

INSOLVENCY AND BANKRUPTCY CONSIDERATIONS IN SOFTWARE LICENSING TRANSACTIONS*

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1.0 INTRODUCTION

When a corporation begins to experience financial difficulties, many people become nervous. Management and employees worry about the status of their employment. Creditors, particularly unsecured creditors, wonder whether they will receive amounts owing to them. Shareholders fear that their shareholdings will diminish in value or, in the worst case scenario, become worthless. Less obvious members of this group of concerned stakeholders are businesses that have been granted a licence to use software by a financially troubled corporation, or that have granted such a licence to a business facing financial hardships. Unfortunately, many licensors and licensees do not consider the prospect of insolvency or bankruptcy at the time that they negotiate a software licence agreement. Those that do consider such matters find that Canadian bankruptcy and insolvency laws as well as intellectual property laws do not adequately address the concerns of licensors and licensees. As a result, parties to software licence agreements are left to their own devices in their efforts to manage the risks of insolvency and bankruptcy.

2.0 BACKGROUND

2.1 Software Licences

Software licence agreements come in many different forms and are used in a variety of circumstances. They may be in the form of stand-alone “shrink-wrap” agreements that accompany copies of software programs sold to the general public. A software licence may also be part of a larger transaction, such as a computer system acquisition, an outsourcing transaction, and even the sale of a business where, despite the transfer of ownership to the purchaser, the vendor is granted a licence to use the software for a limited purpose and/or period of time.

Regardless of the circumstances under which a software licence is granted, software licences share the same legal characterization. Simply put, a software licence agreement is a contract between the holder of the copyright to the software program and the licensee pursuant to which the copyright holder grants permission to the licensee to do something (that is, use the software program¹) that it would not

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otherwise be entitled to do. In other words, it is an agreement that contains the negative covenant of the licensor not to bring an action for copyright infringement against the licensee. As such, it is a personal contract that, though it relates to copyright,² does not grant the licensee a proprietary interest in copyright.³

In addition to the licensor's negative covenant, a software licence agreement often includes other covenants of the licensor and licensee, including the licensee's promise to pay royalties or licence fees and the licensor's commitment to provide technical support and/or software upgrades and to indemnify the licensee in connection with any third-party intellectual property infringement allegations.

2.2 Insolvency and Bankruptcy

When a corporation becomes insolvent,⁴ it usually attempts to reorganize its affairs so that it can regain solvency. Although a reorganization deals primarily with altering the rights of creditors, the insolvent corporation may also wish to rid itself of other burdensome or unfavourable obligations and commitments. In the case of software licence agreements, an insolvent licensor may wish to terminate its obligations to support or develop upgrades for products that it intends to abandon. The insolvent licensor may even wish to terminate licences granted by it so that it can grant new licences on more favourable terms, or assign the copyright in the software to a third party free of any obligations or encumbrances.

Conversely, the licensee will, with rare exceptions, wish to continue to use the software in accordance with the terms originally bargained for by the parties. In addition to merely having the licence remain in force, the licensee will try to ensure that it can continue to enjoy the full benefits of the agreement. For example, the software may be of little use to the licensee if the licensor is no longer obligated, or able, to provide bug fixes or port the software to future platforms.

In cases where it is the licensee that is insolvent, the licensor will be wary of continuing to provide the licensee with permission to use the software, and/or fulfilling obligations such as technical support and maintenance, if the licensee's ability to continue to pay royalty and maintenance fees owed to the licensor is in doubt. As a result, the licensor may wish to terminate the licence agreement upon such events. If the software is critical to the operations of the licensee, such action could have a devastating effect on an insolvent licensee that is already struggling to continue its business.

As the above examples illustrate, in the event of insolvency or bankruptcy, the interests of the insolvent licensor and the licensee are often in conflict. Sections 3 and 4 of this paper consider three of the most critical areas of conflict: (1) the insolvent licensor's ability to terminate the software licence agreement; (2) whether the licensee can enforce the licensor's negative covenant against a third-party assignee of the copyright in the software; and (3) the licensor's ability to terminate the licence agreement upon the insolvency of the licensee. Section 5 considers various protective measures that may be considered by licensees in order to mitigate the risks posed by the insolvency or bankruptcy of the licensor.

3.0 INSOLVENCY OR BANKRUPTCY OF THE LICENSOR

3.1 The Right To Disclaim or Reject

3.1.1 The United States

In order to understand why the right to disclaim intellectual property licence agreements has become a much discussed topic, it is useful to first look to the United States and its experience with intellectual property licence agreements and the insolvency or bankruptcy of licensors.

Section 365(a) of the United States *Bankruptcy Code*⁵ ("the U.S. Code") provides that, with some exceptions, the trustee of the debtor may assume or reject any executory contract of the debtor, subject to the approval of the court. The U.S. Code does not, however, provide a definition of the term "executory contract," and it has been left to the courts to provide a definition of the term. In the oft-cited 1985 decision of *Lubrizol Enterprises v. Richmond Metal Finishers, Inc.*,⁶ the Court of Appeals for the Fourth Circuit confirmed the test for determining whether a contract is executory and at the same time dealt a chilling blow to licensees of intellectual property.

Lubrizol involved a contract under which Lubrizol was granted a non-exclusive licence to use a metal coating process technology owned by Richmond Metal Finishers, Inc. (RMF). Under the terms of the licence agreement, Lubrizol owed RMF the duties of (1) accounting for and paying royalties for the use of the process; and (2) cancelling certain existing indebtedness. In return, RMF owed Lubrizol the duties of (1) notifying and defending Lubrizol in the event of a third-party patent infringement suit; (2) notifying Lubrizol of any other use or licensing of the process; (3) lowering the royalty payments owed by Lubrizol if a lower royalty rate agreement was reached with another licensee; and (4) indemnifying Lubrizol for any losses arising out of any misrepresentation or breach of a warranty of RMF.

Just over one year after entering into the contract, RMF filed a petition for bankruptcy. The matter before the court was whether, as part of RMF's plan to emerge from bankruptcy, RMF could reject its agreement with Lubrizol, thereby allowing it to sell or license the technology without having to take into consideration the restrictive provisions of the Lubrizol agreement.

In applying s. 365(a) of the U.S. Code, the court confirmed that the test for determining whether a contract is executory is the test put forward by Professor Vern Countryman.⁷ Using this test, the court stated that "a contract is executory" if the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute "a material breach excusing the performance of the other."⁸ In applying the test to the case at hand, the court concluded that the licence agreement was an executory contract under s. 365(a) of the U.S. Code, as each party owed to the other unperformed and continuing duties.

In the case of *Lubrizol*, it owed RMF the continuing duty of accounting for and paying royalties for the life of the agreement. In the case of RMF, it owed *Lubrizol* the continuing duties of reporting any further licensing of the process, extending most-favoured customer royalty pricing, notifying *Lubrizol* of any suits regarding process, defending any such suits, and indemnifying *Lubrizol* for certain losses.

The court also found that the second part of the s. 365(a) test—whether the rejection of the executory contract would be advantageous to the bankrupt—had also been satisfied, and ruled that RMF could disclaim or reject the licence agreement. Upon such rejection, *Lubrizol*'s sole remedy was to treat the rejection as a breach and seek damages as an unsecured creditor.⁹

Not surprisingly, the *Lubrizol* case caused a great deal of concern among licensees under executory contracts. This concern prompted the U.S. Congress to amend the U.S. Code in 1988, by introducing a new section 365(n). Under s. 365(n), if an insolvent licensor elects to reject an intellectual property licence agreement, the licensee is given two options. The licensee may treat the contract as terminated, thus giving the licensee a claim against the debtor for breach of contract, or the licensee may elect to retain its existing rights under the contract, provided that it continues to make all royalty payments due under the contract and forfeits any setoff claim it has arising from the debtor's rejection of the contract. While, in rejecting the licence agreement, the debtor does not have to perform future affirmative obligations under the contract, s. 365(n) provides licensees with some measure of comfort in allowing the continued use of the licensed intellectual property.

3.1.2 Canada

3.1.2.1 Bankruptcy and Insolvency Act

The *Bankruptcy and Insolvency Act*¹⁰ (BIA) provides for a formal process under which an insolvent person can make an offer to its various classes of creditors and which, if accepted by the unsecured creditors and approved by the court, will become a compromise that is binding on the classes of creditors who have accepted the proposal.¹¹ If the proposal is not accepted by the unsecured creditors or approved by the court,¹² the debtor is deemed to have made an assignment in bankruptcy.¹³ Upon bankruptcy, and subject to the rights of secured creditors and equities existing before bankruptcy, the property of the bankrupt passes to and vests in the trustee in bankruptcy to be sold and the proceeds distributed to the debtor's creditors in the priority determined by the BIA.¹⁴

In the case of a software licence agreement, a bankrupt licensor's rights in such software, including its copyright, are assigned to the trustee subject to all rights enforceable against the licensor. As a result, the licensee can seek to enforce the licensor's negative covenant not to sue the licensee for copyright infringement against the trustee. Notwithstanding the foregoing, the *Lubrizol* case has prompted some observers to consider whether, in Canada, an insolvent licensor or its trustee in bankruptcy can disclaim or reject executory contracts.

Unlike the U.S. Code, the BIA does not provide for a general right to disclaim executory contracts.¹⁵ As a result, one must consider whether, absent statutory authority, a trustee in bankruptcy has the right to disclaim executory contracts.

In *Stead Lumber Co. v. Lewis*,¹⁶ the court concluded that while a contract is not discharged on bankruptcy, the trustee may elect to adopt or disclaim any executory contracts of the bankrupt. The soundness of the court's conclusion is, however, questionable because its decision is based on English law, which specifically provides for a statutory right to disclaim executory contracts.¹⁷

In *Re Erin Features #1*, the British Columbia Supreme Court was faced with the question of whether a trustee in bankruptcy could disclaim an agreement made by the bankrupt prior to its bankruptcy. Under such agreement, Modern Cinema Marketing Ltd. (MCM) was granted the exclusive marketing rights in Canada for a film in which the bankrupt had a hand in creating. Unfortunately, the court declined to answer the question and instead concluded that the contract was binding on the trustee in bankruptcy because it conveyed a proprietary right to MCM:

*Assuming without deciding that a trustee in bankruptcy generally possess a power to disclaim, I hold that the contract in issue here does not fall within the category of executory contracts which may be the subject of disclaimer. Erin Features sold its Canadian marketing rights to the film to MCM and accordingly the Trustee cannot now assert the right to reverse that sale after bankruptcy simply because there is an element of the contract of sale which remains to be carried into operation. [Emphasis added.]*¹⁸

Although the court did not offer much in the way of analysis to support its conclusion that the contract resulted in an assignment of property, its *obiter* comments suggest that a general common law right to disclaim executory contracts of the bankruptcy may exist.

The court's suggestion, and the authorities on which it relies, have been soundly criticized by several commentators. For example, Takach and Hayes¹⁹ refer to the authorities relied on by the court as "dubious" for the following reasons: (1) the comments on the matter of disclaimer contained in the cases cited are largely *obiter*; (2) the cited cases often rely on English cases after the time when English legislation had been amended to expressly provide for a right of disclaimer; (3) it is unclear whether a common law right of disclaimer existed in England prior to such legislation being enacted; and (4) a codified body of law (that is, the BIA) should be interpreted without reference to the pre-existing common law.²⁰

Despite the arguments against a common law right of disclaimer, it still remains for a court to properly consider and decide the issue. If the courts find that there is a common law right of disclaimer, Canada does not have legislation similar to s. 365(n) of the U.S. Code, which permits a licensee, in the event of a rejection of an intellectual property licence agreement, to continue to use the licensed intellectual property rights.

3.1.2.2 Company Creditors Arrangement Act

Like the BIA, the *Company Creditors Arrangement Act*²¹ (CCAA) provides for a formal process under which an insolvent person can propose a plan to strike a balance among the claims of its creditors. While originally limited in its scope, the CCAA process is now available to any insolvent debtor company,²² and its affiliates, provided that the total creditor claims against the company or its affiliates exceed \$5 million.²³ The CCAA process has certain advantages for qualified debtors. They include increased flexibility (that is, there is no mandatory prescribed priority of creditors), less stigma than a bankruptcy process, and, unlike the bankruptcy process, the fact that bankruptcy does not automatically follow a rejection of the proposed arrangement.

As under the BIA, the courts play a supervisory role in the CCAA process, which includes the granting of a stay of proceedings against the debtor and the sanctioning of arrangement with its creditors. In granting stays and making orders under the CCAA, the courts have exercised a very broad jurisdiction. For example, courts have prevented non-creditors who have contracted with the debtor from asserting claims against the debtor for breach of contract.²⁴ Sanctioned plans have also precluded parties to executory contracts with the debtor from terminating, rescinding, or repudiating their obligations following plan implementation.²⁵ Most important for the subject matter of this paper, courts have also approved plans that allow a debtor to unilaterally terminate executory contracts prior to the filing or implementation of a plan of arrangement or compromise.²⁶ As a result, when a licensor seeks to make a plan of arrangement under the CCAA, the continued right of the licensee to use licensed software may be at risk.

3.2 Enforcing Licence Agreement Against Third-Party Assignees

Even if the trustee of a bankrupt licensor does not have the power to disclaim a licence agreement, the licensee's right to continue to use the licensed software may still be at risk. As discussed above, the trustee's prime responsibilities are to dispose of the bankrupt's unencumbered assets and to distribute the proceeds to the bankrupt's creditors. Such assets include the bankrupt licensor's copyright in the software that has been licensed to the licensee. Similarly, if a secured party has a security interest in the licensor's intellectual property rights, such rights may, on default by the licensor, be sold by a receiver appointed by the secured party. This raises the question of whether the third-party assignee of the copyright is bound by the terms of the licence agreement between the licensor and the licensee.

A non-exclusive software licence agreement is described above as a personal contract that, though it relates to copyright, does not grant the licensee a proprietary interest in copyright. If the licensor or its trustee in bankruptcy were to breach the negative covenant not to sue the licensee in copyright, such negative covenant would be enforceable against the licensor in equity through specific performance or the grant of an injunction.²⁷ The assignee of the copyright, however, is not a party to the licence agreement and has made no such negative covenant to the licensee.

Some commentators argue that, in Canada, an assignee of copyright ought to take the copyright free of any personal equities.²⁸ Gold states that, at common law, an equitable right is not enforceable against a purchaser of land for value whether or not the purchaser had actual knowledge of the licence.²⁹ He argues that the same policy considerations that inform the common law with respect to land purchases should also apply with respect to assignments of copyright—namely, that the viability of commercial dealings requires purchasers to have certainty as to title. Gold also argues that the principle of privity of contract requires that benefits or obligations not be imposed on strangers to a contract.³⁰

If this analysis is correct, licensees of copyright in Canada are at a clear disadvantage to licensees of copyright in the United States and the United Kingdom. In the United States, an assignee of copyright acquires title to such copyright subject to all prior licences.³¹ In the United Kingdom, s. 90(4) of the *Copyright, Design and Patent Act 1988*³² provides that a licence granted by the copyright owner will be binding on every successor in title, unless such successor acquired title in good faith for valuable consideration and without notice of the licence.³³

4.0 INSOLVENCY OR BANKRUPTCY OF THE LICENSEE

It is not uncommon for software licence agreements to contain provisions that permit the licensor to terminate the licence agreement in the event that the licensee becomes insolvent or is declared bankrupt. Licensors include such provisions in their licence agreements because they want to be able to terminate the licensee's right to use the software if its ability to pay ongoing licence fees is in question. In addition, the licensor does not want to have to continue providing services, such as technical support, if there are concerns that it will not be compensated for such services.

For the licensee, the termination of a licence to use a software program that is critical to its operations can be devastating to its efforts to reorganize and continue its business. Sections 65.1(1) and 65.1(2) of the BIA offer some relief to insolvent licensees in providing that, where an insolvent person who is a party to a lease or licensing agreement has filed a notice of intention or a proposal,

s. 65.1(1) no person may terminate or amend any licencing agreement with that person, or claim accelerated payment under any agreement with the insolvent person, by reason only that

(a) the insolvent person is insolvent; or

(b) a notice of intention or a proposal has been filed in respect of the insolvent person.

s. 65.1(2)(c) the insolvent person has not paid rent or royalties, as the case may be, or other payments of similar nature, in respect of a period preceding the filing of

(i) the notice of intention, if one was filed, or

(ii) the proposal, if no notice of intention was filed.

As a result, where an insolvent licensee has filed a notice of intention or a proposal, the licensor will not be able to terminate the licence agreement simply because the licensee has failed to make payments prior to the filing or because the licensee is insolvent.

Section 65.1 of the BIA does not, however, prevent a licensor from terminating a licence agreement for reasons other than those set out in that provision. A licensor can also insist on immediate payment for the provision of services and the use of licensed property after the filing.³⁴ Finally, a licensor can also petition the court to suspend the stay provisions if it is likely that they would cause significant financial hardship.³⁵

5.0 PROTECTIVE MEASURES

As discussed in section 3, Canadian legislation and jurisprudence have not decisively addressed the rights of licensees to continue to use licensed software when the licensor becomes insolvent or bankrupt. In addition, it does not appear that a licensee can enforce the licensor's negative covenant against an assignee of the copyright that is the subject matter of the software licence agreement. As a result, licensees have been forced to create their own strategies for protecting their right to continue to use licensed software. In this section of the article, I outline some of these strategies and discuss their effectiveness in addressing the above-mentioned concerns.

5.1 Source Code Escrow, or Trust, Arrangements

Source code escrow, or trust, arrangements (hereinafter referred to as "source code escrow") are designed to provide software licensees with access to, and a licence to use and modify, the source code to the licensed software in the event that the licensor fails to perform its obligations under the licence agreement with respect to the maintenance of the licensed software. Many source code escrow agreements also provide that the licensee will have access to the source code on the occurrence of events, such as the insolvency or bankruptcy of the licensor, that may threaten the licensor's ability to provide maintenance. While primarily designed as a means to provide licensees with the ability to maintain the licensed software, source code escrows have also been advocated as a means by which to protect the licensee's right to continue to use the licensed software upon the insolvency or bankruptcy of the licensor.

Under the terms of a source code escrow, the licensee's right to use the source code is derived from the grant of a licence contained in either the original licence agreement or the source code escrow agreement. In the event of the insolvency or bankruptcy of the licensor, the same risks as outlined in section 3 apply to source code escrow.

First, due to the licensor's ongoing obligation to provide updates to the source code to the escrow agent, the source code escrow agreement is likely to be considered an executory contract. For reasons discussed in section 3, it is not clear whether an executory contract can be disclaimed by the insolvent licensee or its trustee in bankruptcy. Second, even if the source code escrow is enforceable against the insolvent licensor and its trustee in bankruptcy, the licensee must still face the

possibility that the licensor's intellectual property rights in the software will be sold to a third party as part of a restructuring or liquidation of the licensor. For reasons discussed above, it is doubtful that the licence granted to the licensee will bind the assignee of such intellectual property rights.

5.2 Restrictions on Assignment of Copyright

Most software licence agreements contain provisions dealing with the parties' ability to assign their respective rights and obligations to a third party. However, a restriction on the licensor's ability to assign its rights and/or obligations under the licence agreement to a third party does not address concerns regarding the enforceability of the licence against a third-party assignee of the licensor's intellectual property rights in the software.

One possible solution is to include a provision in the licence agreement that prohibits the licensor from assigning any of its intellectual property rights in the licensed software to a third party, unless such third party agrees to be bound by the terms of the software licence agreement. As with the licence itself, such negative covenant can be enforced against the licensor or its trustee in bankruptcy by way of specific performance or injunction. If, however, an assignment has taken place prior to its discovery by the licensee, the licensee will not be able to enforce such a provision against the assignee and will be left only with a claim for damages against the licensor.³⁶

5.3 Right of First Refusal To Purchase Software

To protect itself from the risk that its licence may not be enforceable against an assignee of the licensor's rights in the software, the licensee may insist that, in the event that the licensor or its trustee in bankruptcy wishes to sell the licensor's rights in the software, the licensee shall have the first right of refusal to purchase such rights. Of course, exercising such a right will only be practical in certain situations.³⁷ Care must also be taken to ensure that the right of first refusal is properly constructed so as not to offend laws prohibiting unjust preferences or fraudulent conveyances.³⁸

5.4 Agreement of Secured Party

Licensees should consider conducting personal property and intellectual property searches on the licensor to determine if the licensor has granted security in its rights in the software to any third party. Where such is the case, the licensee should seek assurances from the secured party that it will honour the licence and, in the event that the licensor's rights in the software are sold to a third party, the secured party and its receiver will require the assignee to be bound by the terms of the licence agreement. The licence agreement should also contain a provision that provides that the licensor will not grant security in any of its rights in the software unless the secured party agrees not to disturb the licence.

5.5 Governing Law

With the more certain treatment of the rights of licensees under the U.S. Code, some parties to licence agreements take the view that a Canadian who licenses software from a U.S. licensor will be protected from the uncertainties of Canadian law if the licence agreement is governed by the laws of a U.S. state. While it is true that the insolvency or bankruptcy of a U.S. licensor will be governed by the laws of the U.S. Code, the copyright in the licensed software will be governed by Canadian copyright law. As discussed above, Canadian copyright law does not provide that a third-party assignee of copyright is bound by licences granted by the assignor.³⁹

5.6 Separate Licence Fee from Other Fees

Even if the licence survives the insolvency or bankruptcy of the licensor, it is often the case that the licensor, or its trustee in bankruptcy, will refuse to perform future obligations under the licence agreement, such as technical support and training. If the royalty fee to be paid by the licensee in consideration of the licence is not listed separately from the fees payable in consideration of the licensor's other obligations, the licensee may find that it must pay the entire fee, even though it is not receiving the services for which it bargained.

5.7 Partial Assignment of Copyright

As discussed above, the risks faced by a licensee when the licensor becomes insolvent arise from the nature of the licence itself. Because a non-exclusive licence is based on personal rather than proprietary rights, the enforceability of such personal rights is questionable when the licensor becomes insolvent or bankrupt, or assigns to a third party its rights in the personal property that is the subject matter of the licence. If, however, the licence could be characterized as a proprietary right rather than a personal right, such uncertainty would be erased.

One possible solution is to have the copyright holder grant a partial assignment of the copyright in the software.⁴⁰ As Gold points out, s. 13(4) of the *Copyright Act* provides for the granting of partial assignments that mimic the scope of a licence that would have been used for the same purpose.⁴¹ By making a partial assignment of copyright to the licensee, the licensee could be assured of the continued use of the software, no matter what happens to the remainder of the copyright.

While this proposal best protects the interests of licensees, it will seem radical to most licensors. As a result, unless the licensee has superior bargaining power, most licensors will resist such an approach.

6.0 SUMMARY

Parties negotiating software licence agreements should consider the effects that the insolvency or bankruptcy of the other party may have on their respective rights and obligations. Of particular concern to licensees is the uncertainty regarding the ability of insolvent licensors and their trustees in bankruptcy to terminate or disclaim executory contracts. Equally important is the apparent lack of enforceability of a licence agreement against a third-party assignee of the copyright in the software that is the subject matter of the licence agreement. On the other hand, licensors must be aware that provisions that provide for termination upon the insolvency or bankruptcy of the licensee may not be enforceable in the insolvency or restructuring context.

With these concerns in mind, contracting parties and their counsel should consider the protective measures outlined in section 5, which may help mitigate the risks arising from insolvency or bankruptcy. As noted, however, many of these strategies have their own limitations. As a result, absent statutory reform, licensees in Canada will remain in a precarious position.

ENDNOTES

- 1 In order to use a software program, the user must copy the software to the memory of his or her computer. It is this act of copying that would be illegal if not for the permission granted by the copyright holder. A software licence may also involve other forms of intellectual property, such as patents. Because copyright is the predominant form of intellectual property concerning software, and for simplicity, this paper focuses on issues surrounding copyright.
- 2 See E. Richard Gold, "Partial Copyright Assignments: Safeguarding Software Licensees Against the Bankruptcy of Licensors" (2000), 33 *C.B.L.J.* 194, at 203.
- 3 The exception would be the grant of an exclusive licence (see s. 13(7) of the *Copyright Act*, R.S.C. 1985, c. C-42, as amended). For greater certainty, it is deemed always to have been the law that a grant of an exclusive licence in copyright constitutes a grant of an interest in the copyright.
- 4 *Bankruptcy and Insolvency Act* (BIA), R.S.C. 1985, c. B-3, as amended, s. 2(1):

insolvent person means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and

(a) who is for any reason unable to meet his obligations as they generally become due,

(b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

(c) the aggregate of whose property is not, at a fair valuation, sufficient, or if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.

- 5 *Bankruptcy Code*, 11 U.S.C., s. 365 (2004).
- 6 *Lubrizol Enterprises v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985) (hereinafter *Lubrizol*).
- 7 Vern Countryman, "Executory Contracts in Bankruptcy: Part I" (1973), 57 *Minn. L. Rev.* 439. This test was adopted by the courts in *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513 (1984).
- 8 *Supra* note 6, at 1045.
- 9 *Ibid.*, at 1048. Under 11 U.S.C. §365(g), Lubrizol would be entitled to treat rejection as a breach and seek a money damages remedy; however, it could not seek to retain its contract rights in the technology by specific performance even if that remedy would ordinarily be available on breach of this type of contract.
- 10 *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended.
- 11 BIA, ss. 50 to 66. A proposal is not binding on secured creditors unless a proposal has been made to, and been accepted by, such creditors.
- 12 After a proposal is made, it is voted on by the creditors, and if a majority in number and two-thirds in value of all classes of unsecured creditors vote in favour of the proposal, it is deemed to be accepted. If accepted and approved by the court, the proposal will be binding on all unsecured claims. The proposal will bind only secured creditors to whom a proposal was made and who accepted it.
- 13 BIA, ss. 57(a) and 61(2). Bankruptcy can also occur when the insolvent corporation voluntarily makes an assignment in bankruptcy, or the court issues a receiving order on petition of a creditor.
- 14 BIA, s. 316.
- 15 BIA, s. 65.2 provides that persons who have filed a proposal or a notice of intention to make a proposal with the official receiver may disclaim commercial property leases upon 30 days' notice to the landlord.
- 16 *Stead Lumber Co. v. Lewis* (1956), 13 D.L.R. (2d) 34 (Nfld. S.C.).
- 17 See, for example, Piero Iannuzzi, "Bankruptcy and the Trustee's Power To Disclaim Intellectual Property and Technology Licensing Agreements: Preventing the Chilling Effect of Licensor Bankruptcy in Canada" (2001), 18 *C.I.P.R.* 367, at 377-78. See also *Report of IPIC Licensing Committee: Intellectual Property Licensing Issues in Bankruptcy or Insolvency* (Ottawa: Intellectual Property Institute of Canada, January 30, 2003).
- 18 *Re Erin Features #1* (1991), C.B.R. (3d) 205, at para. 3 (B.C.S.C.).
- 19 For a convincing argument against a common law right of disclaimer, see Gabor G.S. Takach and Ellen L. Hayes, "Case Comment, Re Erin Features #1 Ltd." (1993), 15 C.B.R. (3d) 66.
- 20 *Ibid.*

- 21 *Company Creditors Arrangement Act*, R.S.C. 1985, c. C-36.
- 22 CCAA, ss. 2 and 3.
- 23 CCAA, s. 3(1)
- 24 *Sairex GmbH v. Prudential Steel Ltd.* (1991), 8 C.B.R. (3d) 62 (Ont. Gen. Div.).
- 25 The Amended and Restated Plan of Compromise or Arrangement of The T. Eaton Company Limited and others, dated September 3, 1997.
- 26 T. Eaton Initial CCAA Order.
- 27 *Supra* note 2, at 206.
- 28 *Ibid.* See also Don Johnston, “Source Code Escrow: Giving and Getting Rights” (unpublished), presented at Canadian IT Law Association, IT Law Spring Training II, May 2003.
- 29 *Supra* note 2, at 207.
- 30 *Ibid.*, at 209.
- 31 *Ibid.*, at 209. See, however, Richard M. Cieri and M. Natasha Labovitz, “License Rights: New Threats to Bankruptcy Protection for IP Licensees” (2003), 230 *N.Y.L.J.* (available at http://media.gibsondunn.com/fstore/documents/pubs/NYLJ_Cieri_License_Rights.pdf), where authors argue that s. 365(n) of the U.S. *Bankruptcy Code* may not be sufficient to protect a licensee when the licensor has sold the intellectual property asset that is the subject matter of the licence.
- 32 *Copyright, Design and Patent Act 1988* (U.K.), 1988, c. 48.
- 33 Section 57(3) of the *Copyright Act* provides that “[a]ny assignment of copyright, or any licence granting an interest in a copyright, shall be adjudged void against any subsequent assignee or licensee for valuable consideration without actual notice, unless the prior assignment or licence is registered in the manner prescribed by this Act before the registering of the instrument under which the subsequent assignee or licensee claims.” As Gold states, *supra* note 2, at 204:

Section 57(3) merely states that a first assignee or licensee has no priority over subsequent assignees or licensees who were first to register; the section does not tell us that registration, by itself, is sufficient to create a right enforceable against subsequent assignees and licensees.
- 34 BIA, s. 65.1(4).
- 35 BIA, s. 65.1(6).
- 36 *Supra* note 2, at 217.
- 37 For example, in a corporate spinoff situation, where the original corporation has retained ownership to certain software for use in its own business but, as part of the spinoff, has granted the new corporation a licence to use the software.

- 38 See *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29; *Assignment and Preferences Act*, R.S.O. 1990, c. A.33; and the settlement provisions of the settlements and preference provisions of the BIA, ss. 91 to 93.
- 39 *Supra* note 2, at 225-28.
- 40 *Ibid.*, at 218-28.
- 41 *Ibid.*, at 218.