

Torys on Intellectual Property

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Enhanced Protection for Licensees of Intellectual Property in the Event of Licensor Bankruptcy

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The long-awaited amendments to Canada's *Bankruptcy and Insolvency Act* (BIA) and *Companies' Creditors Arrangements Act* (CCAA) came into force on September 18, 2009. Among the amendments are provisions that will have a significant impact on licence agreements relating to intellectual property. As a result of the amendments, treatment of intellectual property licence agreements will be similar under the laws of Canada and the United States.

Before the amendments came into force, Canadian courts had ruled that restructuring debtor companies, and receivers (and potentially trustees-in-bankruptcy) acting on their behalf, could disclaim a debtor's executory contracts (i.e., contracts under which both parties have ongoing performance obligations). Thus, an insolvent licensor could disclaim an intellectual property licence agreement and require that the licensee cease using the intellectual property, leaving the licensee with only an unsecured claim for damages arising out of the termination of rights.¹

According to the amendments, a debtor in respect of whom a restructuring case has been filed under the BIA or the CCAA – in which it is intended that a proposal or a compromise or arrangement (an offer to creditors to settle debts) be presented to creditors – may disclaim an agreement by giving 30 days' written notice to the co-parties to the agreement. A co-party may seek a court declaration that the agreement cannot be disclaimed.² Even if an agreement is disclaimed, the amendments provide that the disclaimer will not affect the rights of a co-party to use any intellectual property licensed under the agreement, so long as that co-party continues to perform its obligations in relation to such use.

The term "intellectual property" is not defined in the amendments or in the BIA or CCAA. The term presumably includes patents, copyrights, industrial designs and, perhaps, trade secrets. It appears that trademarks may also be included in the definition; however, because trademarks denote a source of goods or services, continued use by a licensee when the source is a bankrupt company may have an impact on the validity of the marks.

¹ Except in the rare case when the licensee could establish the right to specific performance of the licence.

² Additionally, a trustee or monitor (under the BIA or CCAA, respectively) may refuse to consent to the disclaimer, in which case, a court order is necessary to authorize it.

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While the amendments protect a licensee's continued right to use intellectual property, the licensee is not protected against disclaimer of the licensor's other obligations under the agreement (e.g., support services, which are typical in software licence agreements; obligations to enforce or maintain the licensed intellectual property; and indemnities). Thus, despite a licensee's continued right to use a patent or trademark, the patent or trademark itself may be lost or its value diluted due to a licensor's failure to comply with its obligations. Trademark licensees face a further risk if the licensor disclaims the quality control provisions typically found in trademark licence agreements, since the exercise of control is necessary to ensure the continued validity of any registered marks.

A licensee's use rights in respect of licensed intellectual property after a disclaimer are contingent upon the licensee's performance of its obligations under the licence agreement. Performance by the licensee may be difficult to assess if the agreement includes a licence as well as other obligations, such as ongoing support services, for a single fee. If the licensor's other obligations are disclaimed in such an agreement, it may be difficult for a licensee to determine the correct fee to be paid for the licence to ensure that its obligations are met. Licence agreements may now be drafted or amended to address such issues.

Licensees of intellectual property will want to remember that, notwithstanding the protections provided by the amendments, other new provisions of the BIA and CCAA permit a court to authorize a sale of a debtor's assets (including licensed intellectual property) by a trustee or a receiver free and clear of any security, charge or other restriction. Thus, a licensee may find its use rights terminated upon the sale of the underlying intellectual property asset. The licence agreement cannot protect against this possibility (since any agreement not to sell the asset could be disclaimed).

While the amendments provide some protection to licensees of intellectual property in the event of a licensor's becoming subject to a BIA or CCAA restructuring case, significant risks remain regarding the possible loss or sale of the underlying intellectual property and the licensee's inability to assess whether its obligations are met in order to preserve the right to continued use of the intellectual property. In addition, the limited protection provided in the amendments applies only to a disclaimer in a CCAA or BIA restructuring case and not to a disclaimer by a trustee-in-bankruptcy or receiver of a licensor of intellectual property. Because of these risks, licensees must exercise care when drafting licence agreements (e.g., ensuring licence fees are separately listed, requiring upfront payment of intellectual property maintenance fees) and may want to consider seeking a partial assignment of intellectual property, as an alternative to a licensing arrangement, where possible. 