Webcast Title: Software Licenses in Bankruptcy Proceedings
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**ASSOCIATION OF CORPORATE COUNSEL**

**Moderator: John Thomas**
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Operator: Just a reminder, today's conference is being recorded.

Female: Please go ahead, John.

John Thomas: Welcome each of you to our Web cast, Software Licenses in Bankruptcy Proceedings. Serving as your host and moderator, I'm John Thomas, Technology Counsel at Thompson West and one of the two program chairs for the committee.

Today's program is being presented by the ACC Information Technology Law and E-Commerce Committee, along with the law firm of DLA Piper Rudnick Gray Cary, which is also the sponsor of this Web cast.

You will shortly have the pleasure of hearing from our two very knowledgeable speakers but let me first take a few minutes to tell you about them.

(Janice Duban) graduated from UCLA and obtained her law degree from Loyola University Chicago. A partner at the DLA Piper Chicago officer her practice areas are Chapter 11 reorganizations, commercial transactions, and general commercial litigation. She has been admitted to and practiced before numerous district and bankruptcy courts around the country.

Finally, (Janice) serves on the board of the Chicago Volunteer Legal Services Foundation, the country's largest provider of pro bono legal services.

Our other speaker, also a partner at DLA Piper's Chicago office did his undergrad at Northwestern and has his JD from the University of Illinois. Keith Medansky represents software publishers in connection with counterfeiting matters and the protection and enforcement of intellectual property rights and their software assets.

He has extensive experience in the management of large intellectual property portfolios for all kinds of businesses from large multinational to small startups in more than a hundred countries.

At your leisure I invite you have a look at the more complete biographical notes of our speakers on the Web site.

And you already know who I am, having been told more than once that I have a great face for radio, I refrain from submitting a photo.

Just a couple of points before turning to our program. During our presentation you may wish to pose questions to our speakers. You may seek clarification of a comment, you might want to have additional information. On the lower right-hand corner of your screen you will see the questions box. Just type in your question and click send. If from among the questions posed yours is not selected, please feel free to email our speakers. You will find their email addresses on slide number 33.

In addition, Keith and (Janice) has generously offered to discuss any specific clauses you may be struggling with in a particular transaction. After all, it's never, especially here, never one size fits all.

Finally, at the end and before signing off, please complete the Web cast evaluation form. You see it is item number one in the links box. Your ratings and comments are most important to the selection and presentation of future Web casts.

And now to the presentation. The big software package you successfully negotiated at the end of last year all but guaranteed you will be the company's next general counsel. This morning, however, you learned that the licensor has filed for Chapter 11. This software is mission-critical to our client to say nothing of the related services.

Well, you did a skillful job of negotiating. What can you do now? What should you do now? What should you have done and when? Fortunately, you've retained DLA Piper and, (Janice), Keith, how about giving us a hand here?

Keith Medansky: Hi, I'm Keith and obviously the story that John just talked about is a frightening, a frightening story where the licensee has found himself completely vulnerable because the licensor has now declared bankruptcy and the licensor has certain rights that could terminate the right of the licensee to use the software or to get critical services.

And this, the purpose of this talk is to go into a brief discussion of how bankruptcy law works with respect to technology licenses and also to give you some concrete drafting ideas to try to modulate the risks that can come up under these sorts of circumstances.

(Janice) is going to start the discussion focusing on the nuts and bolts of how a bankruptcy preceding goes forward and what to do at the beginning of the scenario that John discussed.

(Janice Duban): Hi, it's Jan. One of the most important tools with which the bankruptcy code arms a debtor in bankruptcy is the power to get rid of or keep its contracts, particularly if those contracts are what is known as executory in nature. Keith and I are going to discuss how the bankruptcy code implicates intellectual property in general and software licenses in particular.

And we're going to do it from the perspective of both the licensor in bankruptcy, which is John's scenario and which we assume will reach most of the lawyers in our audience. We're assuming that you represent companies that primarily are concerned about licensing software that is critical to your company's operation and the licensor files bankruptcy. But it also may be relevant to those of you who represent company's that are licensors and licensees of software. What happens when a licensee files bankruptcy and what your rights and obligations are and what action should be taken.

As a matter of fact, from a legal perspective the scenarios that exist when a licensee files bankruptcy are actually more interesting and more complicated than when a licensor files bankruptcy. So since we have the opportunity we're going to try to cover both.

So the scenario that John presented at the beginning is that you get to work one morning and you find out that the licensor of software that is, you know, critical to the operation of your business has just filed bankruptcy. And, you know, your CFO or CEO is saying, what the heck are we going to do now?

The first thing that I think it's appropriate for you to do is to have the highest ranking business contact within your company contact the highest ranking business or management contact with whom they have a relationship with the debtor, which is your licensor. I think that is sometimes useful in – to find out what's going on, what the debtor's intentions are.

Oftentimes, however, you're going to be told that there's no problem, there's a very temporary liquidity crisis, there were – there is a bond restructuring that's sort of a prepackaged deal and they're going to be out of bankruptcy in 30 to 60 days. That is very seldom the case. And what management believes is going to happen in the bankruptcy is very frequently different from what the board of directors and what bankruptcy counsel is actually doing or intends to do in the bankruptcy.

So there's a need to investigate the facts. The first thing I would do is if you have the capacity go on to PACER yourself, find the bankruptcy case, determine whether it's a Chapter 7 or a Chapter 11 since that's crucial. I would say that in 90 percent of the

situations it's going to be a Chapter 11. But whether it's a Chapter 7 or 11, even though all of the provisions and the terms of the bankruptcy code that we're going to be speaking of apply to both Chapter 7 and Chapter 11, the timing of your actions may be different depending on which it is.

Assuming it's a Chapter 11, which will likely be the case, it's important to find in one way or the other print and read what are called the first-day motions in a Chapter 11 case. So not withstanding that management is telling your salesmen that they're going to be out of bankruptcy very quickly and there's nothing to worry about and the licensor is going to perform as usual under its license agreement with you, the first-day motions may say otherwise. They may indicate that there's going to be a sale of the assets of the company. There are a number of different scenarios that could provide cause for concern in those court papers.

Depending on the importance of your company to the operations of the licensor, you may also be able to contact the bankruptcy counsel of the licensor director. At the beginning of the filing of the case there's obviously a lot of chaos going on and it may be difficult to get through but as I said, you may be able to find more information out from bankruptcy counsel itself.

It's important also to note that, at this point after a bankruptcy is filed you can't engage in what might be called self-help remedies. The automatic stay in bankruptcy – Section 362 of the Bankruptcy Code, with which I'm sure most of you are familiar – prohibits you from taking any action against the debtor, the assets of the debtor. So at that point it would be inappropriate before investigating further to send any demand letters or to do anything else

that might be perceived as violating the automatic stay which is extremely broad and which is susceptible of imposing sanctions on anyone that willfully violates it.

The hook between the bankruptcy code and intellectual property in general and software licenses in particular begins with the definitional section of the bankruptcy code. You can see on the slide on page five that we've indicated to cover the ((inaudible)) terms of Section 35A that intellectual property in bankruptcy does include software protected by U.S. patents, trade secrets and copyrights. But it does not cover in any way trademarks, foreign copyrights, or foreign patents. So the provisions in the slides that follow will all be applicable to our software licenses.

The more specific hook between software licenses and bankruptcy code is the section on executory contracts that permits a trustee – and the bankruptcy code defines trustee to also include everywhere the debtor or what is often referred to as the debtor in possession and that would be the debtor that isn't in a Chapter 11 case – to subject to the court's approval assume or reject any executory contract of the debtor.

So that would include a software license. And as we will explain in the next couple of slides, software license and bankruptcy – software licenses in bankruptcy are almost always executory contracts.

The reason that they are almost always executory contracts is because executory under the bankruptcy code in applicable case law means there are substantial material obligations that both contracting parties continue to owe to one another. So to distinguish an executory contract from a non-executory contract if there were a sale of intellectual property or, for

example, a loan transaction outside of the context of IP where only one side had an obligation to the other perhaps to make installment payments, that contract would not be construed to be executory in bankruptcy.

In our situation – and first we're going to speak about licensors in bankruptcy – licensors have generally numerous obligations as listed. And generally they always have the obligation for support, indemnification against infringement claims of third parties, et cetera.

Obviously, the licensee always has ongoing obligations under the license agreement because they have to make payments at the very least. And they have to maintain the confidentiality of trade secrets, et cetera.

Let's go back to that slide, Keith.

With respect to exclusive licenses as opposed to nonexclusive licenses, they probably affect your lives less than nonexclusive licenses but there are quirks in the law with respect to exclusive licenses which we will discuss. Oftentimes exclusive licenses are deemed under the law to be quasi ownership or sale transactions. And under the bankruptcy code, as we will discuss in greater depth, it's more likely that an exclusive license will be treated as an assignment or a sale of a license rather than a nonexclusive license would be. So just keep that in mind and we'll go over it.

Keith Medansky: So, Jan, just to kind of re-center everyone, why do we care whether a license is executory or not? How does it fit in with the steps that a licensee would want to take to protect themselves?

(Janice Duban): Keith, the answer is that under the current bankruptcy code if a license agreement is deemed executory and, therefore, the debtor can take certain actions with respect to it, the licensee also has certain rights, rights to retain the usage of the software or other intellectual property. If an executory contract – if a license agreement is not deemed to executory those rights will not exist in the licensee.

On page eight we have a little chart that tries to describe for you each scenario that can occur in bankruptcy when your debtor is your software licensor. On the left we're describing the options that a debtor has with respect to the license agreement if it's executory. If it's not executory, as you can see, I used a sales scenario, then there are no issues in bankruptcy. It's as if the bankruptcy of the licensor has not occurred.

Of course, unless you – unless there are payments due under the license agreement sale agreement in which case those payments may not be made and would obviously turn into a tiny dollar bankruptcy claim.

But let's move down to what happens when you have a nonexclusive software license and you have your licensor in bankruptcy. The first scenario is that the nonexclusive license is executory, which it always will be and the debtor rejects that agreement. A rejection in bankruptcy means that the debtor is able to breach its obligations under the agreement. The bankruptcy code permits breach. It doesn't mean that the agreement is terminated but that it is breached.

And in that case a licensee may elect to treat the license agreement as terminated. And to the extent the licensee has damages that result from the licensor's breach of the agreement, they can file a claim of – a pre-petition claim generally secured – Keith will address security in license agreements later – but generally unsecured for what is presumed to be tiny bankruptcy dollars for the damages they suffer because of the licensor's breach.

We're assuming that more often than not that's not going to be the election that a licensee of software would wish to make. Instead the licensee is going to grab hold of it's 365N rights. 365N is the provision in the executory contract section of the bankruptcy code that covers intellectual property in bankruptcy.

We believe in our slides and in our presentation we're going to cover all of the salient features of 365N and how they affect licensees and licensors. But at the end of our PowerPoint presentation we have reprinted Section 365N in its entirety for you to look at, at your leisure.

In the event that, as I suspect, a licensee is going to want to exercise its rights under 365N it does so in the following manner.

I don't think you have to leave it.

As soon as the bankruptcy is filed before rejection by the debtor licensor or before assumption – which means – hey, why don't you go back one, I don't think I did a very good job.

If the licensor is not going to reject and therefore get out of its obligations under the license agreement it could also assume the license agreement. Assumption in bankruptcy means that – it's supposed to mean that the debtor performs all of its obligations under the agreement and it's as if the bankruptcy did not occur with respect to the licensor or the licensee. Now that isn't always the case but that's ideally the case.

Also in the unlikely event that the licensee does not wish – it wishes to get out of its obligations under the license agreement and it does not want the licensor to assume that agreement, the licensee is able to challenge the licensor's assumption. Assumption requires that a licensor provide adequate assurance of future performance of the licensor's obligations under the agreement and that is quite a challenge oftentimes for a licensor in bankruptcy.

So if a licensee does want to get out a licensee can get out if it can prove to the court that the licensor is not going to be able to perform.

Keith Medansky: So it kind of varies John's scenario a little bit where you look at the bankruptcy as some ways as a guest in that you discover – you got that call, you discovered that your licensor has declared bankruptcy, they wish to assume that contract because it's lucrative for them you overpaid for it. But now they don't have the same level of employees, the same level of support, they can't do the same things. When they try to assume that contract because they want to get the dollars out of it – the licensor tries to assume it the licensee could say, you know what, you're not the same company I bargained with at the beginning. I'm not going to let you assume it. I'm going to file petitions with the bankruptcy court to try to stop you.

(Janice Duban): The difficulty in fighting the debtor is, A, that most bankruptcy courts side with the debtor. That's the reality of the situation because they feel their obligation is to help the debtor to reorganize and keep providing as many jobs as possible and pay its creditors as much as possible.

But in reality the debtor does have to show upon a challenge to assumption that it can perform all of its obligations under the agreement for the term of the agreement. So the difficulty or ease with which one can establish a challenge to assumption oftentimes depends on the terms of the agreement and how long it is.

Just wanted to mention that, at the bottom under the exclusive license when I inserted likely under executory that's because of what I mentioned previously about there have been a couple of cases out there that have held certain exclusive licenses to be non-executory to begin with, fully performed materially by one side with immaterial obligations remaining to be performed by the other side.

So – but it's not – it's very likely that even exclusive licenses are going to be deemed executory so, therefore, they are going to be rejectable or assumable by the licensor as well.

So let's assume that you're a licensee, your licensor has filed, you've determined it's a Chapter 11, you've determined that it's essential that you exercise your right under Section 365N to keep as much as your license rights as the bankruptcy court permits. You're going to be in a transition period, as Keith mentioned. It's probably unlikely that the licensor is going to be performing its obligations.

I mean you don't have a problem if the licensor is performing. In that case the licensor probably intends to assume the license agreement and in that case, unless you want to get out of it, you're not going to care. So we're sort of talking about the rejection scenario here. We're talking about the licensor wanting to get out of all of its obligations under the license agreement, it's support, maintenance and everything else.

The bankruptcy code since 1988 provides a licensee of software the right to keep using the software. The right to – yes, to exploit it to the extent that those rights exist under the contract on the day the bankruptcy case was filed.

One thing that I failed to mention, I think, about executory contracts is that the contract rights that exist on for both sides on the day of the bankruptcy case is file always stay the same with the exception of the debtor's ability to breach the contract. The debtor can't change the terms of the contract. The non-debtor contracting party can't change the terms of the contract.

And contracts have to be assumed or rejected by debtors in their entirety. They can't be piecemeal assumed or rejected. So whatever the licensee's rights are on the date of the filing under the contract they are.

So the licensee can keep its right to use the software. The debtor has – I'll tell you just briefly that in a Chapter 7 case where a Chapter 7 trustee is appointed and there is no debtor in possession – the trustee is immediately appointed. And in 99 percent of the cases the trustee will immediately shut down the business to avoid any risk of liability. In a

Chapter 7 case there are 60 days from the date the bankruptcy is filed to assume or reject executory contracts.

It's important to note that in a Chapter 11 case the bankruptcy code says that a debtor can assume or reject at any time before confirmation of a plan. So they have no time limit. And if a licensee with a licensor in bankruptcy needs to take action, needs to get the debtor to do something, they have to affirmatively do it. You're in limbo.

If you want, for example – if for some reason it's a – the debtor is not performing but the debtor is telling you they are going to perform and you want there to be an immediate rejection, you would have to make a motion with the bankruptcy court to compel the licensor to assume or reject because they are under no time constraint under the bankruptcy code.

But we're going to assume that the scenario for now is rejection because assumption would probably give you the performance that you are entitled to under the agreement. Since there's no time period and a debtor in bankruptcy is going to be in chaos, it's going to be trying to decide what to do with its real property leases all over the country, what it is going to do with its software licenses, what it is going to do with its other assets, they're not going to make any assumption or rejection decision immediately unless your client is so critical to their ability to organize that they are on the phone with you the first day after they file or presumably before they file bankruptcy.

So the bankruptcy code under 365N says that if you want to retain your rights to use the software agreement before rejection you have to send a written notice to the debtor and the

debtor must perform or he must provide you with an IP that it holds. And it can't interfere with your contractual license rights.

John Thomas: Jan, it is just accepted or terminated or is this an opportunity to renegotiate the terms of the licenses?

(Janice Duban): Well, it definitely is because, John, it is going to be a time lag between the date the case is filed and the debtor makes definitive decisions about what it's going to do with its assets and, indeed, how it's going to move forward to reorganize. And in that interim time period, depending on how important your company is to that debtor's business operations, there's definitely an opportunity to renegotiate.

But if you are one of a million licensees of a particular software then, you know, I'd say that that renegotiation opportunity diminishes.

John Thomas: It's really – it's really an issue of leverage and in some cases there is the – it's the scenario you described, John, absolutely. You look at it parties can bargain.

But sometimes you're going to look at it as licensee and you're going to look at the debtor and say I can't live with these people any more. I couldn't really live with them even before the bankruptcy. I don't want to negotiate it. All I really want is to buy through 365N a right to use that software and maybe get – derive a little support by having an escrow or something else to have access to the code for a transition period so you can go to another vendor.

Because ultimately you may not want to – so you may not want them to assume or reject it as soon. You may want to keep it – you may want to force them essentially to reject the contract and you just take a damages claim. You don't exercise our rights under 365N and you walk away. So that would be a reason to not force a rejection or assumption soon but to put it off until you can figure out what you're going to do in the transition time period.

(Janice Duban): At some point in this Chapter 11 the debtor is going to get its act together and figure out what it wants to do with all of its licensees. And we're making the assumption that the debtor is going to reject its license agreement with your company.

At that point it's quite similar to before rejection. If you haven't previously provided a notice of the election of the right to retain the use of the software you're going to do so at that time. You might not have done it because your debtor may have been performing until it makes this decision to reject.

When you exercise your retention rights under 365N you – there are limitations. Not only can you assume that all maintenance, all support obligations and performance disappear, but you only get to use the software for the duration of your contract and any extensions there under. You have to pay royalties for the right to use the software. You don't get any upgrades, any improvements. You only have your rights as they exist under the contract on the day the bankruptcy was filed.

So …

John Thomas: Jan, do you have to pay any royalties if that wasn't in the original agreement?

(Janice Duban): Well that's an interesting question, John. The answer would be no or are you suggesting the scenario where you maybe paid up front?

John Thomas: Right.

(Janice Duban): No, you would not. That would be – that's I think going to be one of Keith's tips is that one of the protections for a bankruptcy filing for a licensee if you don't want to lose everything is to make payments over the term of the contract unless there is a different benefit that is derived from making up front payments because they would be lost. But no, you would not have to continue to pay royalties.

And another thing you may be thinking about now that Keith will address is the allocation issue of if your contract – if your license agreement allocates or does not allocate payments for maintenance and support versus actual royalties you may want to consider doing that because in the rejection scenario where the 365N election is made by the licensee there's obviously going to be litigation. The licensor is going to say 90 percent of the single dollar amount in the license agreement was for royalties and the licensee is going to be saying no, 90 percent was for the support and maintenance that I no longer have to pay for. So that will be a, you know, another drafting issue that Keith will get into a little more.

Keith Medansky: And I think someone asked a question, Jan, that – about whether or not you can get access to the source code merely because you've invoked as licensee 365N and you're entitled to the IP. Maybe you want to talk about not getting better rights by bankruptcy.

(Janice Duban): Yes, that's an excellent question and we know it's really one of the most important questions of this session that Keith will address. But if you contract – if your license agreement on the date of filing bankruptcy does not give you a present grant or a present right to the source code, and if the right – and the right has to be triggered if it's in there, which I doubt it would be – but you would not have access to that. You would only have access under 365N to that intellectual property or software if your contract gives you the right to – gives you the present right to on the date the bankruptcy is filed.

Keith Medansky: Right. And the idea being really this is about the right to use and not to get a better right than you otherwise have had. And even though you may need that better right, even though because of the change in circumstances that better right – you think you might be entitled to it like getting the code, if you haven't set up an escrow or something that with a non-bankruptcy trigger then you're not getting the code. And it's as simple as that.

(Janice Duban): So as Keith mentioned, all you're getting is the right to whatever you had the right to before bankruptcy to enable you to hopefully transition to a new vendor in an orderly fashion because you won't be getting anything else out of the – out of the license or debtor.

What you give us, if you make the 365N election, is what I've indicated. It's in most situations it's probably not going to be enough to make you not exercise the election if the software is, you know, critical to your day-to-day business operations. But you do lose your offset rights. That means – that means that you can't offset any damages that you have against the debtor against your royalty payments that are due.

And number two, you lose any administrative claim or post-bankruptcy claim for damages. You can't exercise your 365N rights and then file a claim against he debtor because they breached their maintenance and support obligations essentially post-bankruptcy.

And then I think I've repeated that there are no improvements, no right to improvements, releases, only what you had a right to on the day before the bankruptcy was filed.

Keith Medansky: It's pretty unusual to have an exclusive software license, although of course it happens. We have custom software. But keep in mind, that is something – the right to retain whatever rights you had pre-bankruptcy you get that and the right to enforce any exclusivity provision, that's also included within 365N. So if your licensor rejects and you go essentially flip it around you get the right to use and to maintenance exclusivity.

(Janice Duban): And that's basically it for licensors in bankruptcy. The alternative if the 365N election is not made, in fact, you have a pre-bankruptcy presumably unsecured claim for any damages caused by the licensor's breach of your software agreement. And you can probably presume that that's going to get you paid in some reorganized entity stock or a couple of cents on the dollar.

Keith Medansky: So kind of to sum up, you're in the situation of the licensee. You basically are going to try to figure out what the licensor going to do – is going to do. If he is going to assume then you have to decide – the what do you do now that John asked is you have to decide whether or not you can live with this licensor anymore. And if you can great, let him assume it. If you can't then you challenge the assumption because you say that you don't get

adequate assurances, you don't get comfy anymore because you don't like them, they're not good enough.

Or they are going to reject it and then you're going to decide do I want to keep this license? And if yes you're going to keep it but stripped down under 365N without maintenance, without support, maybe without source code. Or you're going to say adios and you're going to let them reject it and you're going to have an unsecured claim for whatever damage was incurred.

(Janice Duban): Good summary, Keith.

I wish we had more time but we're going to address now with – beginning with slide 10, just very briefly even though it's not brief it's complicated – the scenario for when a licensee files bankruptcy. Since we've covered so many of the terms already I hope we can get through this quickly and I hope that our slide, the next one on page 11, will give you food for thought if you'd like to look into this issue more as it impacts your client more.

One aspect of the executory contract provision for the bankruptcy code is often called the personal services contract provision. That's on page 10, 11USE Section 365C. Essentially says that a debtor can't assume or assign – because there is an ability to assign executory contracts once the debtor has assumed them in bankruptcy – they can't – you can't assign a personal services contract to a third party because it deprives the non-debtor contracting party essentially of the benefit of its bargain.

Well, in the intellectual property and software license (contacts) section 365C has in most instances been determined to mean that a licensee is not even permitted to assume a license agreement without the consent of the licensor. There are exceptions. You can see on my chart we're talking about non-exclusive licenses right now.

And many circuits have held, based upon different interpretations – this one being called the literal test interpretation of Section 365C and I have a site for you if you're interested – that because the copyright and patent laws do not permit assignment of software licenses that under the bankruptcy code even if a debtor agrees that it will not assign it will only assume and use the license software for its own use – will not assign it to a third party – four circuits at least have decided that it's not assumable. And obviously, if its' not assumable it is not assignable in bankruptcy.

There are at least the first circuit and some lower courts have disagreed and said – applied the actual test under 365C to say that I think the debtor and the debtor in possession can be construed as one instead of two separate entities. And if the debtor agrees that it won't assign a license to a third party it is assumable and usable by the licensee in its bankruptcy.

Once again, assumption can be challenged, as we previously discussed. If you are the licensor and do not wish the licensee to assume or use your software at all it can be challenged. The debtor, the licensee, has to be able to perform.

And there are situations where a challenge may be appropriate and essential. For example, as Keith put it to me, we don't want the fox in the hen house and it could be that a plan of reorganization for a licensee is actually funded by or otherwise there's a merger or otherwise

a competitor of the licensor becomes an insider of the licensee. In that instance, I believe that assumption can be challenged on the basis that the real plan is to violate the trade secret and confidentiality provisions of the license agreement and give a competitor of the licensor that which it should not have.

Since we have such little time left I'll let you peruse page 11 at your leisure and I'm going to turn the session over to Keith to discuss how you can enhance your rights by drafting in the event that your licensor or licensee files bankruptcy.

Keith Medansky: Thanks, Jan.

I think that Jan gave an excellent overview and you'll see how some of the concepts she discussed dovetail with these tips, which aren't pretty much organized in any way other than the order in which I thought of them.

The first, though, probably is the most important. When you have a software license you have a complicated bundle of rights. You may have things in here that deal with rights – the right to use copyrighted or patented software. It may have – it may have rights in addition to support and maintenance. There may even be a trademark license wrapped in to it – are things that are not covered by the definition under Section 101 of intellectual property. And if you recall, there were things that were left out of it like trademarks and contract support services aren't part of Section 101.

So if you don't mention in the agreement that it's intended to be covered as intellectual property under the bankruptcy code you leave an opening. Not to say that a court would

ever construe a software license as not being intellectual property but they might so you want to expressly state that it is.

Next tip, make it clear that the license will be treated as executory. So first we were going to make clear – sure that the software license is going to be treated as an intellectual property license, second, make sure it's going to be considered executory.

Some of the obligations of licensors like indemnity, could be almost argued to be soft obligations, they are theoretical. And there is some risk that a court may try to underplay those soft continuing obligations of the licensor, you know, and not regard the contract as executory in which case when the contract goes away – it's been extinguished by the bankruptcy court – you wouldn't have the rights under 365N to step in and obtain the right to use.

So you want as licensee to make sure that you have the right to get the continued use and, therefore, you want to treat it as executory.

When at the time that – someone asked the question before about source code. Let's say that you did have a source code escrow – and we're going to talk about that – or you had otherwise some access to the source code and you needed to update the code and you needed to do things with it, and you had those rights perhaps to maintain it yourselves before the bankruptcy or even in after invoking the escrow.

You want to be able to maintain – hire consultants. You want to be able to hire vendors and not be breaching the confidentiality agreement in the license agreement that said don't

decompile, don't share it with anyone. There's all these draconian provisions that people stuff into license agreements.

Well since you only get the bundle of rights that you had pre-bankruptcy when you invoke 365N and in fact you may even get lesser rights, you want to make sure that certain rights that you need like to fiddle with the software and to engage assistance you can do that without breaching some other provision.

One of the most important provisions of 365N in order to keep the right to use the software you have to pay the licensor. The licensee can't get a free ride. Now someone before asked the question about a paid-up license. Well the way I read 365N you probably don't have to pay anything more, you basically get to continue to use this license. And the licensor is going to try to figure out ways to force you to renegotiate and pay something.

But – and maybe they'll do that because they want – you want support and they don't have to give you support so they'll dangle out an inflated support number for you to make you do that post the petition because they can reject that, it's gone, and they can force you to buy it at an inflated price later on, if you want to.

But let's say there is provisions in this license agreement to have a provision relating to the use of the software and provisions relating to maintenance. If you lump all this pricing together the bankruptcy court doesn't know what – and you don't know really, what the value is of the license versus the value of the support. And it's very difficult to unscramble this (ag) in the – without litigating it.

So if you want to avoid a court deciding or having a gun to your head with the licensor deciding what the various elements are worth think about it at the beginning and price it separately when you're not in a fight. And you can separate the – you can separate the agreements, you can have separate royalty provisions, or you can even have a deduction.

Issue of present right to use – you – if you want to maintain the software as we were talking about before and you want to do it post-bankruptcy you can't get the right to do that merely because now you've had a bankruptcy. So you want to have these rights triggered by some sort of – and secure as to their performance and not as a financial trigger or a bankruptcy-based trigger in fact a declared bankruptcy can't be the trigger.

It is helpful to have a provision in the agreement that says that if you don't invoke you rights under 365N you retain your right to have a unsecured claim for damages.

I'm going to go very briefly on the concept – you all heard of source code escrows. They're kind of a panacea. They work to some extent and don't work to some extent.

But there are some things that if you're going to have one of them – people put in these agreements all the time that a trigger point to go to the escrow agent is that there's a bankruptcy and you think you just walk in with the proof that there's been a filing that's good enough. That's challengeable as an ipso facto clause. Those are unlawful under the bankruptcy code. It is just simply ineffective if a right trigger is merely because of bankruptcy.

You could have a trigger for your escrow is that they failed to perform, they failed to respond to fixing a bug within a certain amount of days, or a multiple failures within a certain set time period. You can have perfectly satisfactory non-bankruptcy triggers.

Let's see, and someone asked whether the concept of an escrow could apply outside the concept of software. Absolutely, you can escrow anything you want.

You need to think about what needs to be deposited in escrow, it's very important. The code you can have software that's tens of thousands of lines of code ((inaudible)) something significant. You're not going to be able to – it's going to be impractical to try to do this yourself without some schematic or some understanding. So any manuals, whatever you think you might need to be deposited in there, let's get it in there. Let's get – make sure you provide in your contract to get updates in there. Make sure that you have in your contract a present that not just that it will be deposited but that you have the right to whatever should be deposited because then you could ask the court – bankruptcy court for specific performance to get at it because it should have been deposited, it wasn't deposited, but you had the right, pre-bankruptcy right to it. You might be able to ask the bankruptcy to give you that specific performance.

I'm flying through these pretty quickly.

Issue of taking …

(Janice Duban): Keith, let me just – let me just reinforce, Keith, that it has to be a present right. So in addition to clauses saying you have a particular right or trigger because the other

contracting party is insolvent or bankruptcy, not only don't they work because they are illegal but they don't work because that creates a sort of a springing right to – and you can't have a springing right, you have to have a present grant.

Keith Medansky: There are ways – and this is not frequently done, but you could – you could take a security interest in the actual underlying IT for certain liquidated damages based on failures to perform that you could build into your contract particularly if it were a small software licensor and they were hot for the business at the time that you were negotiating with them. You could require them to pledge at IT. It's not going to be – work with someone that's – with who's – is a vendor to multiple sellers.

But if something is custom for you it seems to me that you would want to take a security interest in that intellectual property, you'd want to perfect it using the applicable procedures under UCC 1s and under the copyright law and patent law to make sure you had it tied up. And then you would have an enforceable right and you would not a unsecured claim but a secured claim that would have priority over all the other unsecured claims and would improve your position.

But as I said, it's not always feasible. You're not going to get from some major publisher a security interest in something that they sell to many other people.

One of the things that's very important is that if the – that if there is going to be a sale of assets in bankruptcy you want to make sure – somebody can sell your license out from – essentially the obligation out to another vendor to someone else. If you don't object to that sale then they may be a free – the transfer may be free and clear of any interest. And there

was a recent case in the 7th Circuit that we could – we send you a citation on that deals with this issue.

(Janice Duban): This is a – this is an order to make sure that if you've made that 365N election that the sale of the debtor's assets don't interfere with your continuing right to exercise your rights under 365N. That's what that's about.

Keith Medansky: And then a couple just minor points I think at the end. I'll call this tips 10 and 11. There's no slide for 11.

But some minor housekeeping things, one, you definitely – you do want to make sure that you recognize that you can't get – you can't use this to extend your license. If the license expires during the term of the bankruptcy it's going to expire during the term of the bankruptcy. You can't use it to get an extension unless you can negotiate one.

The rights under 365N end and when the agreement ends or when the extensions to the agreement end. Moreover, this agreement – the 365N wouldn't apply to an agreement that was governed under Manitoba law the law of United Kingdom or something like that. It is critical that your agreement is covered by applicable – by U.S. law in order to take advantage of this.

I'm going to try to preserve some time for questions because really the focus that John asked or tasked was to focus on the licensee issue. And I'm going to skip the two last slides on the tips and open – for licensors and offer folks the opportunity to ask any other questions they have.

John Thomas: OK, folks, here's your chance. I think it was a great presentation. It's certainly a lot of information that we can put to use immediately. It's never one size fits all and we do have a couple of minutes so are there any questions here that – there's one, Keith, about does the escrow concept apply to non-software?

Keith Medansky: Yes, I think I mentioned that you absolutely can use the escrow concept with – deposit masters of films and theory into an escrow and so on so that it would be available. So there's nothing magical about the fact that it's software.

Let's see …

John Thomas: How about international application of the software code on an international basis where the licensor is offshore?

Keith Medansky: Well I would want to try to make sure, as I alluded to as my unspoken tip 11 is that this is governed by U.S. law. Because there are some – there are some odd quirks under Section 101 of the Bankruptcy Act. And I haven't looked lately but the last time I looked at this issue in the concept of some patent licensing is it's – there's some lack of clarity, an unfortunate lack of clarity, about whether or not you can reliably stay that a license – that a patent governed by the laws of an other country, a foreign patent, would be subject to 365N – would be deemed intellectual property under Section 101.

So that's – that would be my principle tip is to try to focus this as much as possible under U.S. law.

And on copyrights that's easy because the rights – let's see – would generally be copyright but there may be situations where things are covered by patents in a client's ((inaudible)).

Let's see, this is March, OK. We're trying to answer …

John Thomas: OK.

Keith Medansky: … we're trying to find the questions …

(Janice Duban): We're trying to read your questions …

Keith Medansky: … and they're coming in so fast that I can't – the screen keeps moving. Let's see …

John Thomas: You can …

Keith Medansky: OK. Here let me just take this one that we can read quickly and OK maybe you can find another one to read.

Address responsibility of licensor to provide support services after the licensee has filed? The licensor once it rejects that contract is no longer obligated to provide any support services. It is free of any obligation.

If it stops performing those obligations during the license after it's filed it's clearly they're going to know that you're ultimately not going to want it assumed. There's going to be no chance that they're going in the end be able to assume it because it would be very hard to give you adequate assurance of assumption.

Should they be performing the contract, it would be nice but I think you could – what your motion would be, Jan, I think, that you'd be making a motion to quickly force the debtor to reject the contract because they're not meeting their obligations to provide those services. Is that right?

(Janice Duban): Yes. That's correct, Keith.

Keith Medansky: OK.

(Janice Duban): We see another question it says, can you get around the bankruptcy by triggering an earlier escrow release for a service failure, et cetera? Also is it better to have a third-party escrow in bankruptcy or does it matter?

Well, I think Keith and – the answer is yes. If the triggering event for you escrow release precedes bankruptcy then you're going to get whatever you need before the bankruptcy is filed. Now it's a little to difficult for me to analyze on this phone call if that triggering event and escrow release occurs within the 90 days before bankruptcy, which is the preference period, whether it somehow could be challenged. But I'd sure get – I'd sure get my source code and worry about what's challengeable later.

And Keith and I are both of the opinion that a third-party escrow is one of the best protections against the licensor's bankruptcy filing.

Keith Medansky: OK, let's see.

John Thomas: One more.

(Janice Duban): Oh well there's a question here about why do we continue – if inserting that the trigger for termination is the bankruptcy or the insolvency of the other contracting party, why do we see it in every contract even though it's unenforceable?

And it's just because people don't accept that it's unenforceable. It's also unenforceable in a, for instance, a lease of real property when you say this lease is terminated if the tenant files bankruptcy. They've been – those clauses have been unenforceable for something like 30 – close to 30 years I think – more than 30 years but …

Keith Medansky: People just put them in.

(Janice Duban): … people just put them in.

Keith Medansky: Some asked a fascinating question about work-for-hire arrangements and I want to know exactly what was in that work-for-hire arrangement. But there's a whole issue in these – in pretty much every tip that we've given and everything we've discussed about form versus substance and if 365N really applies to the scenario where there's a right to use

conferred by contract. And if that right to – whether you call it a license or you call it a something else it shouldn't matter.

But if the contract was ultimately a sale and a work-for-hire agreement by operation of law conveys ownership in the first instance in someone – in a third party or in the – in the contracting party, I not sure that there is going to be ongoing obligations under both sides such that it would be executory such that it would be subject to 365N or any of the things we've really talked about. That's a sale or more equivalent to a sale it seems to me than a license.

(Janice Duban): And if the attorney that posed that question – I noticed that, attorney has asked a number of questions that we may not have gotten to – please feel free to contact us.

Keith Medansky: Let's see what …

John Thomas: Jan, Keith …

(Janice Duban): Yes.

John Thomas: … we've got to wrap it up. So good job, thank you very much. They got lots of valuable information that many of us will put to use on a daily basis.

Keith Medansky: Well, thank you very much for giving us the opportunity to speak to ACC.

John Thomas: And for those attendees, remember before you sign off please go to the number one item in your links box on the right-hand edge of the screen and do fill out that evaluation.

And remember that Keith and Jan have generously offered to discuss any transaction-specific clauses and there's the contact information.

Thank you so much for attending this presentation. I hope that you have indeed profited from it.

Keith Medansky: Thank you very much. Bye-bye.

(Janice Duban): Bye now.

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