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I. INTRODUCTION

Software is primarily marketed as a licensed product and the developer-licensor typically distributes software to end-user licensees only in the form of object code, retaining strict control over the source code. The rationale for this practice derives from the distinct characteristics of object code and source code. To better understand the distinction, a food analogy may be helpful: If object code is the fully prepared meal delivered to your table, then source code is the detailed recipe allowing a skilled chef to re-create the dish. Because the ingredients are secret, and cannot be determined by examining the dish, if the chef dies or the restaurant goes out of business, you may not have access to the dish. But if you possess the recipe, you are not dependent on the restaurant; any skilled chef will be able to re-create the dish.

When software is distributed as object code, the source code is essentially inaccessible for purposes of reverse engineering, the process whereby a competing designer starts with a publicly available end-product, and by taking it apart, learns how the original designer created the product. In effect, with object code, the licensee gets only the prepared dish, not the recipe. Distributing object code protects the original design, and facilitates the licensor’s control over maintenance, support, and production of derivative works and updates; all are important sources of revenue and the basis of a company’s strategic plan to recoup its investment in developing the software. While licensors could rely on intellectual property law to protect their rights, control of the source code is more effective and less expensive than policing the marketplace and litigating to enforce intellectual property rights.1

However, for many software applications, readily-available access to source code is essential to end-users if the developer-licensor is no longer willing or able to support the software (i.e., the chef dies). The tension between a licensor’s need to limit access to source code and the licensee’s need for uninterrupted access to the software can be mediated by a trusted, neutral third-party. The neutral third-party, acting as escrow agent, is charged with administering an escrow account containing the source code deposited by the developer-licensor. The source code is held by the escrow agent unless a release event occurs (i.e., the chef dies), in which case the escrow agent delivers the source code to the licensee. Release events are typically based on some failure, or threat of failure, of the licensor to meet the expectation interest of the licensee under the license agreement.

Licensors and licensees are motivated to enter into technology escrow agreements by widely different interests. The licensee’s motivation to establish an escrow account includes the desire to mitigate the risk of losing access to the software, but escrows are also often seen as a way to increase leverage with the licensor in the event the licensee is not satisfied with the licensor’s support.

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1 See generally Lawrence Lessig, Code and Other Laws of Cyberspace 19-22, 85-99 (Basic Books1999) (an in-depth discussion of the notion that technical controls imposed by software developers are an alternative to regulation via statutes and other legal means).
Licensor, on the other hand, are usually reluctant to place intellectual property in the form of unprotected source code into the hands of an escrow agent with a potential outcome that the source code will be released to the licensee, or that the threat of release will be used as a lever in maintenance and support disputes. Nevertheless, due to the licensee’s increased dependence on the unhindered access to the software, and heightened awareness of risk scenarios, licensors are increasingly likely to face the choice of accepting the software escrow or forgoing a licensing opportunity. This is especially true in the context of large-firm software licensees dealing with small-firm software developer-licensors. As in all commercial transactions governed by contract, the parties’ ability to define private law as between each other is circumscribed by statutory and common law restrictions. Intellectual property law and bankruptcy law pose significant limitations on licensing parties’ ability to control the ultimate outcome of the licensing agreement as well as the escrow transaction. The degree to which licensor’s bankruptcy trustee is able to alter the parties’ rights and obligations, particularly with respect to licensee’s access to source code under the license and escrow agreements, is the subject of this article.

II. THE CHILLING EFFECT OF LUBRIZOL AND THE POLICY ISSUES UNDERLYING THE ENACTMENT OF THE INTELLECTUAL PROPERTY LICENSES IN THE BANKRUPTCY ACT (§ 365(n))

The 1985 Fourth Circuit case, Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., provided the catalyst for Congress to enact the Intellectual Property Licenses in Bankruptcy Act in 1988, now codified in 11 U.S.C. § 365(n) of the Bankruptcy Code. Section 365(n) provides licensees of intellectual property, including software licensees, with a measure of protection against unilateral rejection of the software license by a licensor’s bankruptcy trustee. Analyzing Lubrizol is important for at least two reasons. First, Lubrizol establishes a baseline from which to assess the impact of § 365(n). Second, although § 365(n) essentially overturns the decision in Lubrizol, unless a transaction meets all the requirements of § 365(n), the Lubrizol court’s interpretation of other related bankruptcy provisions still controls.

The central issue in Lubrizol was whether, under § 365(a), the debtor in possession, licensor Richmond Metal Finishers, should be allowed to reject the technology license agreement with licensee Lubrizol Enterprises. “On [licensor’s] motion for approval of the rejection, the bankruptcy court properly interpreted § 365 as requiring it to undertake a two-step inquiry to determine the propriety of rejection: first, whether the contract is executory; next, if so, whether its rejection...
would be advantageous to the bankrupt.\textsuperscript{5}

Important from a policy perspective, not to mention from the licensee’s viewpoint, is the omission of any consideration in this two-step inquiry of the impact rejection would have on the licensee.\textsuperscript{6} The only concession to a licensee’s interests by the \textit{Lubrizol} court was to remind licensee that licensee could have, but failed to, present evidence discounting licensor’s claim that rejection was advantageous to the licensor.\textsuperscript{7} Of additional concern to licensees was the \textit{Lubrizol} holding that a trustee’s rejection of the license was distinct from ordinary breach of contract.\textsuperscript{8} Under this rule, a trustee’s rejection of the license precluded the opportunity to seek specific performance, leaving the licensee without the use of the software and with only a money damages claim against a bankrupt licensor.\textsuperscript{9}

However, in dicta, the \textit{Lubrizol} court gave voice to the substantial negative consequences flowing from its decision:

\begin{quote}
Lubrizol strongly urges upon us policy concerns in support of the district court’s refusal to defer to the debtor’s decision to reject or, preliminarily, to treat the contract as executory for § 365(a) purposes. We understand the concerns, but think they cannot control decision here.
\end{quote}

It cannot be gainsaid that allowing rejection of such contracts as executory imposes serious burdens upon contracting parties such as Lubrizol. Nor can it be doubted that allowing rejection in this and comparable cases could have a general chilling effect upon the willingness of such parties to contract at all with businesses in possible financial difficulty. But under bankruptcy law such equitable considerations may not be indulged by courts in respect of the type of contract here in issue. Congress has plainly provided for the rejection of executory contracts, notwithstanding the obvious adverse consequences for contracting parties thereby made inevitable. Awareness by Congress of those consequences is indeed specifically reflected in the special treatment accorded to union members under collective bargaining contracts, and to lessees of real property. But no comparable special treatment is provided for technology licensees such as Lubrizol. They share the general hazards created by § 365 for all business entities dealing with potential bankrupts in the respects at issue here.\textsuperscript{10}

The twin goals of bankruptcy law are “maximizing creditor recovery and

\textsuperscript{5} \textit{Lubrizol}, 756 F.2d at 1045.
\textsuperscript{6} This is not to say that exceptions never occur. See Philip S. Warden & Joseph G. Mansour, Source Code Escrows In Bankruptcy, 219 PLI/Pat 285, 306-307 (Feb. 1, 1986). ("An exception to the business judgment test has been applied to at least one case involving a license. The court in the case of \textit{In re Petur U.S.A. Instrument Co., Inc.} refused to allow the rejection of a license agreement where the damage to the non-debtor party was grossly disproportionate to the benefit realized by general unsecured creditors." 35 B.R. 561, 563 (Bankr. W.D.Wash. 1983). The court noted as follows: "here we are not only dealing with harm resulting from a mere disappointment of legitimate expectations. Rather we are dealing with the actual ruination of an otherwise profitable, successful and ongoing business. Equity will not permit such a result." \textit{Id.} at 564.
\textsuperscript{7} \textit{Lubrizol}, 756 F.2d at 1047.
\textsuperscript{8} \textit{Id.} at 1048.
\textsuperscript{9} \textit{Id.}
\textsuperscript{10} \textit{Id.} (emphasis added).
rehabilitating the debtor. Protection from the “chilling effect” on licensing transactions, and the potentially devastating consequences to licensees, are not included. Given the plain meaning of the statute, the legislative history, and the traditional goals of bankruptcy policy, the decision of the Fourth Circuit in Lubrizol should not have been a surprise to the licensing world. That the Lubrizol court addressed policy concerns at all was likely done as a courtesy, in response to licensee’s arguments, and perhaps by way of sending a message to Congress that the current state of the law lacked reasonable protection for licensees and accelerated the downward trajectory of distressed developers with its “chilling effect” on new licensing opportunities that could potentially reverse the descent.

To appreciate the scope of the policy issues underlying the problems raised by Lubrizol, it may be helpful to examine an analogous context that gave rise to the law of secured transactions. This mature, but continuously evolving, body of law is sometimes credited as a factor in the success enjoyed by the post-World War II American economy as compared with other national economies. Innovation and market leadership is fostered when entrepreneurs are not constrained by lack of ready access to credit. Investors of course need to minimize their risk. The law of secured transactions provided a mechanism whereby entrepreneurs could leverage all of their existing and, in some instances, future resources in a way that provided the lowest risk to creditors. Legislators, and those they relied on to develop the uniform regulations, recognized the need to mediate the competing interests of creditors and borrowers in such a way as to foster an environment conducive to entrepreneurship and innovation.

The Lubrizol court acknowledged Congress’ willingness to shield certain interests from the impact of unrestricted power of the trustee over executory contracts. Subsections (h) and (i) of § 365 protect lessees and purchasers of interests in real property. The Lubrizol dicta implied that the shield should extend to licensees of software due to the real harm to licensees as well as the less obvious harm to financially distressed developers, who in the aftermath of Lubrizol, were unable to provide potential customers with adequate assurances of...

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11 Precision Indus., Inc. v. Qualitech Steel SB Q, LLC, 327 F.3d 537, 548 (7th Cir. 2003). See also MICHAEL J. HERBERT, UNDERSTANDING BANKRUPTCY, § 1.01[B]-[C] (1995) (providing historical context of the “dual” or “twin” purposes of the Bankruptcy Code).

12 This notion was posited by Professor Curtis Nyquist during a Secured Transactions class at New England School of Law in 2001. Original source unknown.


15 Lubrizol, at 1048 (providing examples of special treatment as accorded union members under collective bargaining contracts and real property lessees).

continued access to the software. Mitigating this latter risk is only a slight enlargement in scope of the traditional bankruptcy goal of a fresh start for debtors. The rationale given by Congress in support of § 365(n) shows sensitivity to this broader context in which disputes between bankrupt software developers and their licensees play out. In enacting § 365(n), Congress sought to avoid the “chilling effect” of the Lubrizol decision and demonstrated a continuation of an ongoing commitment to protect America’s leadership position in the creation and exploitation of intellectual property.

The remainder of this article presents a chronology and analysis of the post Lubrizol developments, aiming to illustrate questions posed by the application of § 365(n) and the statute’s interaction with other law.


The literature written after the Lubrizol decision, but prior to the enactment of § 365(n), emphasizes the risks to licensees and suggests approaches to minimize those risks. Authors Cary H. Sherman and Jonathan S. Berck describe a trustee’s powers to reject the license and the potential problems for parties to escrow agreements that rely on licensor’s bankruptcy as a trigger event:

If bankruptcy is the cause of the failure to provide maintenance, special problems must be addressed. In addition to the concerns listed above, if the vendor files for bankruptcy under the Bankruptcy Code as it stands at this writing (Oct. 3, 1988), the user could actually lose both the right to continue using the software and physical possession of the software.

Specifically, there are three special problems arising from the Bankruptcy Code that the practitioner must plan around:

a. Retaining the right to use the software. Under the Bankruptcy Code, 11 U.S.C. § 365(a), the trustee of the debtor has the right to accept or reject any executory contracts, in the exercise of his sound business judgment. . . . Software licenses, in which the user has continuing obligations of confidentiality and the vendor has ongoing warranty, maintenance, and indemnification duties, have been construed to be executory contracts, and thus subject to rejection by a bankruptcy trustee.

b. Retaining possession of the software. . . . Section 362(a) of the bankruptcy code provides for an automatic stay of all actions to gain possession of or obtain control over property of the estate. And under § 704 of the bankruptcy code, the trustee has the responsibility of collecting and reducing to money all of this property. Therefore, the trustee could technically demand physical return of the software, unless title to the medium has been passed to the user.

17 Lubrizol at 1048.
19 Id.
c. Invalid Bankruptcy Clauses. To the surprise of most practitioners, under 11 U.S.C. § 365(e)(1), clauses which use bankruptcy as a trigger [to release the escrow deposit] are per se invalid. See, e.g., In re Computer Communications, Inc., 824 F.2d 725 (9th Cir. 1987). This presents a tricky drafting problem: how can you specify bankruptcy without using the ‘b-word’ itself?

Under present law, the answer is to substitute objective events for bankruptcy. If the real problem with a vendor’s bankruptcy is the failure of the vendor to provide maintenance, then that should be substituted as a [release] condition.

Another pair of authors, Philip S. Warden and Joseph G. Mansour, in a post-Lubrizol, pre-§ 365(n) article, also warn of the pitfalls associated with using bankruptcy as a release event:

The circumstances under which the escrow agent may release the source code should be carefully defined. The interest of the end-user can best be protected if the conditions for release are tied to the performance of the software and the developer’s response to defects in the program. . . . In no event should the escrow agreement provide that delivery of the source code be triggered by the filing of a bankruptcy petition by or against the developer. Section 365(e) provides that no right or obligation under an executory contract or unexpired lease may be terminated or modified by the commencement of a case under Title 11. Subject to limited exception, the Bankruptcy Code would invalidate a contract provision requiring the escrow agent to turn over the source code once a petition in bankruptcy had been filed by or against the debtor (11 U.S.C. § 365(e)).

The authors go on to warn licensees seeking release of source code of problems presented by the automatic stay provision:

Even if sufficient information has been escrowed the ability of the end-user to access the information may be impaired if the developer enters bankruptcy. Two major problems have developed. The developer may reject the license agreement as an executory contract and recover information escrowed pursuant thereto. The developer may also prevent recovery of the information under the automatic stay provisions of section 362.

Section 362(a) provides, among other things, that filing of a petition in bankruptcy operates to stay “any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate” (11 U.S.C. § 362(a)(3)). Thus, if the escrowed source code is property of the estate, the end-user would be unable to access the source code from the escrow agent. Indeed, the escrow agent may be required to turn the property over to the debtor’s estate pursuant to section 542.

The end-user would violate the automatic stay provisions if it seeks recovery of the

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End-users are vulnerable to problems in bankruptcy with source code escrows. These problems may be reduced if the transaction is structured in the manner described elsewhere in the article. However, the suggested approach is untested, and it remains to be seen whether source code escrows can be fashioned in a way to protect all concerned.  

The post- Lubrizol, pre- § 365(n), Ninth Circuit case, In re Computer Communications, Inc., further defined the interaction of the automatic stay provision of § 362, and the so-called ipso facto provision of § 365(e). Although Computer Communications involved a contract for sale of computer equipment (that included software) rather than a software license per se, it illustrates the court’s interpretation of these two bankruptcy provisions prior to § 365(n). The court’s holdings can be thought of as a baseline from which to assess the impact of § 365(n) on future transactions that qualify for § 365(n) protection.

In Computer Communications, shortly after the parties entered a contract for the sale of computer hardware and software, the seller CCI filed a petition under Chapter 11 and thereafter, buyer Codex notified debtor seller that it was terminating the contract pursuant to a contract clause that puts any party filing for bankruptcy in default. Debtor seller sought injunctive relief for wrongful termination in violation of the automatic stay provision of the Bankruptcy Code, 11 U.S.C. § 362.  

In reaction to the motion by debtor seller, buyer later notified debtor seller that it was terminating under a different contract clause allowing for termination with notice and partial payment. Debtor seller sought relief claiming that buyer’s termination under the notice clause violated the automatic stay provision of 11 U.S.C. §362 and termination under the bankruptcy clause of the contract violated the ipso facto section, 11 U.S.C. §365(e).

This case is important for the rule that not only is a termination upon bankruptcy clause unenforceable under the ipso facto provisions of § 365(e), but a termination upon notice and partial payment clause could not be enforced as it violated the automatic stay provision of § 362. The court held that buyer could have sought relief from the automatic stay provision and that buyer’s violation of it was willful and the court awarded punitive damages.


The courts below held that the automatic stay prohibited [buyer] Codex from

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22 Id. at 293, 308-11.
23 In re Computer Comm’n, Inc., 824 F.2d 725 (9th Cir. 1987).
24 Id. at 726.
25 Id.
26 Id.
27 Id.
28 Id.
29 Id. at 727.
unilaterally terminating the Agreement. We agree. Even if Codex had a valid reason for terminating the Agreement, it still was required to petition the court for relief from the automatic stay under § 362(d).  

The court next examined the legislative history and overall statutory scheme:

Congress intended the scope of the stay to be broad. “All proceedings are stayed, including arbitration, license revocation, administrative, and judicial proceedings. Proceeding in this sense encompasses civil actions as well, and all proceedings even if they are not before governmental tribunals.”

The court also examined buyer’s argument that the statute did not apply because the contract was not property of the estate - the court found this argument unavailing:

11 U.S.C. § 541 (1982) defines property of the estate. It neither explicitly includes or excludes contract rights. The definition includes “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). The legislative history states that the scope for this paragraph is broad. “It includes all kinds of property, including tangible or intangible property [and] causes of action . . . .” H.R.Rep. No. 595 at 367, reprinted in 1978 U.S.Code Cong. & Admin.News at 6323. This court has held that insurance contracts are embraced in the statutory definition of “property.” In re Minoco Group of Companies, Ltd., 799 F.2d 517, 519 (9th Cir.1986).

The foregoing cases and articles illustrate the challenges faced by post Lubrizol licensees attempting to secure rights to continued use of software and access to escrowed materials. Next, we examine Congress’ answer to those challenges in the form of § 365(n) as well as the interaction of § 365(n) with other provisions of the Bankruptcy Code. This includes §365(n)’s interaction with § 365(e), which limits use of ipso facto clauses; § 362, the automatic stay provision; and § 363(f) which allows the trustee to sell property of the estate, free of encumbrances.

IV. SECTION 356(N): CONGRESSIONAL INTENT, APPLICATION, AND POTENTIAL CONFLICTS WITH OTHER BANKRUPTCY LAW PROVISIONS

A. Congressional Intent

Three years after the decision in Lubrizol, Congress enacted the Intellectual Property Licenses in Bankruptcy Act. In its report on the bill, the Senate stated its intention was,
to amend Section 365 of the Bankruptcy Code to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to Section 365 in the event of the licensor’s bankruptcy. Certain recent court decisions interpreting Section 365 have imposed a burden on American technological development that was never intended by Congress in enacting Section 365. The adoption of this bill will immediately remove that burden and its attendant threat to the development of American Technology and will further clarify that Congress never intended for Section 365 to be so applied.35

Aside from taking the courts to task for seeming to improperly interpret § 365,36 the Senate report makes it clear that licensee’s rights to intellectual property are to be protected from trustee’s power to reject the license.37 The report also provides forward-looking guidance to courts interpreting the § 365(n) by stating a broader goal of the bill:

This bill is intended to restore confidence in the system of intellectual property licensing, and courts interpreting it should be sensitive to the reasonable practices that have and will evolve among parties seeking to add to the technological and creative wealth of America.38

B. Early Cases Interpreting § 365(n)

In 1994, Patrick Law, in a Commercial Law Journal article, analyzed what he believed to be the only two cases (as of that writing) to construe § 365(n).39 Ironically, in both instances the statute was invoked by the debtor to “compel the licensee to choose either to terminate the licensing agreement or to retain its rights as they existed immediately before bankruptcy.”40 Law goes on to note that § 365(n), in such cases, “has not served the Congressional purpose of encouraging investment in intellectual property. The licensee involved would be less likely to enter into a licensing agreement if they might be forced to make a Section 365(n) election which is not to their best financial interests.”41

Law concludes his article by noting that:

[given the scarcity of case law construing [§ 365(n)], it is difficult to say with certainty that the Act has indeed achieved its purpose. The two decided cases relying upon Section 365(n) suggest that situations exist where the statute will not effect favorable treatment of licensees. In addition, situations involving trademark licensees, improvement clauses, and assignment of licensor’s rights may all present unfavorable treatment of licensees. Nevertheless, in the majority of licensing

35 S. REP. NO. 100-505, at 1-2 (1988)
36 See id. at 4.
37 Id. at 1.
38 Id. at 9.
39 In re El Int’l, 123 B.R. 64 (Bankr.D.Idaho 1991); In re Prize Frize, Inc., 32 F.3d 426 (9th Cir. 1994).
41 Id. at 270.
relationships, the IPLBA is likely to correct the deleterious effects of Lubrizol. Given the recentness of the Act, commentators must at this time take a wait-and-see posture until time puts its judicial gloss on this legislation.\(^{42}\)

C. The Application of § 365(n) To Source Code Escrows

In spite of Congress’ broadly stated goals, practitioners seeking to exploit § 365(n) were confronted with more questions than answers, especially in light of the early caselaw interpreting its provisions. There was considerable question as to just what powers could be exercised by bankruptcy trustees and what, if anything, practitioners could do to protect the rights of licensees. An area of particular concern was the impact of § 365(n) on source code escrow arrangements, which had become a key element in the strategy to protect licensee’s expectation interests in their license contracts. The Senate report on § 365(n) provides a summary of the new law relative to escrow agreements and explains the reference in § 365(n) to “any agreement supplementary to such contract.”\(^{43}\)

\[\text{The licensor may have contracted to supply the licensee with a product incorporating the licensed intellectual property and may have agreed that the licensee would only have access to information necessary to produce the licensed intellectual property in the event of the licensor’s inability or unwillingness to supply the licensee. To assure the licensee of access to such secret information at the defined time, the licensor may have agreed to turn over such information to a third party to be held in escrow until the triggering event. The third-party escrow agent would be a party to such an agreement, and the agreement would be set forth in a document separate from the basic license. Section 365(n)(1)(B), thus, speaks of the retention by the licensee of rights to the intellectual property under ‘any agreement supplementary to such contract.’ The licensee retains both the rights set forth in the rejected license itself and any agreement supplementary thereto, whether the supplementary agreement was itself the subject of a rejection by the trustee.}\]

The last sentence contains an important proposition: namely, parties to license agreements may place additional rights to the source code in a supplementary agreement and those rights would be protected under § 365(n) whether or not the trustee rejects the escrow agreement itself. The Senate report continues and explains the scope of protected rights and the necessity of careful drafting to secure those rights under the new law.

Among the rights retained by the licensee electing under new Section 365(n)(1)(B) is the right to any embodiment of the intellectual property to which the parties’ contracts entitle the licensee. For instance, the parties might have agreed that the licensor would prepare a prototype incorporating the licensed intellectual property. If such a prototype was prepared prior to the filing of the petition for relief, but had not been delivered to the licensee at that time, then the licensee can compel the delivery of the prototype in accordance with the terms of the rejected license.

\(^{42}\) Id. at 275.
\(^{44}\) S. REP. NO. 100-505, at 9 (1988).
Other examples of embodiments include genetic material needed to produce certain biotechnological products and computer program source codes. There are many other possible examples of embodiments, but critical to any right of the licensee to obtain such embodiments under this bill is the prepetition agreement of the parties that the licensee have access to such material and the physical existence of such material on the day of the bankruptcy filing.45

Here, the Senate report identifies a key requirement in § 365(n): only rights to the intellectual property “as such rights existed immediately before the case commenced”46 are preserved under the new law. Practitioners may postulate whether a licensee meets this requirement when a licensee’s access to the escrowed source code is conditioned on an event that could occur on or after the date of filing. While the balance of the Senate Report and the provisions of the statute itself indicate that Congress intended to protect access under these conditions,47 practitioners still faced the more problematic question of whether licensees could enforce rights to access the escrowed source code when those rights were conditioned on the act of filing a bankruptcy petition itself. The possible answers to this question are discussed in the following section.

D. Ipso Facto Clauses As Release Conditions in Escrow Agreements

As practitioners began to incorporate § 365(n) into their strategy to counteract the Lubrizol problem, they did so without the benefit of the “judicial gloss”48 that would only come with time. In 1992, an intellectual property section committee of the American Bar Association published Model Software License Provisions including a model escrow agreement.49 Both the software license and the escrow agreement anticipated bankruptcy as an event that could trigger a release of escrowed source code:

s261.6 Release Events for Source Code Escrow Package. The Source Code Escrow

45 Id. at 9-10.
47 While not addressing this exact issue, the Senate Report does indicate that protected rights could be conditioned on future events. See S. Rep. No. 100-505, at 8 (1988). The report states: "It is important to note that the amendment, when referring to retention of rights under 'such contract,' deliberately omits the phrase 'the term of which has commenced' appearing in the somewhat parallel subsection 365(h) in connection with leases and time share plans. Frequently, the term of the license agreement is contingent upon the occurrence of a future event, such as FDA approval or issuance of the patent. The benefits of the bill are intended to extend to such license agreements, consistent with the limitation that the licensee's rights are only in the underlying intellectual property as it existed at the time of the filing." Id.
48 Law, supra note 40 at 275.
49 L. J. Kutten, Computer Software Protection-Liability-Law-Forms: Software License Agreement, 2 Computer Software Appendix 9E (Thompson West 2007) (reprinting the Model Software License Provisions - Working Draft 3.0 (March 22, 1992) from the American Bar Association, Section on Patent, Trademark, & Copyright Law, Committee on Computer Programs). The ABA cautions that: "The Model Provisions are presented as a drafting aid for professional use by lawyers; while it is believed that nonlawyers may find them of interest as general information, they are not intended and should not be used as a substitute for legal advice. The Model Provisions have not been approved or endorsed by the ABA or any component thereof." Id. The document is dubbed a "working draft" dated 1992, but no more recent offering was identified by this author.
Package may be released from escrow to LICENSEE, temporarily or permanently, solely upon the occurrence during the Maintenance Period of one or more of the following ‘Escrow Release Events’ defined below:

(a) permanently, if LICENSOR becomes insolvent or admits insolvency or admits a general inability to pay its debts as they become due;

(b) permanently, if LICENSOR files a petition for protection under the Bankruptcy Code of the United States, or an involuntary petition in bankruptcy is filed against LICENSOR and is not dismissed within sixty (60) days thereafter.

L. J. Kutten, the author of the article containing the copy of the ABA’s Model Software License Provisions, notes:

Many escrow agreements contain an ipso facto bankruptcy clause which states that in the event the escrower has (1) an appointment of a trustee, (2) an assignment of assets for the benefit of its creditors, or (3) files for bankruptcy (either voluntary or involuntary), then the escrowee will automatically transfer the escrowed material to the escrow beneficiary. Until the passage of the Intellectual Property Protection Act, all such clauses were void under the Bankruptcy Reform Act of 1978.

Another example of a developer’s bankruptcy as a release condition was found in an article placed on the website of a software escrow service provider. Author Shelly Rothschild urges licensees to arrange for a source code escrow “that provides for the automatic turnover of the source code to the licensee upon the occurrence of certain specified events, such as rejection of the license agreement, filing of a bankruptcy case by or against licensor, or breach of the licensor’s obligations under the license agreement.” There, Rothschild makes no reference to ipso facto problems.

These examples indicate that at least some practitioners accepted bankruptcy as a valid release condition despite the provisions of § 365(e). What is less clear is the basis for this belief. Section 365(n) protects licensee’s rights to the intellectual property upon certain conditions, but § 365(n) does not refer specifically to § 365(e) and it does not necessarily follow from the text of § 365(n) that its provisions trump § 365(e).

A threshold question in the interpretation of the effect of § 365(n) is whether the license has been rejected by the bankruptcy trustee. Attorney Michael Egger, in a practice-oriented article, states that: “[w]here Section 365(n) becomes relevant is during the period after the trustee files a bankruptcy petition (but prior to the

50 Id.
53 Id.
54 11 U.S.C. §§ 365(e), (n).
trustee’s election to accept or reject a license agreement) and, more important, after the trustee rejects a license agreement.¹⁵⁵ The first three subsections of § 365(n) protect a certain licensee’s rights, and are all conditioned on trustee’s rejection of the executory contract.¹⁵⁶ On the other hand, the last subsection provides somewhat similar protections during the period of time prior to a trustee’s rejection.¹⁵⁷ Therefore, § 365(n)(4) acts to prevent the trustee from delaying the exercise of the licensee’s rights by merely postponing rejection indefinitely.¹⁵⁸

1. Ipso Facto Clauses Upon Trustee’s Rejection of the License

In the case where the trustee rejects the license, subsections (1), (2), and (3) of § 365(n) support congressional intent with respect to source code escrows, as expressed in Senate Report 100-505 by allowing licensees “to obtain such intellectual property (or such embodiment) from another entity.”¹⁵⁹ Under this provision, a licensee may obtain source code from an escrow agent (another entity) if the escrow agreement provides for such release. But if the release condition consists of a developer’s filing for bankruptcy, a trustee may arguably assert that access to the source code was not a right protected by §365(n) because it violates §365(e), which states:

(e)(1) 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.

Without a clear statement in the Bankruptcy Code or judicial interpretation, it

¹⁵⁶ 11 U.S.C. §§ 365(n)(1)-(3)
¹⁵⁸ Depending on the type of bankruptcy protection under which debtor sought protection, the trustee's obligation to assume or reject executory contracts varies. See Herbert, supra note 11 at § 9.04[C] (stating that there "is no single date by which the trustee/DIP must assume or reject. Generally, in a Chapter 7 case, the decision must be made within 60 days of the order for relief (unless the court extends this period). In a Chapter 9, 11, 12, or 13 case, the confirmation of the plan is usually the date by which the decision must be made, although the court can change this for cause").
¹⁵⁹ 11 U.S.C. §§ 365(n)(1) - (3).
appears that the requirements of § 365(n) and § 365(e) conflict when access to the source code is conditioned solely on the developer’s bankruptcy. A logical interpretation of congressional intent suggests that this conflict could be resolved in favor of releasing the source code. But will courts who confront this issue resolve it based on a similar reading of congressional intent or will they seek to force Congress to make an unequivocal statement, as occurred in Lubrizol?

Practitioners representing licensees may avoid the problem by not relying on ipso facto clauses as release conditions. Release can be conditioned on a trustee’s rejection of the license; this is not one of the enumerated prohibitions in § 365(e). Additionally, release can be conditioned on developer’s material breach of the license or maintenance agreements, an event that by definition exists if the license was rejected. However, many existing escrow agreements rely solely on a developer’s bankruptcy as a release condition. With practitioners operating under the assumption that § 365(n) allows for this, many escrow agreements will be written which rely on bankruptcy as the sole release condition. To exacerbate the situation, developers may be motivated to limit release conditions to bankruptcy for two possible reasons: first, they may be less concerned about protecting source code if they are liquidating; second, they may believe that bankruptcy as a release condition could be contested under § 365(e), especially if they reorganize and believe they could meet their license contract obligations.

2. Ipso Facto Clauses Prior to Trustee’s Rejection of the License and Upon Trustee’s Assumption of the License

If a trustee does not immediately reject the license, a licensee may still rely on § 365(n)(4)(B) which provides the same protection of right to an escrow deposit as § 365(n)(3)(B), but is conditioned on a licensee’s written request rather than a trustee’s rejection. Owing to the similarity of § 365(n)(4)(B) to § 365(n)(3)(B), it may be argued that the same exception to the escrow deposit protection is available. Escrow release mechanisms may be structured in two fundamentally different ways. Under the more common release structure, parties agree to allow developer a period of time to issue "contrary instructions" in response to licensee's request for release. If contrary instructions are received, the agent continues to hold the deposit pending resolution of the dispute regarding whether a release condition has indeed occurred. Under the alternative "demand release" structure, licensee sends a notice to escrow agent asserting that a release condition has occurred. Upon such notice, the escrow agent immediately releases the source code to licensee. If the developer disputes the occurrence of a release condition, a developer must seek remedy after the licensee already has the source code.

The inclusion of a notice and cure period prior to a release condition becoming valid may allow developers to prevent or delay release of the source code should the licensee insist upon structuring the escrow as a release on demand.

Id.
Id.
Id.

63 Practitioners representing developer's interests may wish to allow for a cure period should a release condition occur when they inadvertently breach or are temporarily unable to meet contractual obligations.

64 Owing to the similarity of § 365(n)(4)(B) to § 365(n)(3)(B), it

65 11 U.S.C. § 365(n)(4) states: “(4) Unless and until the trustee rejects such contract, on the written request of the licensee the trustee shall— (A)to the extent provided in such contract or any agreement supplementary to such contract— (i)perform such contract, or (ii) provide to the licensee such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law) held by the trustee; and (B)not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual
is likely that the ipso facto issue will be determined in the same way under both provisions. However, if the trustee assumes the license during this time, the interpretation of § 365(n) presents an additional complication. A literal interpretation of the condition in § 365(n)(4): "Unless and until the trustee rejects such contract" 65 would have the conditioned provisions apply when a trustee assumed the license, because the trustee had not yet rejected it. But if a trustee assumed the license, and met all the conditions imposed by § 365(b) in doing so, there should be, at least in theory, little basis for licensee to require access to the source code. Of course licensees faced with relying on a bankrupt licensor for support, maintenance and upgrades of mission critical software may think otherwise. The uncertainty occasioned by a developer’s bankruptcy is likely to cause licensees to pursue direct access to the source code under the escrow agreement. But if developer has assumed the license and is performing it, licensees seeking to proactively guard against default in obligations to support mission critical software, prior to there actually being any default, may be forced to rely on ipso facto clauses as release conditions. If they do, will courts answer the question of whether § 365(e) makes such conditions invalid be the same as if developer had rejected the license?

Lacking case law addressing the point, we might gain some insight by further examination of congressional intent. Senate Report 100-505 explains the purpose of § 365(n)(4):

Prior to rejection by the debtor licensor but upon nonperformance by the trustee (n)(4)), as well as upon rejection by the debtor licensor combined with the licensee’s election to retain rights in intellectual property ((n)(3)), the trustee, upon written request by the licensee, as provided in the parties’ agreements, shall turn over to the licensee intellectual property held by the trustee and shall not interfere with the licensee’s contractual rights to use the intellectual property or to obtain it from a third party.66

Although the statute does not actually require that the debtor be non-performing, it is hard to escape the conclusion that the authors of the Senate Report reach: if a trustee is performing the license (or has assumed the license which requires performance), special protection, including giving ipso facto clauses effect, would represent an unfair burden to the debtor and not part of the protection Congress

property (including such embodiment), including any right to obtain such intellectual property (or such embodiment) from another entity.”

There may be some temptation for trustees to interpret § 365(n)(4) as providing a trustee with the option, prior to rejection, to either perform the contract or not interfere with a licensee’s right to access the escrow deposit, but this author does not believe the structure of the statute supports this conclusion. Section 365(n)(4) contains two subsections: (A) and (B), and since the last provision in (A) ends with the conjunction "and," both (A) and (B) must be satisfied "unless and until the trustee rejects such contract" should the licensee request it in writing. Possible confusion may result because § 365(n)(4)(A) has two subsections: (i) and (ii) which are joined by the conjunction "or" and so are properly interpreted as alternatives. However, subsection (B) is clearly an additional requirement because of the word "and" following the last subsection in (4)(A) as well as the outline structure itself. See generally BRYAN A. GARNER, A DICTIONARY OF MODERN LEGAL USAGE 624 (Oxford University Press 2nd ed. 2001) (1996) (discussing problems associated with thee interpretation of the words "or" and "and").

intended to provide licensees.

Similar questions will arise should licensees seek to rely on endless variations of release conditions that do not qualify under § 365(e) as ipso facto clauses, but allow for release upon such broad grounds; for example: licensee’s sole determination that a reasonable threat to licensee’s continued use of software exists; or: developer’s key engineering staff is no longer available to support software. Will licensees be able to rely on these as release conditions upon trustee’s assumption of the license? Absent a bankruptcy code based restriction similar to the prohibition on ipso facto clauses or a court’s broad interpretation of these close cousins to ipso facto clauses, debtors will be required to accept the consequences or reject the escrow agreement, which will lead to the same result: release of the source code.

It is likely that many software licensees believe that if the licensor files for bankruptcy, they will be assured of gaining access to the source code in an escrow deposit under the provisions of § 365(n). This was certainly Congress’ intent if licensor rejects the license, but this certainty decreases until trustee actually rejects the license and decreases further if trustee assumes the license. If the sole release condition is the act of filing, certainty is further diminished. Even assuming a licensee avails itself of the provisions of § 365(n)(4), and gains access to the source code in the period after filing, but before a trustee assumes the license, a licensee’s continued access to source code is questionable should a trustee assume the license at some later date.

Congress recognized and asked courts to be sensitive “to the reasonable practices that have and will evolve among parties seeking to add to the technological and creative wealth of America.” The dynamic nature of these practices makes a difficult task of drafting statutes to mediate the interests of debtor and non-debtor parties to these transactions. In the material that follows, we shall see that there are additional reasons why, unless trustee actually rejects the license, licensees of bankrupt developers may be forced to forgo release of the source code and accept performance from the debtor or debtor’s assignee.

E. Assumption and Assignment of Intellectual Property Licenses.

1. Trustee’s Power to Assume and Assign Intellectual Property Licenses.

Senate Report 100-505 states that the bill enacting § 365(n) does not address certain issues and that “determinations of whether intellectual property licenses are assumable or assignable can be made in accordance with sections 365(c) and (f).” Section 365(a), subject to specific conditions, allows a trustee to assume executory contracts of the debtor. These conditions include providing adequate

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67 Id. at 9.
68 Id. at 5.
assurances of future performance and the cure of, or promise to promptly cure, any defaults, except those that are deemed penalties. Section 365(f) allows a trustee to assign executory contracts if the trustee assumes the contract and provides adequate assurance of future performance by an assignee, unless the assignment is prohibited by provisions of § 365(c).

The power to assume an executory contract is a threshold issue because, as was discussed in a previous section, the protections afforded licensees in § 365(n) are conditioned on trustee’s rejection, or on a licensee’s written request during the period prior to rejection. Therefore, if a licensee can prevent assumption by the trustee or force a determination that the license is rejected, the licensee may avail itself of the protections afforded in § 365(n), including access to source code. In the analysis that follows, it is essential to distinguish between debtor licensees and debtor licensors, as exemplified in the Senate Report, which explains that “[t]he bill [enacting § 365(n)] does not deal with debtor licensees.”

2. Licensee’s Power to Prevent Assumption or Assignment

Under § 365(c), “[t]he trustee may not assume or assign any executory contract or unexpired lease of the debtor . . . if 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 . . . .” This language is neutral as to the licensee versus licensor question, but the role of the party seeking protection is a critical factor in the practical application of this provision.

The limits imposed by § 365(c) are primarily based on “applicable law” excusing a party from accepting performance from another entity. Courts have uniformly recognized that federal patent, copyright and trademark laws and the common law related thereto are “applicable laws” that excuse a non-debtor party from rendering performance to or accepting performance from a third party pursuant to Bankruptcy Code section 365(c). It is the author’s belief that this body of “applicable law” is primarily oriented to protect the rights of the licensor, that is, the patent or copyright holder, and does not place restrictions on the licensor’s ability to assign its own rights. The rationale for this belief becomes

74 See Aleta A. Mills, The Impact of Bankruptcy on Patent and Copyright Licenses, 17 Bankr. Dev. 575, 576 (2001). There is considerable disagreement over exactly how this provision operates. Id. at 575. There is currently a split of authority over whether the debtor licensees are prevented from assuming licenses they intend to continue to utilize as debtors in possession or whether this is allowed and only outright assignments to external parties are prohibited. Id. at 576. Courts deciding one way or the other are said to be applying the “actual” versus “hypothetical” test. Id.
75 11 U.S.C. § 355(c).
clear when it is considered that it is of far less consequence to a licensee if licensor assigns its rights in the license to another entity (support and improvement issues aside), it just means licensee pays royalties to another entity. So it is probably a red-herring to think of § 365(c) as a vehicle to prevent assumption of executory contracts by debtor licensor because “applicable law” does not provide licensees with powers useable under that section.

Authors writing for practitioners provide some support for this conclusion. Madlyn Primoff and Erica Weinberger, in an American Bankruptcy Institute Law Review article, focused on a trustee’s powers to assume and assign executory contracts (IP licenses) under § 365(c).77 When Primoff and Weinberger reviewed the “applicable law” of patents and copyrights, they found that non-exclusive licenses may not be assigned and perhaps not even assumed, by a trustee or a debtor in possession of a bankrupt licensee.78 However, when the analysis is extended to the debtor licensor context with respect to patents:

[I]t appears that Bankruptcy Code section 365(c) does not bar assumption and assignment by a debtor-licensor of a non-exclusive patent license without the consent of a non-debtor licensee, provided that section 365(f)(2)(B) of the Bankruptcy Code’s adequate assurance of future performance test is satisfied. The issue of whether, under section 365(c) of the Bankruptcy Code, a debtor-licensor may be prohibited from assuming and assigning an exclusive patent license without the consent of the non-debtor licensee does not appear to have been addressed by the relevant case law.79

With respect to copyrights, Primoff and Weinberger find:

It appears that section 365(c) of the Bankruptcy Code does not, however, prohibit a debtor-licensor from assuming and assigning a non-exclusive copyright license without the consent of a non-debtor licensee. The issue of whether a debtor-licensor might be barred from assuming and assigning an exclusive copyright license without the consent of the non-debtor licensee does not appear to have been addressed by the relevant case law.80

Primoff and Weinberger discuss a licensee’s stake in seeing that only the licensor (and not a third party) provide support and maintenance, but stop short of saying this interest translates into statutory protection:

By the same token, an intellectual property license may impose continuing obligations on the licensor, such as the obligation to provide maintenance, service, or technology upgrades. The licensee’s ability to use the intellectual property or technology may be entirely dependent upon the licensor’s performance of such obligations. If a licensor files for bankruptcy and thereafter assumes and assigns the license, the results could be disastrous for the licensee if the assignee is unable or unwilling to perform the licensor’s obligations under the license.81

77 Id. at 307-08.
78 Id. at 323-24, 326.
79 Id. at 324.
80 Id. at 327.
81 Id. at 320.
For the purpose of understanding the powers available to the trustee when a debtor-licensor seeks to prevent the release of the software source code from escrow, we will consider the limits placed on assumption and assignment under § 365(c) to be unavailable to non-debtor licensees.

3. Assignment as a Release Condition in Source Code Escrows

After filing for bankruptcy, executory contracts, including source code escrow contracts, will be performed or not performed according to whether the trustee rejects or assumes the contracts.\(^{82}\) As previously discussed, in cases where a trustee rejects a contract for rights to intellectual property, § 365(n) provides some protection for the interests of non-debtor licensees.\(^{83}\) Among the protected interests are continued use of the intellectual property if provided for in the license, and access to the source code if provided for in an escrow agreement.\(^{84}\) We have also seen that escrow agreements that rely solely on “ipso facto” clauses as release conditions in the escrow agreements may encounter opposition by debtors claiming they are invalid under § 365(e). A similar situation exists for escrow agreements that rely on assignment of the license as a release condition. On one hand, as a term in the escrow agreement, a licensee may consider this a term that must be performed if a trustee is to assume the contract, or one that is protected under § 365(n) should trustee reject the contract. However, like “ipso facto” terms, provisions that limit a debtor’s power to assign, may encounter opposition by a trustee’s claiming that these provisions are invalid under § 365(f)(3), which states:

\[\text{Notwithstanding a provision in an executory contract... that terminates or modifies... such contract... on account of an assignment of such contract or lease, such contract, lease, right, or obligation may not be terminated or modified under such provision because of the assumption or assignment of such contract or lease by the trustee.}\]

Section 365(f)(3) not only prevents anti-assignment terms from halting an assignment; it could be argued that it also allows a trustee to prevent a release based on an escrow agreement release condition, providing for a release of the source code upon assumption or assignment by the developer. Unlike “ipso facto” clauses, anti-assignment clauses may still have effect outside of bankruptcy proceedings, but licensees must be aware of the potential for trustees to invoke § 365(f)(3) if a licensee attempts to request release of the source code based on an anti-assignment release condition in the escrow agreement.

F. Conflict Between § 363(f) Sale of Assets and § 365(h) Protecting Lessees of Real Property

Benjamin S. Halasz, writing in a 2003 Hale & Dorr Commercial Advisor

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\(^{83}\) See § 365(n).

\(^{84}\) See § 365(n).

article, cautions that a then-recent Seventh Circuit case, *Precision Industries*,
“could change the balance between lessors and lessees, and raises questions about
the rights of a licensee of intellectual property under 11 U.S.C. § 365(n).” Even
though the leased property in *Precision Industries* consisted of real property,
Halasz speculates that the decision poses problems for licensees of intellectual
property by analogy.

In *Precision Industries* the non-debtor lessee of a parcel of real property
claimed it could not be evicted because under § 365(h) its possessory interest was
protected even if the lease was rejected. Debtor lessor claimed that § 363(f)
allowed it to sell the property of the estate free and clear of all encumbrances,
including lessee’s possessory interest. The Seventh Circuit reversed the district
court’s decision, holding that § 365(h) did not trump § 363(f) and the debtor lessor
was free to sell the asset of the estate free of lessee’s possessory interest. The
court determined that it was possible to reasonably interpret both statutes in such a
way that avoided conflict between them. To do so, the court concluded that
Congress intended § 365(h) to apply only in the narrow context where debtor
lessor actually “rejected” the lease, otherwise, § 363(f) operated to allow debtor
lessor to sell the property free of encumbrances. The court was not unaware of
problems associated with this interpretation:

Granted, if the Sale Order operated to extinguish Precision’s right to possess the
property—as we conclude it did—then the effect of the sale might be understood as
the equivalent of a repudiation of Precision’s lease. But, nothing in the express
terms of section 365(h) suggests that it applies to any and all events that threaten
the lessee’s possessory rights. Section 365(h) instead focuses on a specific type of
event—the rejection of an executory contract by the trustee or debtor-in-
possession—and spells out the rights of parties affected by that event. It says
nothing at all about sales of estate property, which are the province of section
363.

It is worth noting that the court also supported its conclusion with the fact
that § 363 provides some limited protection for the lessee’s interest. Section
363(e) requires the bankruptcy court to, upon request of party with an interest at
risk by the sale, to “prohibit or condition such . . . sale . . . as is necessary to
provide adequate protection of such interest.” The court acknowledges that

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86 *Precision Indus., Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003).
87 Benjamin S. Halasz, *Seventh Circuit Ruling on Sale of Bankrupt’s Assets Eliminates Rights of
Lessee -- Decision May Have Implications for Rights of IP Licensees*, HALE & DORR COMMERCIAL
88 Id. at 1-3.
89 *Precision Indus.,* 327 F.3d at 541.
90 Id.
91 Id. at 540.
92 Id. at 548.
93 Id. at 547-48.
94 Id. at 547.
95 Id. at 547-48.
96 *Precision Indus.,* 327 F.3d at 547-48 (quoting 11 U.S.C. § 363(e)).
while this may not provide a complete remedy or ensure lessee’s continued right to possess the property, it demonstrated that it was not essential to rely on § 365(h) to protect lessee’s interests and the statutes could co-exist.\textsuperscript{97} It is not known what protection the bankruptcy court might have provided because the lessee in \textit{Precision Industries} never contested the sale or sought to exercise its rights under § 363(e).\textsuperscript{98}

In support of his contention that the decision in \textit{Precision Industries} may threaten the rights of intellectual property lessees, Halasz notes that “[n]ot only is the structure of § 365(n) similar to that of § 365(h), but the legislative history of § 365(n) indicates that it was modeled on § 365(h).”\textsuperscript{99} Halasz concludes his article with some advice to lessees of intellectual property:

\begin{quote}
It is difficult to know so soon after this Seventh Circuit decision whether a license or lease can be protected from a sale under § 363(f). However, some of the pitfalls of the \textit{Precision Industries} decision may be avoided if lessees and licensees are vigilant in objecting to a sale of assets that does not adequately protect their interests.\textsuperscript{100}
\end{quote}

Later cases proved just how difficult it would be to determine the rights of a lessee or licensee confronted with a sale of the leased or licensed asset. In a 2005 District of Massachusetts Bankruptcy Court case, \textit{In re Haskell}, the court chose not to follow the Seventh Circuit and recognized a split in the case law over the issue decided in \textit{Precision Industries}.\textsuperscript{101} The \textit{Haskell} court refused to follow the Seventh Circuit and reasoned that: “[i]f the Court were to grant the Debtor’s Sale Motion, the provisions of § 365(h) would be eviscerated. In other words, the Debtor would be doing indirectly what it could not do directly, namely, dispossessing [lessee] NEBH.”\textsuperscript{102}

By way of comparing the policy underpinnings of the two disparate conclusions, the court in \textit{Precision Industries} noted that its interpretation was consistent with the twin purposes of bankruptcy policy,\textsuperscript{103} while the court in \textit{Haskell} expanded the purposes to include the interests of lessees.\textsuperscript{104} It is also worth noting that there are important differences between interests in real property and interests in intellectual property. The primary distinction is the lack of ability to “share” real property. Depending on the terms of the license (exclusive versus non-exclusive) and the context of the licensee’s use of the software (competitive market versus in-house use), it may be possible for a debtor licensor to sell the software asset while § 365(n) would allow a licensee continued use of the software. This would be consistent with the legislative intent for § 365(n): to strike a balance between various interests along lines of removing affirmative

\begin{footnotes}
\item[97] Id.
\item[98] Id. at 543
\item[99] Halasz, supra note 86, at 2.
\item[100] Id. at 3.
\item[102] Id. at 9
\item[103] \textit{Precision Indus.}, 327 F.3d at 548.
\item[104] \textit{In re Haskell}, 321 B.R. at 9-10.
\end{footnotes}
obligations of licensors while enforcing passive obligations to not interfere with licensees’ use of the software.\textsuperscript{105}

V. CONCLUSION

With the enactment of § 365(n), one thing remains clear: Congress intended to preserve the rights of licensees of intellectual property against rejection of the license by trustees of bankrupt licensors.\textsuperscript{106} However, as indicated by the examples above, many questions remain unanswered. Should a developer-licensor enter bankruptcy with significant assets at risk? These areas of uncertainty will likely be tested in the courts. Licensors and licensees in the process of drafting software licenses and source code escrow agreements may avoid some of the risk of this uncertainty by recognizing the issues summarized below:

A. Ipso Facto Clauses

Prior to the passage of §365(n), some practitioners may have proceeded under the assumption that § 365(e), which limits the effect of “ipso facto” clauses, would not preclude a licensor’s bankruptcy from functioning as a release event. It may be that licensees did not consider the effect of § 356(e), or that they believed it would not be invoked so long as the escrow provided for the licensor’s bankruptcy as a release event. Perhaps some licensor’s were content to enter escrows where bankruptcy was a release event (or, perhaps where it was the only release event) with the expectation that, if it proved desirable, § 365(e) could be relied upon to prevent release of the source code should bankruptcy occur. After the passage of § 365(n), which was silent as to its relationship with § 365(e), examples can be found that indicate practitioners were still proceeding under the same assumptions.\textsuperscript{107} While the rights of non-debtor licensees to continued use of software upon trustee’s rejection of the license seems assured under § 365(n), it is less clear whether a debtor licensor could make the argument that filing for bankruptcy alone was an invalid condition upon which to trigger release of software source code from escrow. It is even more likely that courts would not enforce ipso facto release conditions if a debtor licensor wished to assume the license (and escrow agreement), as a debtor in possession in a reorganization, or wished to assume and assign the license in an effort to maximize the value of debtor’s assets, and wished to prevent the release of the escrowed source code which could be argued to diminish the value of the asset. Licensees wishing to ensure access to source code should carefully consider whether to rely exclusively on ipso facto clauses as release events or whether to augment them with additional release triggers that do not depend on licensor’s filing for bankruptcy. To ensure access to source code, should it be needed to support uninterrupted use of the software, licensees should negotiate escrow release conditions that directly address the events which harm or threaten harm to continued use of the application. In this

\textsuperscript{105} S. REP. NO. 100-105, at 4 (1988).
\textsuperscript{106} Id. at 1-2.
\textsuperscript{107} See Kutten, supra note 51 at 11:16.
way, whether the license is rejected, assumed, assigned, or the intellectual property asset is sold, licensees reduce the risk that a trustee will have power to prevent the release of the source code.

B. Assumption and Assignment

Unlike non-debtor licensors, who have some protection under § 365(c) from unconsented-to assignment of their licenses by debtor licensees, non-debtor licensees are likely powerless to prevent assignment by debtor-licensors. The upside of this result is that § 365(f)(2) requires a debtor, as a condition to assignment, to assume the license (thus curing all non-penalty breaches) and provide adequate assurance of future performance by the assignee. Between curing breaches which may have functioned as release events, and the potential ineffectiveness of ipso facto clauses and anti-assignment clauses, as release conditions, it is unlikely that licensees would secure a release of the source code based on either an ipso facto clause or an anti-assignment clause, or that any release based on such terms would not be later reversed by a court considering the events in total. The most secure approach here, as before, is to negotiate release events that go directly to the actual or threatened harm, rather than relying on questionable power to prevent assignment or use assignment as a release event.

C. Sale of an Intellectual Property Asset

The real property case, Precision Industries, and the subsequent split in authority as represented in In re Haskell, prevent anticipating how courts would rule on the question of the validity of a sale of an intellectual property asset if non-debtor licensees would be deprived of some or all of their interests. Considering the clearly stated intent of Congress upon the enactment of § 365(n), there are two probable outcomes: that courts will either interpret the Bankruptcy Code to provide the protection afforded under § 365(n), or deny that protection and present Congress with another Lubrizol-like problem. The subtle, yet distinct, differences between real and intellectual property will likely yield a final result that is not identical to the solution that ultimately resolves the split of authority regarding the real property question. Until the split is resolved and until its relevance to intellectual property assets is better understood, licensees should prepare for the possibility that developer’s trustee may have the power to sell the asset free of all encumbrances. In the unlikely event that this occurs, it is almost certain that Congress would respond as they did to Lubrizol. In the interim, escrow release events that do not depend on bankruptcy filing or assignment can provide a hedge against that risk.