S. Bankruptcy Code,** the court may grant relief to a foreign debtor "*only* if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected." The bankruptcy court conducted the balance of interests test and determined that the application of Section 365(n) in Qimonda's U.S. bankruptcy proceeding was necessary to ensure that the interests of the U.S. patent licensees were "sufficiently protected." The German administrator appealed the bankruptcy court's decision and, upon order from the district court, the Fourth Circuit authorized a direct appeal.

On appeal, the German administrator argued, among other things, "that the bankruptcy court misunderstood the type of protection afforded by Section 1522(a) by applying a test that balanced the debtor's interests and the creditors' interests instead of a test that placed all creditors on an equal footing." According to the administrator, Chapter 15 required the bankruptcy court to defer to foreign substantive law except only in the more extreme circumstances addressed by Section 1506 of the U.S. Bankruptcy Code, which allows a United States bankruptcy court to refuse to take any action that would be "manifestly contrary" to the public policy of the United States.

The Court of Appeals, however, was not persuaded and disagreed with the administrator's reading of the relevant provisions of Chapter 15. Based on its plain reading of the statutory text, review of the legislative history for Section 365(n), and review of the **Model Law on Cross-Border Insolvency** (as enacted by the United Nations Commission on International Trade Law and on which Chapter 15 is based), the Fourth Circuit concluded that the district court correctly interpreted "Section 1522(a)'s sufficient protection requirement as requiring a particularized balancing analysis that considers the 'interests of the creditors and other interested entities, including the debtor.'" The appellate court noted that its interpretation of Section 1522(a) is similar to that reached in the Fifth Circuit in *Vitro*. The Fourth Circuit also noted that Section 1506 is a more general protection of U.S. interests that does not necessarily need to be considered in connection with Section 1522(a) analysis.

Because the Fourth Circuit affirmed the bankruptcy court on its application of Section 1522(a), the appellate court did not reach the issue of whether limiting a licensee's rights under Section 365(n) would be manifestly contrary to U.S. public policy so as to trigger the application of Section 1506. Even so, the Fourth Circuit, in what the concurrence referred to as "unnecessary dictum," added that its decision would necessarily further the public policy that underlies Section 365(n), suggesting that any attempt to abridge those critical licensee protections may, indeed, be manifestly contrary to U.S. public policy.

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[1] *Jaffe v. Samsung Electronics Company, Ltd.*, --- F.3d --- (4th Cir. 2013).

[2] The administrator moved the U.S. Bankruptcy Court to modify its initial order applying Section 365 so that it may address performance of the licenses under German procedure, which would have the effect of denying licensees their license retention rights under Section 365(n) of the U.S. Bankruptcy Code. The bankruptcy court granted that relief and entered an amended order restricting the applicability of Section 365. Certain licensees then appealed the amended order. On appeal, the U.S. District Court remanded to the bankruptcy for determination of two issues: (1) whether limiting the applicability of Section 365(n) appropriately balanced the interests of the foreign debtor and the U.S. patent licensees and provided “sufficient protection” to the licensees, and (2) whether the U.S. Bankruptcy Court's restricting the application of Section 365(n) would be “manifestly contrary” to

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