



The Insolvency-Proof Nature of Licenses in the Insolvency of the Licensor under German Law

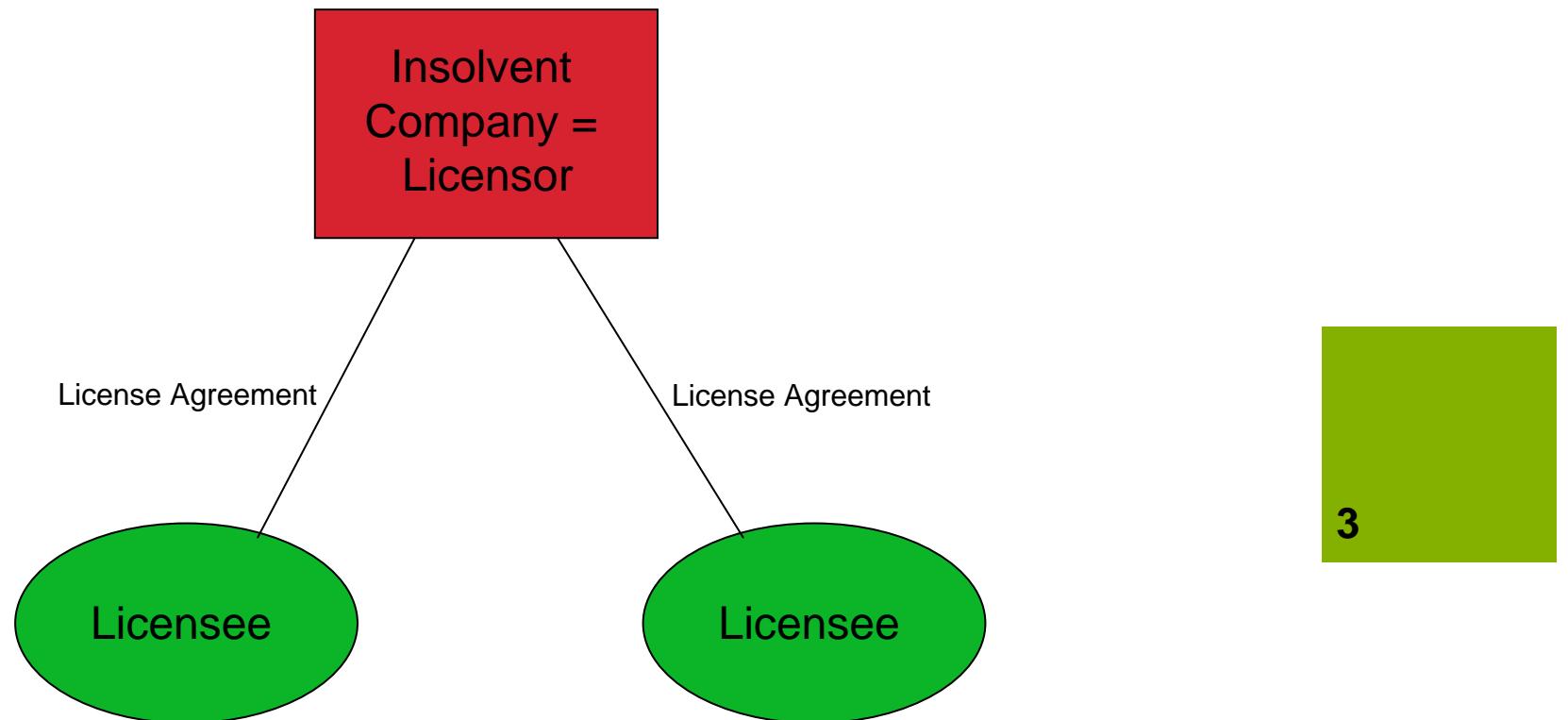
Prof. Dr. Georg Streit, Attorney
Partner and Head of the Restructuring Practice Group
Heuking Kühn Lüer Wojtek, Munich

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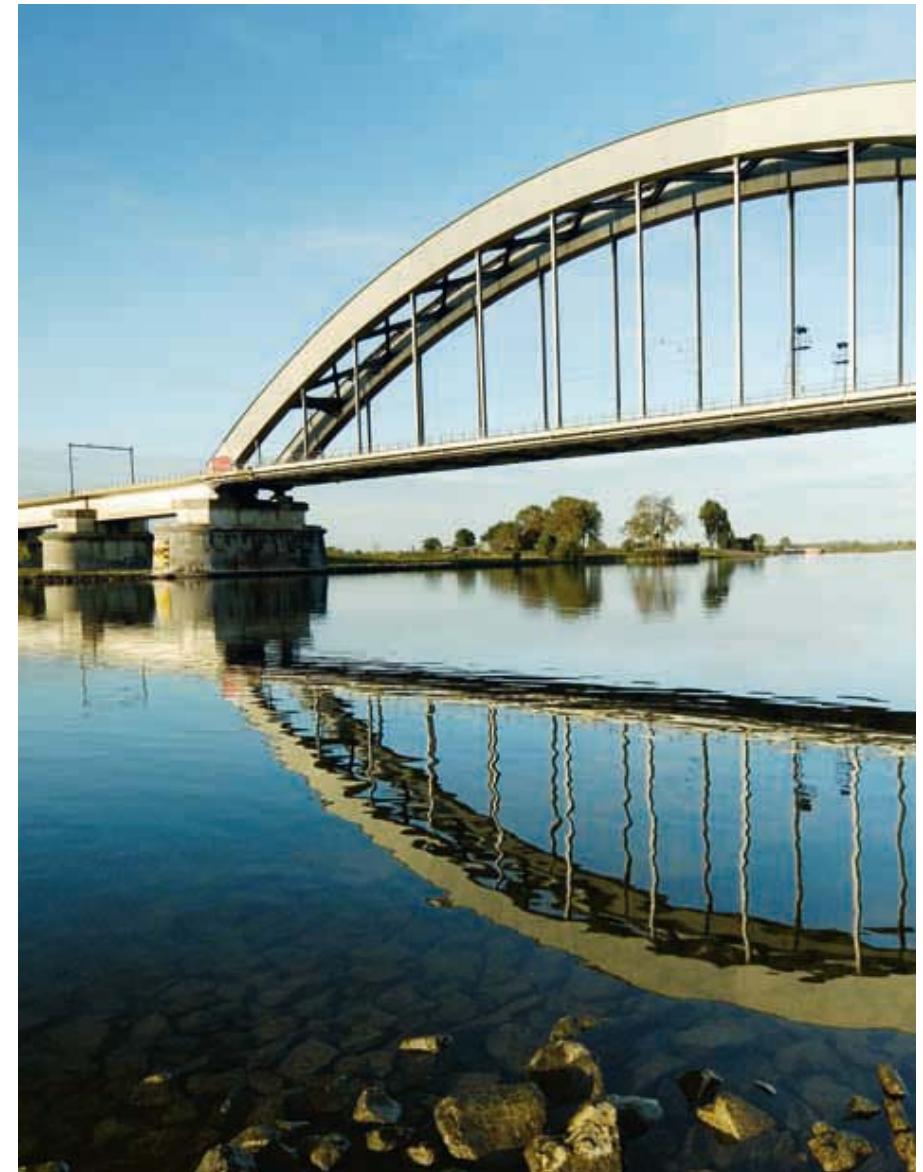
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Typical Scenario – Illustration



**I. Prior law under the German
Bankruptcy Code –
bankruptcy-proof nature of
licenses (in effect until 31
December 1998)**



Prior law under the German Bankruptcy Code (KO) – bankruptcy-proof nature of licenses

- By analogous application of § 21 para. 1 of the German Bankruptcy Code (KO) licenses were insolvency-proof: "**§ 21 Validity as against the bankruptcy estate**

(1) If the bankruptcy debtor has delivered to a renter or lessee, prior to institution of the proceeding, property rented or leased by the bankruptcy debtor to the renter or lessee, the rental or lease agreement is also valid as against the bankruptcy estate."

- § 21 para. 1 of the Bankruptcy Code is an exception from the general rule in § 17 of the Bankruptcy Code:

"§ 17 Option of the administrator for bilateral contracts"

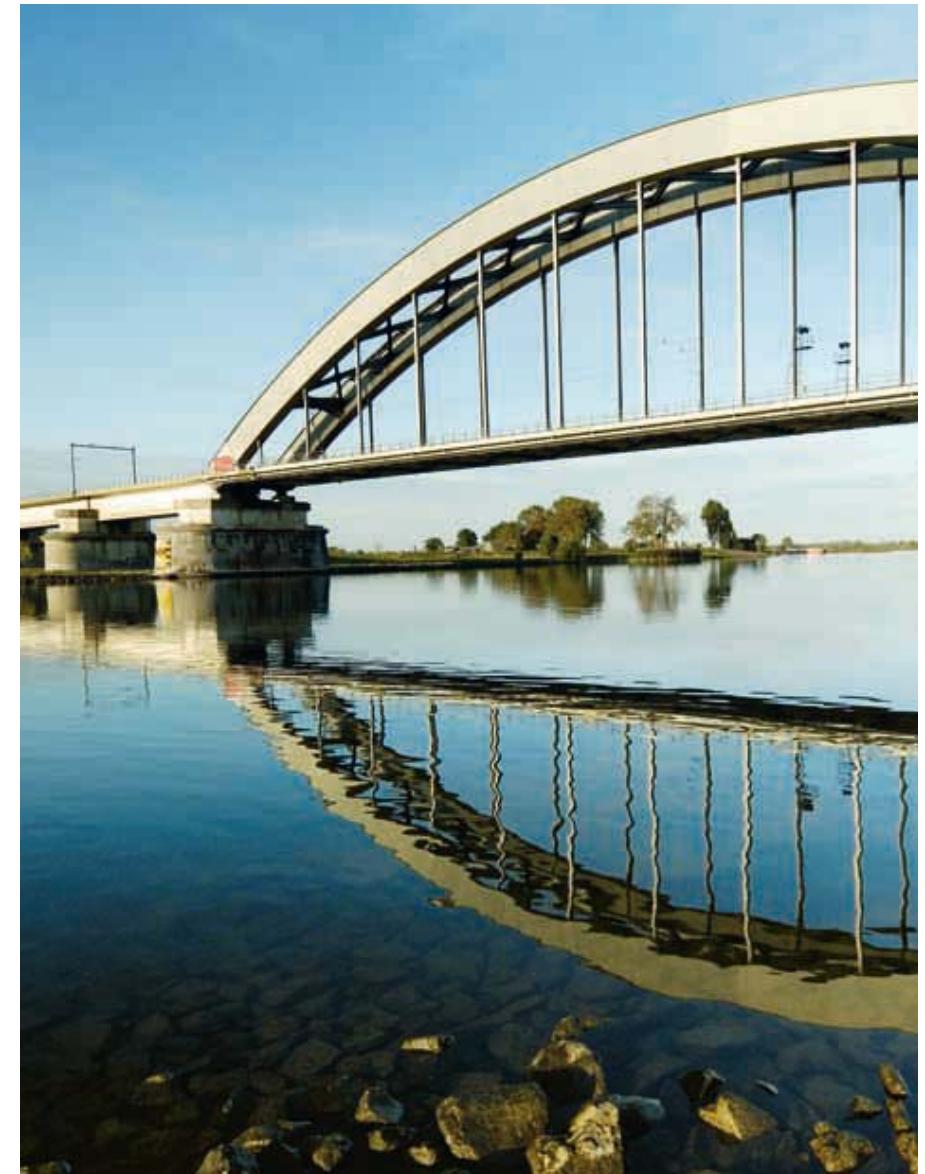
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(1) If at the time the bankruptcy proceeding is instituted a bilateral contract has not been performed or has not been fully performed by the bankruptcy debtor and the other party, the bankruptcy administrator may perform the contract in place of the bankruptcy debtor and demand performance by the other party."

Prior law under the Bankruptcy Code – Insolvency-proof Nature of Licenses

- **General rule:** Under § 17 para. 1 of the Bankruptcy Code the insolvency administrator may opt to perform contracts that have not yet been (fully) performed and demand performance by the other party **or choose not to do so.**
- **Exception:** By analogous application of § 21 para. 1 of the Bankruptcy Code, this general rule does not apply to licenses.
→ When the Bankruptcy Code applied (and 31 December 1998), an insolvency administrator did not even have the option of proceeding as the insolvency of the administrator did in the Qimonda case (U.S. bankruptcy court decision in re Qimonda). For when the Bankruptcy Code applied, an insolvency administrator did not have the option of choosing non-performance of a license agreement.

**II. Current law since the German
Insolvency Code took effect
on 1 January 1999 –
no insolvency-proof nature
of licenses**



Current law since the German Insolvency Code took effect on 1 January 1999 – no insolvency-proof nature of licenses

- On 1 January 1999 the Bankruptcy Code was replaced and superseded by the Insolvency Code (*InsO*): Licenses lost their insolvency-proof nature.
- The legislature did not intend for licenses to lose their insolvency-proof nature.
- **Background:** § 21 para. 1 of the Bankruptcy Code was replaced and superseded by § 108 para. 1 sentence 1 of the Insolvency Code. The latter provision however only relates to **immovable property**, etc.

"§ 108 Continued Validity of Certain Contracts"

*(1) Rental and lease agreements of the debtor with regard to **immovable property** or premises, as well as service agreements of the debtor shall have continued validity for the insolvency estate. [...]"*

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- ➔ **Consequence:** Absent equivalent interests, analogous application to licenses no longer possible.

Consequence: option under § 103 para. 1 of the Insolvency Code is a general rule without any statutory exception – even for licenses

- The option under § 17 para. 1 of the Bankruptcy Code was replaced by § 103 para. 1 of the Insolvency Code with hardly any changes:

"§ 103 Option of the Insolvency Administrator"

(1) If at the time the insolvency proceeding is instituted a bilateral contract has not been performed or has not been fully performed by the bankruptcy debtor and the other party, the insolvency administrator may perform the contract in place of the debtor and demand performance by the other party [...]."

Consequence: option under § 103 para. 1 of the Insolvency Code is a general rule without any statutory exception – even for licenses

- **General rule:** § 103 para. 1 of the Insolvency Code preserves the option of the insolvency administrator.
- **No exception:** Because § 108 para. 1 of the Insolvency Code can no longer be applied to licenses by analogy, there is **no longer an exception for licenses**. The option under § 103 para. 1 of the Insolvency Code now also covers licenses. Licenses are no longer insolvency-proof.
- If performance is refused in accordance with § 103 para. 2 sentence 1 of the Insolvency Code, remedies are limited to claims for damages against the insolvency estate.

Contractual stipulation to insolvency-proof nature generally not possible due to § 119 of the Insolvency Code, only narrowly defined exceptions apply

- Pre-insolvency agreements circumventing the option of the insolvency administrator are generally invalid under § 119 of the Insolvency Code:

"§ 119 Invalidity of Conflicting Agreements

Any pre-insolvency agreements excluding or limiting the applicability of §§ 103 through 118 are invalid."

Contractual stipulation to insolvency-proof nature generally not possible due to § 119 of the Insolvency Code, only narrowly defined exceptions apply

■ **Narrowly defined exceptions:** Federal Supreme Court (*BGH*):

1. Where an exclusive license is granted and the protected right is simultaneously assigned in exchange for one-time, reasonable compensation – due at the time of termination – subject to the condition precedent that the agreement is terminated for good cause, including, without limitation, because continued performance has become unduly burdensome, provided that both parties enjoy the same termination right.
 2. Where an exclusive principal license is lost due to § 103 para. 1 of the Insolvency Code after a sublicense has already been granted.
- **Consequence:** The insolvency-proof nature of licenses generally cannot be contractually stipulated.

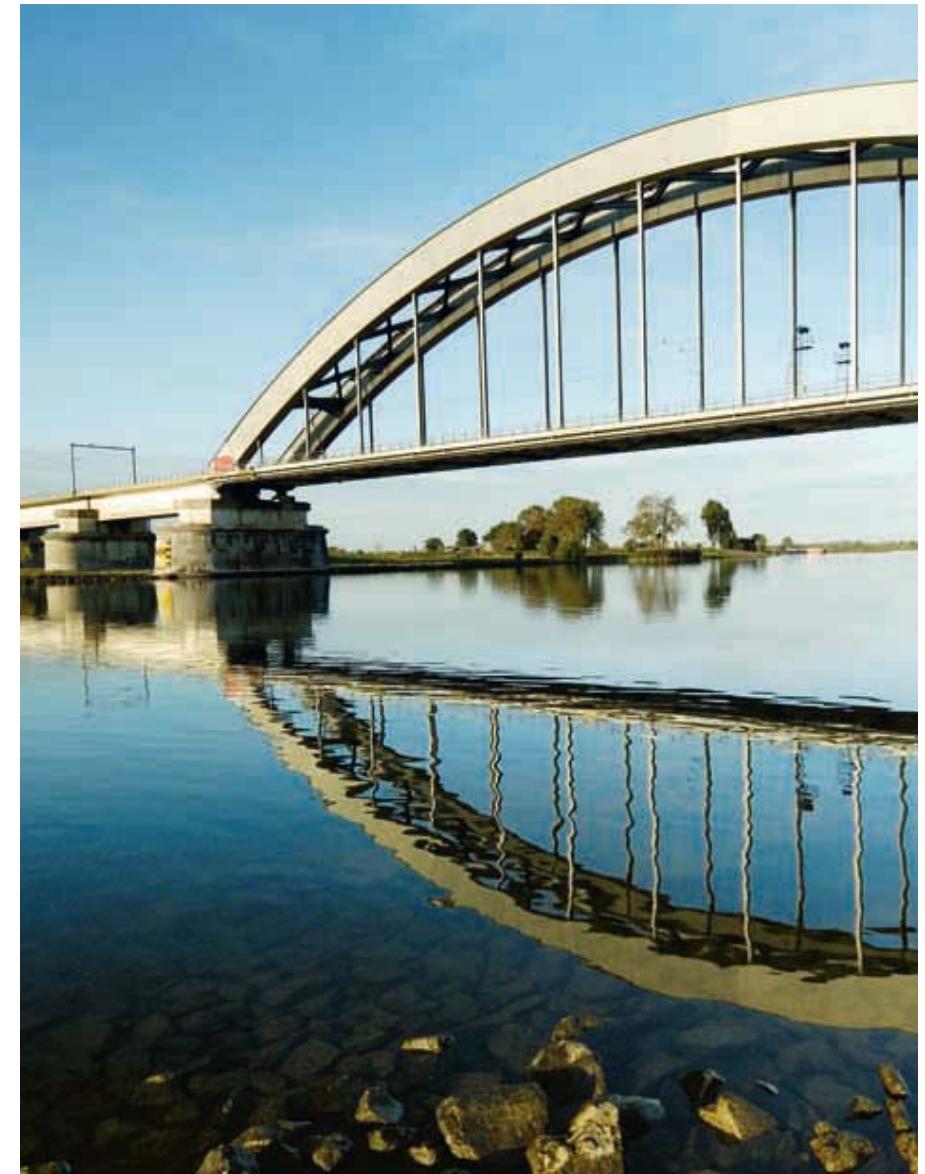
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Need for legislation on the insolvency-proof nature of licenses

- Current law does not account for the interests of the parties involved.
 - The insolvency administrator may refuse continued performance of the license agreement and transfer new licenses or principal rights.
 - **Consequence in some cases:** Licensee's continued existence is jeopardized by the insolvency administrator's refusal of performance (licensee no longer has the right to continued use of the licensed rights).
 - This affects, in particular, the following:
 - Automobile industry
 - Pharmaceutical companies
 - Music publishers
- If the Qimonda case (US. bankruptcy court decision in re Qimonda) had been tried in a German court, the insolvency administrator would have prevailed because (if German law applied) his choice of non-performance would have been lawful.

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**III. § 108a of the German
Insolvency Code (draft) –
failed draft bill dated
22 August 2007 regarding
the insolvency-proof nature
of licenses**



Failed draft bill dated 22 August 2007 regarding the insolvency-proof nature of licenses

- The draft bill of § 108a of the Insolvency Code dated 22 August 2007 was intended to remedy the situation:

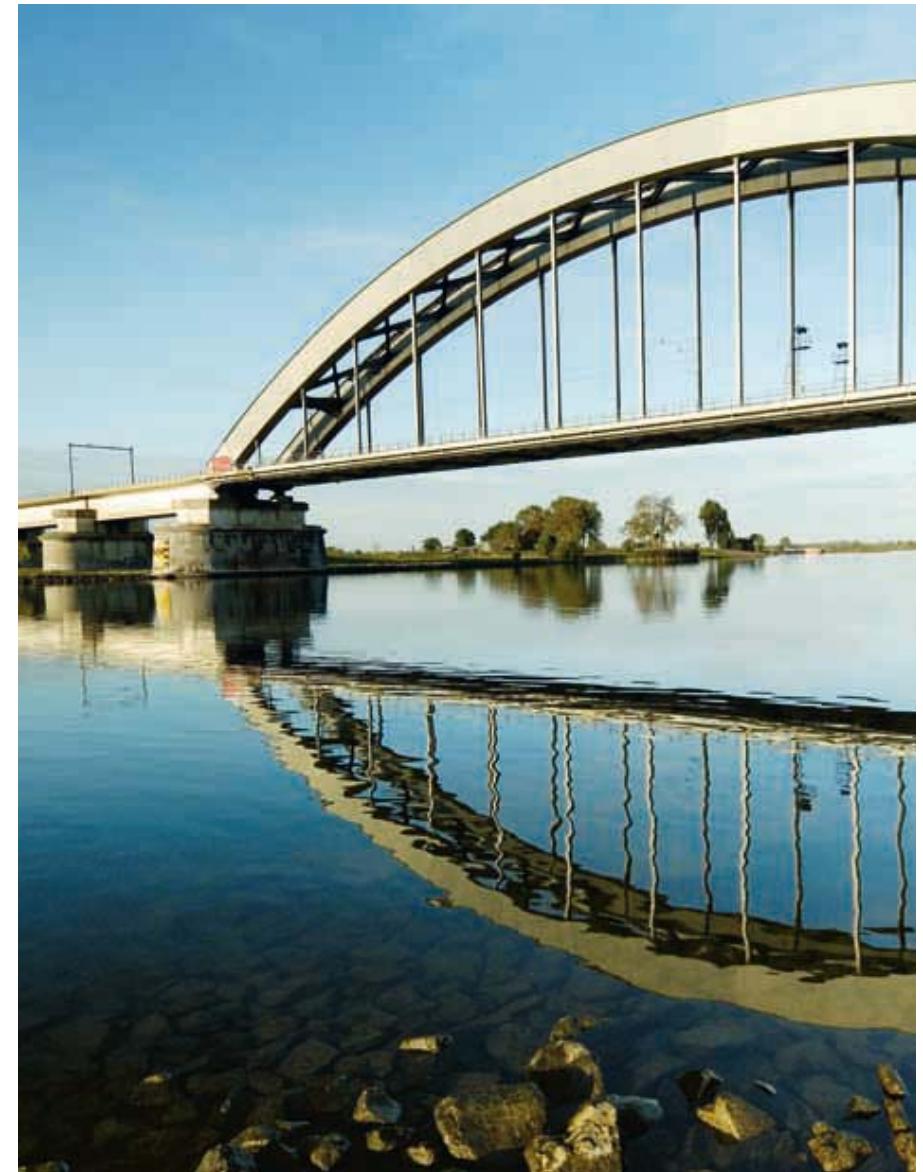
"§ 108a Debtor As Licensor

*A license agreement made by the debtor as a licensor with respect to a right to intellectual property **shall have continued validity as against the insolvency estate**. This shall apply to contractual subsidiary obligations only to the extent that their performance is required to allow the licensee to use the protected right. If the license fee provided for in the licensed agreement is conspicuously disproportionate to prevailing market rates, the insolvency administrator may demand an adjustment of the license fee; in such case the licensee may terminate the agreement without notice."*

Failed draft bill dated 22 August 2007 regarding the insolvency-proof nature of licenses

- Had the draft bill of § 108a of the Insolvency Code dated 22 August 2007 taken effect, the insolvency administrator of Qimonda AG (U.S. bankruptcy court decision in re Qimonda) appointed by the insolvency court of Munich on 1 April 2009 (case no. 1542 IN 209/09) could not have proceeded as he did. There would have been no Qimonda AG case (U.S. bankruptcy court decision in re Qimonda).
 - ➔ However: Before the legislative process during the 16th legislative period in the year 2009 was completed, elections were held for German Parliament (*Bundestag*).
 - ➔ As a result, the draft bill of § 108a of the Insolvency Code dated 22 August 2007 did not become law in the year 2009 (or thereafter).

**IV. § 108a of the German
Insolvency Code (draft) –
current draft bill dated 18
January 2012 regarding the
insolvency-proof nature of
licenses**



Interests of the parties

- **Interests of the licensee:**

- Generally, continued use of the licenses.

- **Interests of the insolvency administrator:**

- If restructuring appears possible:

- Continued performance of the license agreement, if the terms and conditions are favorable;
 - Termination of the license agreement and execution of new a license agreement on more favorable terms and conditions, if the terms and conditions are unfavorable.

- If restructuring it appears impossible:

- Termination of the license agreement and sale of the protected right to increase the assets of the insolvency estate.

Current draft bill dated 18 January 2012 regarding the insolvency-proof nature of licenses

- Overview of the provisions of the **draft bill of §108a of the Insolvency Code (§ 108a of the Insolvency Code (draft))**:

- **§ 108a para. 1 of the Insolvency Code (draft):**

The insolvency administrator has an option under § 103 para. 1 of the Insolvency Code also with respect to licenses, and licensee has the **right to enter into a new agreement upon reasonable terms and conditions** if performance is refused by the insolvency administrator.

- **§ 108a para. 2 of the Insolvency Code (draft):**

A sublicensee generally has a **right to enter into a license agreement with the head licensor**, if the insolvency administrator refuses to perform the license agreement with the head licensor.

- **§ 108a para. 3 of the Insolvency Code (draft):**

Provisions to bridge the time period from refusal of performance to signature of a new agreement in accordance with para. 1 and 2.

§ 108a para. 1 of the Insolvency Code (draft) – option of insolvency administrator and right of licensee to enter into new license agreement

"§ 108a Debtor As Licensor"

(1) If the insolvency administrator refuses performance, in accordance with § 103 of the Insolvency Code, of a license agreement under which the debtor is the licensor, the licensee may demand within one month from receipt of the refusal that the administrator or his legal successor enter into a new license agreement allowing licensee to continue to use the protected right based upon reasonable terms and conditions. The agreed license fee shall also guarantee that the insolvency estate shall receive a reasonable share of the benefits and income received by the licensee from its use of the protected right; expenses incurred by the licensee in preparation of its use of the protected right shall be taken into consideration, to the extent that they increase the value of the license. [...]"

§ 108a para. 1 of the Insolvency Code (draft) – regulatory contents

- The **option** of the insolvency administrator under § 103 para. 1 of the Insolvency Code **is preserved with respect to licenses**.
- **However**, if performance is refused, the licensee has a **right to enter into a new license agreement** based upon reasonable terms and conditions; demand must be made within one month.
- The insolvency administrator may sell the rights irrespective of the licensee's decision; in that case the licensee has a claim **against the legal successor**.

§ 108a para. 1 of the Insolvency Code (draft) – reasonable balance of interests

■ The insolvency administrator

- may continue to opt for non-performance of a license agreement, if the terms and conditions are unfavorable;
- may sell the protected right to increase the assets of the insolvency estate, thereby retaining his ability to act;
- will know for sure within one month whether the licensee exercises his right to enter into a new license agreement, enabling the insolvency administrator to plan his future course of action;
- can make sure that the insolvency estate will receive a reasonable share of the benefits from any new license agreement.

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§ 108a para. 1 of the Insolvency Code (draft) – reasonable balance of interests

■ The licensee

- can secure continued use of the licensed rights by entering into a new license agreement – also as against any legal successor;
- may take into account expenses when agreeing to the license fee under the new license agreement, if such expenses increase the value of the license;
- has sufficient time to deliberate, one month.
 - **However: § 108a para. 1 of the Insolvency Code (draft) does not expressly provide for an obligation of the insolvency administrator to inform the licensee of the one-month period if performance of the license agreement is refused.**

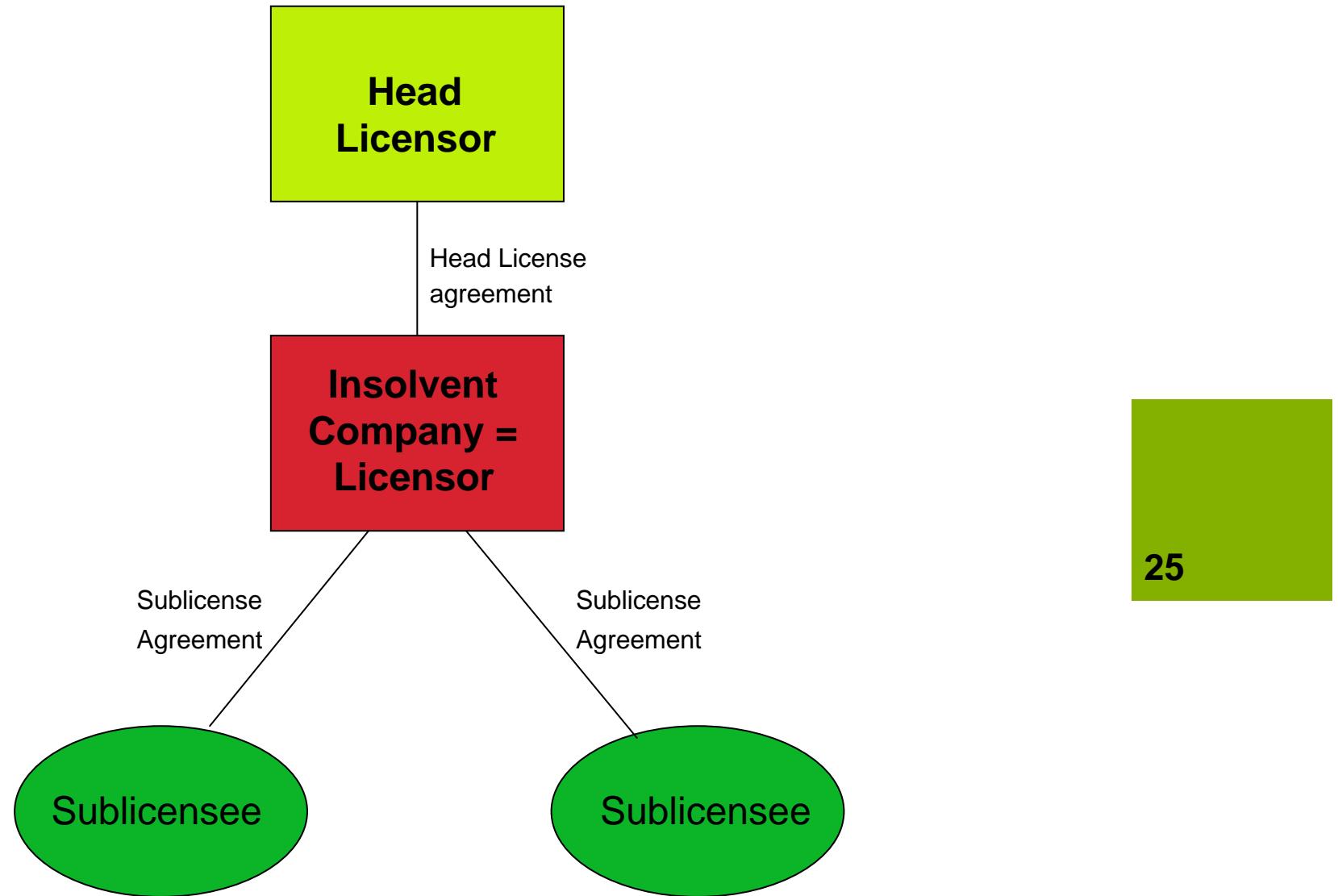
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§ 108 para. 2 of the Insolvency Code (draft) – as a general rule, a sublicensee has a right to enter into a license agreement with the head licensor

"§ 108a Debtor As Licensor

(2) If the debtor is a licensor under a sublicense agreement and the insolvency administrator refuses to perform the license agreement with the head licensor, the sublicensee of the debtor may demand to enter into a license agreement with the head licensor subject to the terms and conditions of para. 1. If there are serious doubts as to the sublicensee's ability to perform his obligations under the agreement, the head licensor may make a new agreement conditional upon delivery of security. [...]"

§ 108a para. 2 of the Insolvency Code (draft) – Illustration



§ 108 para. 2 of the Insolvency Code (draft) – regulatory contents

- **Current law:** A sublicense is lost if the licensee becomes insolvent and the insolvency administrator refuses to perform the license agreement with the head licensor.
- **Future law:**
 - **In all cases:** a sublicense is lost if the insolvency administrator refuses to perform the license agreement with the head licensor.
 - **However:** **The sublicensee has a right to enter into a license agreement with the head licensor** in accordance with the provisions of § 108a para. 1 of the Insolvency Code (draft):
 - Demand must be made within one month.
 - License fee must be agreed upon in accordance with § 108a para. 1 sentence 2 of the Insolvency Code (draft).

§ 108a para. 2 of the Insolvency Code (draft) – reasonable balance of interests

- The sublicensee is able to make sure that he will be able to continue to use the licenses and does not have to worry whether the head licensor will be willing to enter into an agreement with him.
 - This accounts for the loss of the sublicense.
- The freedom of the **head licensor** to choose his licensee is not unreasonably impaired by the fact that he may have to contract with an unknown sublicensee:
 - Because the licensee has the right to grant sublicenses, the head licensor already has relinquished the right to select the sublicensee.
- The financial interests of the **head licensor** are adequately protected by § 108a para. 2 sentence 2 of the Insolvency Code (draft):
 - If there are serious doubts as to the solvency of the sublicensee, the head licensor may make the new agreement conditional upon the sublicensee's solvency.

§ 108 para. 3 of the Insolvency Code (draft) – provisions to bridge the time period from refusal until signing of a new agreement

"§ 108a Debtor As Licensor

*(3) Until a new license agreement is signed, the licensee shall have the right to use the licensed rights **in accordance with the terms of the current license agreement**. If no new license agreement is signed **within three months** from receipt of the licensee's demand to enter into a new license agreement, continued use shall be permitted only if*

- 1. a fee is paid and the amount of the fee is in conformity with the requirements of para. 1 and*
- 2. the licensee **furnishes proof** with an exclusionary period of two weeks that he has filed a **complaint** against the insolvency administrator or in the case of para. 2, against the head licensor, to compel the administrator or head licensor to enter into a new license agreement.*

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Unless otherwise agreed by the parties, the new agreement shall have retroactive effect as of the date the insolvency proceeding was instituted."

§ 108 para. 3 of the Insolvency Code (draft) – regulatory contents

- The provision bridges the time period from refusal of performance by the insolvency administrator to the signing date of the license agreement.
- Until the new license agreement is signed – however at most for **three months** from the licensee's demand to enter into a new agreement – the licensee has the right to continue to use the licensed rights **to the same extent and in the same manner as before**.
- **Starting with the fourth month** without a new agreement, the licensee has a **right to continued use only if he pays** a fee in accordance with § 108a para. 1 sentence 2 of the Insolvency Code (draft) and furnishes proof within two weeks that he has filed a **complaint** to compel the insolvency administrator or head licensor to enter into a new license agreement.
- **However: § 108a para. 3 of the Insolvency Code (draft) does not expressly provide for a possibility to lengthen the period amicably.**
- The new agreement has **retroactive effect** as of the date the insolvency proceeding was instituted, **unless** otherwise agreed.

§ 108 para. 3 of the Insolvency Code (draft) – reasonable balance of interests

- The **licensee** may, for the time being, continue to use the licensed rights based upon the same terms and conditions as before – despite the temporary absence of a valid license agreement. To continue to use the licensed rights thereafter, the licensee must however take all steps necessary on his part to enter into a new agreement and do so within three months. If necessary, the licensee must file a complaint. The licensee must take positive steps and may not profit from favorable terms and conditions of the prior license agreement on a long-term basis.
- The **licensor/insolvency administrator** is bound by the original terms and conditions only on a temporary basis, while at the same time being prevented from profiting from a delayed signature of a new license agreement on a long-term basis.

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§ 108a of the Insolvency Code (draft) intentionally omits provisions with respect to cross-licenses

- § 108a of the Insolvency Code (draft) intentionally does not regulate cross-licenses.
- The legislature transferred responsibility for the treatment of cross-licenses to the contracting parties and their attorneys.
- The contracting parties and their attorneys can find solutions that account for the interests of the parties on a case-by-case basis more appropriately than a blanket rule devised by the legislature.
- ➔ A new license agreement should take into consideration the special features of cross-licenses, in particular that when licenses are replaced, the license fee previously owed may no longer be of interest to the insolvent licensor. Instead, the parties should agree on a reasonable license fee.

Effective date of the new § 108a of the Insolvency Code

- The formal legislative process for § 108a of the Insolvency Code (draft bill dated 18 January 2012) has yet to begin.
 - In the course of the legislative process § 108a of the Insolvency Code (draft) may still undergo changes.
 - The new § 108a of the Insolvency Code is expected to **take effect at the end of 2012/beginning of 2013**.
- If and when § 108a of the Insolvency Code takes effect, an insolvency administrator will no longer have the option of proceeding as the insolvency administrator did in the Qimonda AG case (U.S. bankruptcy court decision in re Qimonda).
- At that point, German law will once again protect a licensee from an insolvency of the licensor.

Our ranking

- JUVE, German Commercial Law Firms 2012, p. 375:

HEUKING KÜHN LÜER WOJTEK

Restructuring and Corporate Rescue



→ **Comment:** This recommended firm for restructuring enjoys most praise for its Munich office, where it covers sensitive instructions for companies and shareholders. Specialist experience in tricky liability issues and legal challenges enables activity both for and against insolvency administrator claims. New additions, e.g. Dr. Karsten Kühne from Heussen in Berlin and Adi Seffer from Heymann in Frankfurt, are reviving corporate rescue work on the interfaces with corporate restructuring and PE/IT respectively.

Development potential: The firm could tap further potential by improving links between its German offices as well as internationally.

→ **Recommended:** Prof. Dr. Georg Streit (“impressive work”, competitor).

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Our ranking

JUVE, German Commercial Law Firms 2012, p. 374:

Leading names in restructuring and corporate rescue

Dr. Helmut Balthasar

Kolja von Bismarck

Dr. Eberhard Braun

Dr. Michael Frege

Frank Grell

Alfred Hagebusch

Peter Hoegen

Dr. Michael Malitz

Dr. Sven Schelo

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**Prof. Dr. Georg Streit**

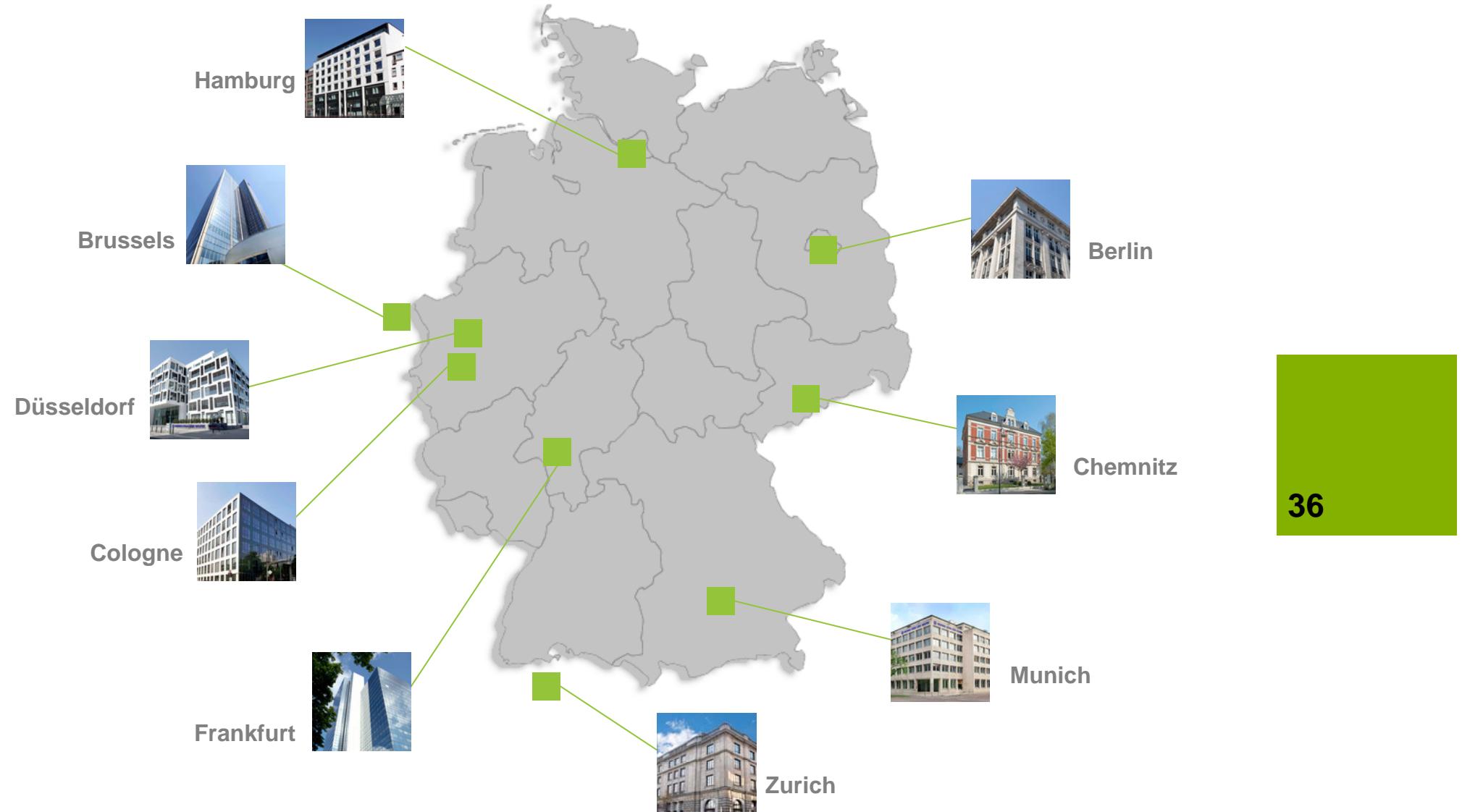
**Rechtsanwalt, Partner und Leiter
der Practice Group Restructuring**

**Heuking Kühn Lüer Wojtek
Prinzregentenstraße 48
80538 München**

**Tel.: 0049 (0) 89 / 540 31 227
Fax: 0049 (0) 89 / 540 31 527
E-Mail: g.streit@heuking.de**

Prof. Dr. Georg Streit is an equity partner and attorney at the law firm Heuking Kühn Lüer Wojtek, where he heads the financial reorganisation department. Prof. Dr. Streit provides a wide range of consultancy services and also conducts litigation in all areas that touch on the legal aspects of default, restructuring and insolvency. Prof. Dr. Streit provides advice and acts as legal counsel for companies hit by financial crisis; for creditors throughout the debtor's illiquidity and insolvency; for investors wanting to acquire a defaulting or insolvent business; for partners or the management in transactions aimed at overcoming a financial crisis or averting insolvency (restructuring liabilities, debt-equity swaps, trust models, etc.); for directors and executive officers on avoiding and averting liability risks and issues relevant under criminal law; and for private equity funds if portfolio companies default (in particular by assisting with measures to restructure liabilities). Prof. Dr. Streit is lecturer in insolvency law and recapitalisation at the University of Mannheim since 2003, and he is also the author of numerous publications on topics concerning insolvency law.

Our locations



**Berlin**

Unter den Linden 10 · D-10117 Berlin
T +49 (0)30 88 00 97-0 · F +49 (0)30 88 00 97-99
berlin@heuking.de

**Brussels**

Avenue Louise 326 · B-1050 Brussels
T +32 (0)2 646 20-00 · F +32 (0)2 646 20-40
brussels@heuking.de

**Chemnitz**

Weststraße 16 · D-09112 Chemnitz
T +49 (0)371 382 03-0 · F +49 (0)371 382 03-100
chemnitz@heuking.de

**Düsseldorf**

Georg-Glock-Straße 4 · D-40474 Düsseldorf
T +49 (0)211 600 55-00 · F +49 (0)211 600 55-050
duesseldorf@heuking.de

**Frankfurt am Main**

Grüneburgweg 102 · D-60323 Frankfurt am Main
T +49 (0)69 975 61-0 · F +49 (0)69 975 61-200
frankfurt@heuking.de

**Hamburg**

Neuer Wall 63 · D-20354 Hamburg
T +49 (0)40 35 52 80-0 · F +49 (0)40 35 52 80-80
hamburg@heuking.de

**Cologne**

Magnusstraße 13 · D-50672 Cologne
T +49 (0)221 20 52-0 · F +49 (0)221 20 52-1
koeln@heuking.de

**Munich**

Prinzregentenstraße 48 · D-80538 Munich
T +49 (0)89 540 31-0 · F +49 (0)89 540 31-540
muenchen@heuking.de

**Zürich**

Bahnhofstrasse 3 · CH-8001 Zürich
T +41 (0)44 200 71-00 · F +41 (0)44 200 71-01
zuerich@heuking.ch