# Reconciling Commercial Law and Information Technology: An Essay on Bankruptcy Practice during the Next Business Cycle

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## Introduction

Commercial law, including the United States Bankruptcy Code, developed over time to meet a brick and mortar economy's needs. While intellectual property and computer systems have long played a role in business, their role in commercial business transactions was minor, or limited in scope. This is changing and information technology now plays an essential role in US business transactions, largely because of the Internet.

Existing bankruptcy law is not designed to coordinate with the laws governing information technology. Right now, because of the strong economy, the problems are not that apparent, but when the economy next slows many technology companies and technology reliant companies will fail. Then the problems will emerge, and gain in importance.

This essay does not attempt to identify all of the problems that will arise, nor does it attempt to prove, through rigorous argument, the conflicts between commercial and intellectual property laws. What it will do is review some of the already identified situations where the Bankruptcy Code does not interact well with intellectual property and licensing concepts, as well as potential problem areas. It will attempt to examine the impact of the decisions to date in this area, and identify some of the possible solutions available to the bankruptcy system.

**Understanding the New Economy**

The late 1990's have generally been an unhappy time for bankruptcy attorneys. A strong economy and expanding financial markets greatly reduced the number of business bankruptcies filed. Chapter 11 business bankruptcy filings dropped from 13,379 cases in the year ending September 1994 to 7,953 cases during the year ended June 1999.[1] This change coincides with an incredible expansion of the information technology (IT) industry resulting, in large part, from the Internet's integration into U.S. society and business.

The Internet is a major component of the networks and non-networked applications generally referred to as "cyberspace." The term generally applies to "any interactive environment that is or can be outside of real time and real space."[2] The term cyberspace references the network of computers that can be accessed over the Internet, and the information available on that network.[3] The Internet is not as new as some might think. Its predecessor, ARPANET (the Advanced Research Projects Agency Network of the U.S. Department of Defense), was completed as far back as 1970. The current TCP/IP transmission protocol went into use in 1982. However, it was not until HTTP (hyper text transfer protocol) was established (1991) and the Mosaic browser created (1993) that the Internet as we now know it began to emerge.[4]

Still, at the end of 1994, when the author first started using the Internet, only 10,000 Web site servers were connected to the Internet. By August 1999, that number had increased to more than seven million.[5] Today, HTTP allows the World Wide Web, which consists of millions of connected Web sites and is what most people think of when they think of the Internet. The Mosaic browser has gone through several transformations to become Netscape Communicator. Hundreds of millions now use it or similar Web browsers to surf the Internet.

Understanding the Internet's impact on future bankruptcy practice requires examining how the Internet has changed technology use in U.S. business. After all, the computer industry is not a new industry, technology-oriented bankruptcies are not new, and businesses have used computers since the 1940's. The difference is that the Internet raises the stakes. The tools the Internet makes available create such a business advantage for the businesses using them that they must be adopted. Law practice provides a convenient example. Three years ago many major law firms had neither e-mail nor Web sites, nor did all of their attorneys use personal computers. Today, almost all major firms have these things because they must to remain competitive. Without e-mail, attorneys no longer have the ability to communicate with clients in the manner clients require. Without a Web site, firms can no longer project a world class image. The software required to work collaboratively with clients and other firms does not run on older DOS based computers, nor will the software needed to access the Internet, so the firms are forced to upgrade their computer systems.

This integration of the Internet, and the technology needed to use it, has occurred throughout U.S. business. The result is that today any major corporation has a Web site, and probably uses that Web site to sell goods, automate its supply function, or otherwise operate its business. Software systems, especially database management programs (like Oracle) and enterprise communication tools (like Lotus Notes or SAP) form the backbone of most corporations. Without these technology systems, they can not exist. Domain names are valuable property and companies will pay six or even seven figure sums to obtain the rights to their domain name.

Technology issues will play a greater role in future bankruptcy cases partly because technology, and new forms of technology, are now more pervasive in industry. Moreover, the acceleration in the U.S. economy is information technology based. The winners in the stock market are not the

brick and mortar companies, but the software companies, the computer companies, and the .com start-ups. These are the companies that now are on the cutting edge and are most likely to fail when the business cycle next turns downward.[6] When they do, technology related issues will play a major role in their bankruptcy cases. The same is true for the non-technology companies that rely on technology-related assets to sustain business operations.

The increased importance of information technology in U.S. industry has another effect. The concepts of information technology property law are now more important, and have a higher profile, than before. Attorneys and legislatures are focusing more on intellectual property law, software licensing, and electronic signatures and documents. New statutes, such as the Uniform Electronic Transactions Act (UETA), the Uniform Computer Information Transactions Act (UCITA), revisions to The Lanham Act, and revised UCC Article 9 are changing the legal landscape and focusing attention on technology issues. When technology companies, or simply companies using technology, go bankrupt, old fact patterns will give rise to new issues as bankruptcy attorneys gain greater knowledge and appreciation for technology related issues. This has already started to occur.

**Customizing the Bankruptcy Code**

Historically, changes in industry and society require changes to the Bankruptcy Code (referred to in this essay as the Code). The Code recognizes a balance among the interests of debtors, creditors, and other interested parties, such as employees and customers. The Code weighs the debtor's need to reorganize against creditors' legal rights and attempts to strike a fair balance between both these interests and the interests of third parties. The Code also tries to strike a balance among creditor interests, seeking results that achieve a fair distribution among creditors based on principles inherent to the bankruptcy process. The result is creditor treatment under the Code that is different than under non-bankruptcy law, quite often including curtailment or elimination of non-bankruptcy rights.

As new industries arise, new factual patterns arise in related bankruptcy cases. The Code must be revised, or judicially interpreted, to meet the new factual patterns and maintain the desired balance of interests. Arguably, maintaining the integrity of bankruptcy law principles should prevail over preserving parties' rights under non-bankruptcy law.

Examples of this exist throughout revisions to US bankruptcy law, either at the time of the Code's enactment or as part of the Bankruptcy Reform Act of 1994. Subchapter IV of Chapter 11 adjusts the Code to reflect the special needs of railroad reorganizations. Code section 1110 addresses special issues related to aircraft and vessel leases. The Bankruptcy Reform Act of 1994 amended section 365(h) to protect purchasers of timeshares. It also amended section 507(a)(3) to recognize the increased use of independent contractors in U.S. industry, and section 541(b)(4) to reflect new business practices in the petrochemical industry. Section 218 of the 1994 Act, creating the "single asset real estate case," dealt with imbalances in real estate reorganizations that only became apparent during the real estate crash of the early 1990's.

The increased importance of information technology in business has already caused dissonance in the bankruptcy process. Bankruptcy law is, in general, designed to handle commercial law concepts. It works well when it is applied to business relationships defined by contract law and the Uniform Commercial Law. It does not work well when applied to relationships defined by intellectual property and licensing laws. So far, application of the Code to these relationships has generated results that upset, rather than balance, the relationships between the various parties to a bankruptcy case.

**The Lubrizol Problem: an Example**
Technology transfers typically take the form of licenses, which bankruptcy courts generally treat as executory contracts.[7] In many cases, the licensee requires use of the licensed technology for its business operations. Allowing a debtor to legally breach the terms of its license and leave the licensee with only liquidated damages as a remedy creates a situation where the licensee is put out of business, while the debtor and other creditors might gain only a comparatively minor benefit.

The Fourth Circuit Court of Appeal's decision in *Lubrizol Enterpises, Inc. v. Richmond Metal Finishers*[8] illustrated the problem. Although this case is relatively old, and the problem it illustrates has been resolved by subsequent amendments to the Code, it demonstrates this essay's theme. Richmond Metal Finishers had granted Lubrizol Enterprises, Inc. a non-exclusive license for the use of a metal coating process. Richmond Metal Finishers then filed a chapter 11 petition and its trustee sought under section 365 to reject the license to "facilitate sale or licensing of the technology unhindered by restrictive provisions in the Lubrizol agreement." The Fourth Circuit let the trustee reject the contract.

The Fourth Circuit, in deciding *Lubrizol*, took the harsh position that the harm caused the licensee by rejection of the contract was not relevant to the court's decision whether or not to authorize contract rejection. This interpretation of section 365 fails to balance the interests of the debtor, and the estate, against the interests of third parties. More importantly, the decision created severe business risks for companies relying on licensed technology and would, some argued, chill technology development and innovation. One option for the court would have been to adopt a flexible test, refusing to authorize rejection where the licensee would be damaged disproportionately to any benefit to be derived by the general creditors of the estate. Other courts, in fact, took this option.[9]

Legislating around the decision was another option. In response to the *Lubrizol* decision, Congress enacted the Intellectual Property Licenses in Bankruptcy Act, codified at 11 U.S.C. § 365(n). Section 365(n) allows certain licensees to retain some rights under intellectual property licenses despite the licensor rejecting the license agreement, most importantly, the right to retain use of the licensed intellectual property for the remaining license term.[10]

The *Lubrizol* case illustrates a situation where the existing Code provisions produced a result inconsistent with the goals of the bankruptcy process when applied to a new situation. It also demonstrated how both judicial interpretation and legislative action provided solutions.

**The Dorer Problem: Cyberassets as Property Interests**
The Code's failure to handle technology-related issues is rooted in the differences between the legal structures used to define business relationships. The Code was designed to reorganize businesses governed by contract and property laws. These legal concepts do not control the major relationships governing technology-related businesses. Licensing law replaces contract law. Intellectual property laws replace property laws. When courts apply legal rules designed to work with contract and property law to business relationships governed by licensing and intellectual property law, undesired results occur.

Domain names provide an example. Two decisions show how the confusion over what domain names are causes confusion when applying property law rules to domain names. Although the cases are non-bankruptcy cases, their application to issues that arise in bankruptcy cases is clear.

In *Umbro International, Inc. v. 3263851 Canada, Inc.,*[11] a Virginia state court was asked to determine whether a sheriff could seize a domain name and sell it at a sheriff's sale to satisfy a judgment against the domain name registrant. The plaintiff had obtained a money judgment against the defendant, which had registered several domain names with Network Solutions, Inc. Although most of the domain names were not related to the plaintiff's cause of action, the plaintiff wanted them sold to raise funds to satisfy its money judgment. The court viewed the defendant's domain names as personal assets subject to lien and allowed the seizure.

The US District Court for the Eastern District of Virginia reached a different approach in *Dorer v. Arel.*[12] Faced with a plaintiff seeking sale of a domain name by sheriff's sale, the Court denied the requested relief. The court believed the plaintiff's intent was to effect transfer of the domain name and advised the plaintiff to use Network Solution, Inc.'s domain name dispute process to accomplish this end. In dicta, the court suggested that a domain name is not personal property subject to judicial lien, but instead represents trademark rights (to the extent the domain name holder has trademark rights in the term registered as a domain name) and contract rights (under the contract between the domain name holder and Network Solutions, Inc.) The Court opined that a domain name is merely an address, and has value subject to lien only to the extent that the manner of its use adds value. The court stated "if the only value that comes from transfer of the domain name is from the value added by the user, it is inappropriate to consider that an element subject to execution."[13]

What are domain names? Laymen tend to treat them as assets, assigning them independent value and selling them for profit. Trademark rights have a tremendous impact on domain names. Perhaps, a domain name inherently includes some trademark rights. Perhaps having a domain name merely means having rights under contract with the domain name registrar. Perhaps it is a form of license right. In the bankruptcy system, courts will have to develop a definition of what a domain name is, and apply the Code to that definition, so as to provide a result consistent with the goals and needs of the bankruptcy process.

**The Peregrine Problem: Perfection of Security Interests in Copyrights**
One goal of commercial law is to provide lenders ease and certainty in perfecting security interests in property. Uniform Commercial Code, Article 9 ("Article 9") accomplishes this goal by allowing perfection against most assets by filing a simple document with a centralized registry. Easily obtained security interests simplify lending and open capital sources. The Code is designed to recognize secured creditor's rights when they comply with the applicable rules, and balance those rights against the needs of the debtor and other creditors.

The carefully constructed rules cease working when applied to security interests in copyrights because of a provision in the US Copyright Act[14] and a California District Court decision, In re *Peregrine Entertainment, Ltd*[15]. The US District Court for the Central District of California addressed a creditor's claim that it had properly perfected its lien on a film library by filing a UCC-1 financing statement in accordance with the provisions of Article 9. The court held that the US Copyright Act preempted the Article 9 perfection provisions and therefore filing with the Copyright Office was required to perfect a security interest in a copyright.

The court's conclusion flows naturally from provisions of the Copyright Act and Article 9. Section 205(a) of the Copyright Act provides that "any transfer of copyright ownership or other document pertaining to a copyright may be recorded in the Copyright Office.." and Section 205(c) provides that recording any such document in connection with a registered copyright gives all persons constructive notice of the facts stated in the recorded document. The Copyright Act defines the

term "transfer of copyright ownership" to include "an assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright."[16] This definition clearly encompasses security interests in copyrights.

The UCC, because it is enacted as a state statute, is subject to preemption by Federal statutes. UCC, § 9-104(a) provides that Article 9 does not apply to a security interest subject to a Federal statute "to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property."[17] Section 9-302(3)(a) states that a UCC-1 Financing Statement is not necessary to perfect a security interest in property subject to any statute or treaty of the United States which provides for national or international registration or which specifies a place for filing a security interest.[18] The provisions of Section 205 of the Copyright Act appear to satisfy the requirements for federal preemption of Article 9.

The decision in *Peregrine*, and the later, but similar, decision in In *re AEG Acquisition Corp.*,[19] applied to security interests in registered copyrights. Thus, their direct impact was limited to intellectual property assets that are easily defined and determined. Registered copyrights are relatively easy to identify through the US Copyright Office's records and due diligence. Further, in the context of the entertainment industry (the subject of *Peregrine*) lenders want to secure with respect to a specific asset, usually a film or other artistic work, without regard to ownership. The perfection structure dictated by *Peregrine* serves this need. Copyrights in these works are always registered and the US Copyright Office provides a central filing location.

The *Peregrine* structure does not work when applied to the software industry, as demonstrated by the US Bankruptcy Court for the District of Arizona's decision in *In re Avalon Software, Inc.*[20] That court held a creditor does not have a perfected security interest in property subject to protection under the Copyright Act, unless (1) the debtor has registered its copyright in the property, and (2) the creditor files its security interest with the U.S. Copyright Office. Thus, the *Avalon* decision extends the *Peregrine* decision to unregistered copyrights.

In 1994, Avalon Software, Inc, a computer software developer, obtained a loan from Imperial Bank. Avalon granted Imperial a security interest in all its assets, then or after acquired, including accounts, general intangibles, equipment, inventory and proceeds. Imperial filed a UCC-1 financing statement with the Arizona Secretary of State, thus satisfying the perfection requirements of Article 9 as enacted in Arizona. At that time, Avalon had registered with the Copyright Office copyrights in software developed between 1989 and 1991. However, after 1991, Avalon did not register copyrights in its software. Imperial did not file any documents providing notice of its security interest with the Copyright Office. After 1994, Avalon continued to produce new software programs. It also created updates, modifications, amendments and enhancements to its existing software programs. Avalon did not register a copyright in any of these works. Avalon subsequently filed a chapter 11 petition and substantially all of its assets were sold, with court approval, to a third party. Imperial's lien attached to the sale proceeds.

The debtor and the creditor's committee sought to avoid Imperial's lien against the proceeds from the sale of Avalon's software and software licenses. Judge Marlar, following the *Peregrine* and *AEG Acquisition* decisions, held that Imperial's failure to file its security interest with the U.S. Copyright Officer meant its lien was unperfected as against all Avalon's software related assets, including the proceeds from selling those assets. A product susceptible to copyright protection acquires its character as "copyrightable" when the intellectual work is created.[21] A work can receive copyright protection even if the copyright is not registered. Thus, the court concluded,

regardless of whether the copyright in the work is registered, a lien in the copyright can only be perfected by filing a security agreement with the Copyright Office. Based on this argument, the bankruptcy court judge held in *Avalon* that Imperial's lien was unperfected against Avalon's software, even the copyrightable software that had not been registered with the Copyright Office. The lack of perfection extended to software that was a modification, enhancement or offshoot of the existing programs, and also extended to Avalon's rights under licenses of the software rights.

*Avalon* took rules that worked when applied to the entertainment industry and applied them to a software company. In the entertainment industry, copyrights in finished works are always registered. Lending is project based, not entity based. In the software industry, copyright registration is less often used, especially since copyright registration of software code is inconsistent with the concept of using trade secret laws to protect source code. Also, copyright protection is available for a broad variety of assets, for which registered copyright protection is not sought. Marketing materials, brochures, instruction manuals, internal correspondence, accounting and business records, white papers, advertising copy and graphics, logos, artwork, and even buildings are all examples of common business assets subject to copyright protection. As a business matter, registering a copyright in all such assets is impractical and expensive. Further, registering a copyright in some types of copyrightable assets, such as intellectual property works in progress, is not possible, because registering a copyright requires making a deposit of the work. Imagine filing as a public record a copy of a Web site for a product that is not yet launched.

The *Avalon* decision also creates a problem with respect to after-acquired property. Maintaining the security interest against after-acquired or derivative works becomes more difficult because the security agreement filed with the Copyright Office must reference each individual copyright registration. Thus, as new works are created and old works are revised, the lender and borrower must file a continuous stream of copyright registrations and security agreements.

Perhaps the *Avalon* decision's greatest problem is its failure to recognize that while a debtor can have a copyright in a work, the copyright is not the work. For example, software consists of tangible media, trade secret rights, license rights, trademark rights, and patent rights. Even if the court held that Imperial's lien against Avalon's copyrights in its software was unperfected, that is not the same as holding that Imperial's lien against the software was unperfected. Even following the decisions of the courts in *Peregrine* and *AEG Aqcuisitions*, courts need to develop methods for determining the value that is attributable to the copyright in a work, and the value of the work attributable to other factors. This calculation will differ on a case by case basis. The approach taken by the court in *Avalon*, determining that the lender's failure to perfect its lien in copyrights in the software obviated any lien it had in the software itself, simply misapplies copyright law, confusing a personal right in an aspect of a property asset with the property asset itself.

The American Bar Association (ABA) is exploring legislative solutions to the *Peregrine* problem. Its Joint Task Force on Security Interests in Intellectual Property has proposed enacting comprehensive legislation, known as the Federal Intellectual Property Security Act, to establish a central Federal filing system to allow perfection of liens against trademarks, copyrights and patents. The filing system would allow "blanket" filings to allow a lender to obtain a lien against all a debtor's intellectual property, including after acquired property. The Commercial Finance Association has proposed a "quick fix" to the problem by amending the Copyright Act to eliminate the Federal preemption issue and allow perfection of a lien against a copyright by filing under the UCC. Either of these proposals will resolve the *Peregrine* problem, but neither has had success to date in the legislative process.

**The Everex/Catapult Problem: Assumption and Assignment of Intellectual Property**

**Licenses**
The Code recognizes that a reorganizing debtor must have the ability to hold third parties to existing contractual obligations where beneficial to the estate, and even transfer the contractual obligations to third parties. Section 365 grants the debtor the ability to assume and assign such executory contracts. The debtor's ability to assume and assign a contract is not absolute. The Code recognizes that in some circumstances allowing a debtor to assign a contract to a third party creates too great an imposition on the other party to the contract. Rather than define the specific instances when a contract may not be assigned, section 365 (c)(1)(A) of the Code restricts assignment when non-bankruptcy laws (but not contractual terms) excuse the non-debtor party to the contract from accepting performance from an assignee.[22] Thus, the Code looks to other law, either statutory or judicial, to determine when forced assignment of contract rights is too unfair to the non-debtor party to be allowed.

In the *Everex Systems, Inc. v. Cadtrak Corporation*[23] case, the Ninth Circuit Court of Appeals sustained a licensor's objection to a debtor assigning its rights under a non-exclusive patent license. The decision focused on the language of section 365 (c)(1)(A). The relevant applicable law was the Federal common law principal that non-exclusive patent licenses contain an implied term restricting assignment. [24]

The decision in *Everex* stems from an important distinction between a license and a contract. A contract is an agreement between parties defining mutual obligations to each other. A license is an agreement by the holder of intellectual property rights to allow a third party to violate those intellectual property rights. A license is sometimes described as an agreement not to sue. Intellectual property rights are generally considered personal to the owner. For example, a patent is considered a personal right of the inventor (although patent rights can be assigned.) As a personal right, patent law recognizes a strengthened right of the patent holder to control who uses or, more accurately stated, who is allowed to violate the patent. This translates into a recognized right to control the terms, and recipient, of any license of the patent rights. The *Everex* decision rests on this principle.

The decision in *Everex* has a potentially chilling effect on reorganizations. It grants a patent licensor undue control over a licensee's reorganization, especially if that reorganization requires a sale or transfer of assets. In some cases, allowing forced assignment of a patent license will cause severe problems for the licensor (although such situations can be avoided through proper drafting of the patent license.) However, in many other cases involving technology companies the patent license rights are essential to the debtor's operation and the debtor must retain the rights for it, or its successor, to continue operations. In some of these cases, the cost to the patent licensor of forced assignment is, at most, loss of a relatively small amount of revenue. Patent licenses also occur within relationships that do not fall within the scope of the standard technology transfer. For example, many software licenses include a patent license component.

By extension, the *Everex* holding prevents not only assignment of patent license rights but mere assumption by a reorganizing debtor. Code section 365(c) uses the language "the trustee may not assume or assign any executory contract or unexpired lease of the debtor..."[25] One line of cases has adopted a "hypothetical test" in interpreting the use of the word "or" in section 365(c), holding the section restricts assignment of an executory contract when a hypothetical assignment would be prohibited.[26] Another line of cases concludes that restricting assumption merely because applicable law prohibits assignment is nonsensical and applies an "actual test" holding that section 365(c) limits assumption only when the trustee intends to subsequently assign the

assumed contract.[27] In *In re Catapult Entertainment*,[28] the Ninth Circuit Court of Appeals adopted the hypothetical test and held a debtor could not assume rights under a non-exclusive patent license over the licensor's objection. [29]

The *Catapult* decision expands the *Everex* decision's impact and gives patent licensors veto power over a debtor's ability to retain license rights after reorganization. While granting a licensor control over assignment of the licensee's interest is backed by existing public policy considerations, allowing a patent licensor the ability to terminate the license merely because the licensee has filed a bankruptcy runs contrary to the bankruptcy policy against ipso facto clauses in contracts.

The restrictions on assumption and assignment of patent licenses may also apply to assumption and assignment of a licensee's rights under a non-exclusive copyright license. In *Emmylou Harris v. Emus Records Corporation*,[30] the Ninth Circuit Court of Appeals applied the concepts later expressed in the *Everex* decision to a copyright license, stating that the bankrupt licensee of rights under a mechanical recording license could not assign those rights to a third party because the rights were personal in nature. Although the *Emmylou Harris* case was decided under the Bankruptcy Act, the holding was, in *In re Patient Education Media, Inc.*,[31] applied to bar assignment under the Bankruptcy Code of a non-exclusive copyright license to reproduce photographs.

The decisions in the *Emmylou Harris* and *Patient Education* cases go beyond assignment of recording contracts and photograph reproduction rights. The principles espoused in the cases apply, theoretically, to the entire field of copyrights since they are based in the concept of what a copyright is, not what type of copyrighted material is at issue. Judge Bernstein's decision in *Patient Education* described the Copyright Act as "intended to motivate the creative activity of authors and inventors by the provision of a special reward."[32] This "reward" is the right to control transfer and use of the copyrighted works.

In the context of a recorded song or an artistic photograph, protecting the artist's right to control his work seems reasonable. Protecting this right seems less reasonable in the context of copyrightable material produced for commercial purposes, such as software, Web sites, marketing materials, and commercial graphics. For example, if an advertising agency designs a brochure cover but does not sign a written copyright assignment the advertising agency retains the copyrights in the brochure cover. Should the advertising agency have the right to prevent its client from using the brochure cover post-bankruptcy? Imagine a .com business that hires a design firm to produce and manage its Web site, but fails to include a copyright assignment in the design contract. Should the .com be forced to abandon its entire Web site just because it passes through a bankruptcy case? These are the results dictated by the decisions in the *Emmylou Harris* and *Patient Education* cases.

Courts can avoid the negative results of these decisions by realizing that the Federal common law doctrine espoused in *Everex* might not be appropriately applied to all patent and copyright licenses. The commercial nature of many types of patent and copyright licenses suggests that they be treated as any other commercial contract. Parties should have the right to retain and assign the license rights absent contrary contractual terms, and contractual terms prohibiting assignment of rights should be unenforceable in a bankruptcy case. A line can and should be drawn between licenses that are subject to *Everex* protection, and licenses that are not.

Legislatively, the Code can be amended to allow assumption and assignment of licensee's interests in patent and trademark licenses over the licensor's objection. This expansion of section 365 could

grant licensors additional protection beyond the existing requirement that the trustee provide adequate assurance of future performance under the license.[33] For example, the Code could prohibit assignment of a license interest to a direct competitor of the licensor where the assignment would cause the licensor undue prejudice.

**Looking into the Future**

Determining the nature of cyberassets, maintaining security interests in copyrights, and preserving license rights during reorganization are major issues for future bankruptcy cases. As more technology oriented or dependent businesses file bankruptcy petitions, situations similar to those in *Dorer*, *Peregrine*, *Avalon*, *Everex*, and *Catapult* will arise more frequently. The dissonance between those decisions and the policies governing the bankruptcy process will become more apparent. Hopefully, as the same issues continue to arise, either the courts or the legislature will find appropriate ways to resolve the conflicts.

The cases discussed in the previous sections have already received significant attention from the bankruptcy bar. They do not, however, represent the only trouble spots on the horizon. Other areas of concern exist and they also deserve attention.

*The Kaspar Problem: Recognition of Electronic Documents and Signatures*

Electronic forms of documents and signatures are now used regularly in commerce, even in situations where a firm statutory foundation for their enforceability does not exist. This trend will accelerate with the adoption of revised UCC Article 9 and the Uniform Electronic Transactions Act. In some areas, the Code dictates different treatment for written and oral records, or requires that a document be signed. This has the potential to require different treatment for electronic records and paper records in inappropriate situations. Three Code sections in particular refer to written or signed documents in circumstances where electronic records or signatures are encountered.

1. Section 523 (a)(2)(B) - A debt for money, etc., to the extent obtained by use of a materially false statement regarding the debtor's or an insider's financial condition is only non-dischargeable if, inter alia, the statement is in "writing."
2. Section 546(c)(1), (d)(1) - The trustee's rights under certain provisions of the Code are subject to certain reclamation rights (such as those provided under the UCC) but only if, inter alia, the seller makes a reclamation demand in "writing" within specified time limits.
3. Section 547 (c)(3)(A)(1) - A transfer that creates a security interest in property acquired by a debtor is not an avoidable preference to the extent it secures new value that was, inter alia, given at or after the "signing" of a security agreement that contains a description of such property as collateral.

These provisions create a danger if the terms "writing" and "signed" contained within them are interpreted to exclude electronic forms of writing or signing. Electronic forms of documents, created in most cases before the commencement of the bankruptcy case, may, outside of the bankruptcy process, be valid and enforceable. However, when viewed in light of the related bankruptcy code provisions, the efficacy of the documents in electronic form becomes subject to question.

The decision of the Court of Appeals for the Tenth Circuit in *Bellco First Federal Credit Union v. Kaspar*[34] illustrates this phenomenon. In that case, a credit card issuer interviewed a customer and obtained financial data over the telephone. The issuer's employee entered the financial data obtained into a computer database maintained by the credit card issuer. When the customer filed

a bankruptcy petition, the issuer discovered the financial data provided was incorrect and filed a complaint seeking to determine the debt owed by the customer non-dischargeable pursuant to 11 U.S.C. § 523(a)(2)(B). The issuer claimed the computer database record created from the telephone comment was a "statement in writingÖthat the debtor caused to be madeÖwith intent to deceive." The court held that the electronic data record could not constitute a "writing" for purposes of 11 U.S.C. § 523(a)(2)(B). The court's focus on the issue of whether the computer record could be a "writing," and its statement that it was not, demonstrate that the use of the term "writing" in the Code may be held to refer only to paper documents and exclude electronic documents.

The ABA's Electronic Transactions in Bankruptcy Subcommittee of the Business Bankruptcy Committee has proposed a legislative solution in the form of the "Electronic Commerce in Bankruptcy Recognition Act." This legislation would amend Code section 102 to provide that the use of the terms "writing" and "signed" within the Code shall not limit the effect of electronic records or signatures where enforceable under applicable non-bankruptcy law. [35]

*The Bankruptcy Code Definition of Intellectual Property*
Earlier, in reviewing the Lubrizol decision, I discussed Code section 365(n). Section 365(n) only applies to executory contracts under which the debtor is a licensor of a right to "intellectual property." The term "intellectual property"[36] has a special meaning under the bankruptcy code and is limited to a:

- trade secret;
- invention, process, design or plan protected by United States patent law;
- patent application;
- plant variety;
- work of authorship protected under United States federal copyright law; or
- mask work protected by United States federal law.[37]

Section 365(n) does not apply to licenses for the use of a trademark, licenses of technology or content that are not protected by federal copyright or patent law, such as matter protected under foreign law,[38] or licenses for the use of non-copyrightable database compilations.[39] These limitations, especially the exclusion of trademarks, were intentional, but could cause complications in applying section 365 to future technology related bankruptcy cases. A trademark license frequently accompanies other technology licenses, especially Web linking, content sharing, and content licensing agreements essential to Web site operation. Database content is licensed for use in computer programs, compilations, Web sites, and interactive CD-Roms. Because of the Internet's international scope, a US company might license foreign patent rights. Excluding these assets entirely from the Code definition of "intellectual property" can cause a chilling effect. It creates a situation where a technology licensee, presumably protected from the evils of the *Lubrizol* decision by section 365(n), is unprotected because key elements of the license package are excluded from section 365(n)'s coverage.

*Treatment of Personal Data in Bankruptcy Cases*
The Internet is making personal data a valuable business asset. Marketing professionals have long valued the ability to collect and analyze personal data about potential customers. Computers allowed processing of personal data to determine trends, identify correlations, and target potential customers, but the methods for collecting the data remained relatively limited. The Internet changed this. Visitors to Web sites provide enormous amounts of personal information, both by providing information as they register for on-line services and through systems that track their activity on the Internet. Technology companies treat this personal data as a valuable business

asset. Today, some business models are built solely around collection and use of personal data - with the apparent business run as a loss leader.

Professor Jane Winn and Jim Wrathall have written a paper[40] suggesting that how collected personal data passes through the bankruptcy process will become an issue for future cases. Currently, few rights attach to corporate use of personal data. What rights do exist are provided solely by statute. A business that collects data can use the data how it likes.[41] It can sell the data and presumably retain the data in a bankruptcy case.

The trend is toward greater regulation of personal data. The Federal Trade Commission and consumer protection groups encourage companies to self regulate by adopting "privacy policies." Companies, by enacting these policies, essentially contract with their customers regarding the use of personal data. This creates a contract regime, which limits and controls the use of data. Are these contracts executory? Can the data controlled by the contract be transferred in a bankruptcy case? Could a company that files a bankruptcy petition breach the use restrictions by transferring the data in violation of the contract, reject the contract, and leave individuals with general unsecured claims?

A privacy regime provides another option, giving the individual a statutory or judicially created right to control personal data.[42] This right would be similar to the rights granted a patent or copyright holder. Privacy rights in personal data would give individuals significant control over the data - businesses could only use what rights they contract for, and these rights probably will not be transferable in bankruptcy without the individual's affirmative consent. In this respect, personal data rights might be treated much like patent rights and copyrights, giving rise to problems similar to those caused by the *Catapult* and *EmmyLou Harris* decisions.

*Conclusion*

Eventually, the number of technology related bankruptcies will increase. As courts apply bankruptcy laws to the new situations these cases present, two options present themselves. First, interpreting, and when needed proactively changing, the Code to give effect to underlying bankruptcy principles. Second, applying the Code using mechanical principles of interpretation to achieve results appropriate only to the specific bankruptcy case being decided. The first option supports and perpetuates the bankruptcy system, and supports existing commercial systems and practices. The second option results in decisions like *Lubrizol*, *Avalon*, and *Catapult*, disrupts existing commercial systems and creates traps for the unwary.

Practitioners will find themselves in situations where the second option seems to provide the best result for their client. In that situation, they have an obligation to argue the position that benefits their client. But counsel should also remain aware that how bankruptcy law is applied to technology issues has an effect reaching beyond the impact on the immediate case and seek a position, and develop a structure for the court, that encompasses not just the desired result in the immediate case, but leads to the right result for the bankruptcy process in general.

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1. Source: Administrative Office of the United States Courts Web site at http://www.uscourts.gov:80/Press_Releases/ (accessed 12/17/99).
2. Hayden Mead and Brad Hill, THE ON-LINE/E-MAIL DICTIONARY (Berkeley Books, 1997).
3. For a fuller discussion of the term 'cyberspace," see John December and Neil Randall, THE WORLD WIDE WEB UNLEASHED, Pgs. 328-333 (2d ed. 1995).
4. Source: HOBBES' INTERNET TIMELINE V4.2, at http:// http://www.isoc.org/zakon/Internet/History/HIT.html (accessed 12/22/99).
5. Id.
6. Josh Martin, Down But Not Out, MANAGEMENT REVIEW, Pg. 57 (December 1999).
7. See, *In re Quintex Entertainment, Inc.*, 950 F.2d 1492 (9th Cir. 1991). While licenses are not automatically treated as executory contracts, they typically contain ongoing obligations on the part of both parties that continue for the life of the license.

8. *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), *cert denied*, 475 U.S. 1057 (1986).
9. *In re Huang*, 9 BCD 972 (9th BAP 1982), *In re Petur*, 35 B.R. 561 (Bankr. W.D. Wash. 1983), *In re Logical Software, Inc.*, CA no. 87-0042 (D. Mass. June 25, 1987).
10. See Agin, BANKRUPTCY AND SECURED LENDING IN CYBERSPACE (Bowne & Co., Inc. 2000), §10.03; NORTON BANKRUPTCY LAW AND PRACTICE, 2D, §39:57.
11. *Umbro International, Inc. v. 3263851 Canada, Inc.*, 1999 WL 117760 (Va. Cir. Ct. Feb. 3, 1999).
12. *Dorer v. Arel*, 1999 WL 691677 (E.D. Va. Sept. 3, 1999).
13. Id.
14. Title 17 of the US Code.
15. *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (C.D. Cal. 1990).
16. 17 U.S.C. §101.
17. UCC § 9-104(a) (1995).
18. UCC § 9-302(3)(a) (1995).
19. *In re AEG Acquisition Corp.*, 127 B.R. 34 (Bankr. C.D. Cal. 1991), *affirmed*, 161 B.R. 50 (9th Cir. BAP 1993).
20. *In re Avalon Software, Inc.*, 209 B.R. 517 (Bankr. D. Ariz. 1997).
21. 17 U.S.C. §§101, 201(a).
22. 11 U.S.C. §365(c)(1)(A).
23. *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673, 679-80 (9th Cir. 1996).
24. See, e.g., *Commissioner v. Sunnen*, 333 U.S. 591, 609 (1948).
25. 11 U.S.C. § 365(c).
26. *In re Catapult Entertainment*, 165 F.3d 747 (9th Cir. 1999), *In re James Cable Partners*, 27 F.3d 534 (11th Cir. 1994), *In re Writ Electric, Inc.* 852 F.2d 79 (3rd Cir. 1988), *In re Catron*, 158 B.R. 629 (E.D. Va. 1993), *affirmed w/o opinion*, 25 F.3d 1038 (4th Cir. 1994).
27. See *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489 (1st Cir. 1997), cert. denied, 117 S. Ct. 2511, 138 L. Ed. 2d 1014 (1997).
28. *In re Catapult Entertainment*, supra (1999).
29. Also, *In re Access Beyond Technologies, Inc.*, 237 B.R. 32 (Bankr. D. Del. 1999). However, in *Institut Pasteur, supra*, the First Circuit Court of Appeals applied the actual test and allowed a debtor to circumvent the *Everex* prohibition on assignment by assuming the rights under a patent license and then transferring the equity interest in the entity that had assumed the license. The lesson, pass up the temptation to file your next technology bankruptcy case in Delaware: go to the 1st Circuit instead.
30. *Emmylou Harris v. Emus Records Corporation*, 734 F.2d 1329 (9th Cir. 1994).
31. *In re Patient Education Media, Inc.*, 210 B.R. 237 (Bankr. S.D.N.Y. 1997).
32. Id. at 240, quoting *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417, 429, 78 L. Ed. 2d 574, 104 S. Ct. 774 (1984).
33. 11 U.S.C. §365(b)(1)(c).
34. *Bellco First Federal Credit Union v. Kaspar*, 125 F.3d 1358 (10th Cir. 1997).
35. More information about the specific provisions of the proposed act is available from the author.
36. 11 U.S.C. § 365(n)(1).
37. 11 U.S.C. § 101(35A).
38. 35 U.S.C. §§ 1, et. seq., 17 U.S.C. §§ 101, et. seq.
39. *See Feist Publications, Inc. v. Rural Tele. Serv., Co.*, 499 U.S. 340 (1991).
40. Winn and Wrathall, *Who Owns the Customer? The Emerging Law of Commercial Transactions in E-Business Customer Data* (forthcoming in THE BUSINESS LAWYER.)
41. With some exceptions, the most notable being medical and financial data.
42. This is the situation through-out most of the European Union.

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