International Corporate Rescue

ChaseCambria
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Centre for Commercial Law
UCL LAWS

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2014 (6 issues)
Print or electronic access:
EUR 695.00 / USD 845.00 / GBP 495.00
VAT will be charged on online subscriptions.
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International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

Jaffé v Samsung Electronics Co., Ltd.: Exploring the Limits of 'Additional Relief' and 'Additional Assistance' under Chapter 15 of the US Bankruptcy Code

Michael D. Good, Managing Principal, South Bay Law Firm, Torrance, California, USA

Chapter 15 of the US Bankruptcy Code is drafted to provide administrators of non-US insolvency proceedings considerable latitude in seeking and obtaining assistance from US Bankruptcy Courts. Beyond the relief that follows automatically with recognition of such proceedings in US courts, both sections 1507 and 1521 of the Bankruptcy Code make 'additional relief' or 'special assistance' available for the administration of such proceedings.

But this assistance is not without its limits: Sections 1507[1] and 1522[2] each condition the Court's provision of 'additional assistance' on the requirement that the Court provide appropriate 'protection' for creditors of the non-US debtor. Section 1506 separately permits US Bankruptcy Courts to refuse relief 'if [that relief] would be manifestly contrary to the public policy of the United States'.[3]

The latter section (section 1506) is known colloquially as chapter 15's 'public policy exception', and its application remains somewhat unclear. At least two appellate courts have found, under differing circumstances, that it *does not* apply;[4] but to date, no appellate decision has found that it *does*. The Fourth Circuit Court of Appeals, however, has at least added to the growing discussion surrounding section 1506. *Jaffe v Samsung Electronics Co., Ltd.*,[5] though decided on other grounds, nevertheless provides food for thought on how sections 1507 and 1522 may – or may not – work together with section 1506 to impact the 'additional relief' and 'additional assistance' otherwise available to administrators under chapter 15.

Background: the German insolvency proceeding of Qimonda AG

Qimonda AG (Qimonda), a producer of Dynamic Random Access Memory (DRAM) chips, also held a portfolio of approximately 10,000 patents. Approximately 4,000 of these were of US origin.

Qimonda's patents were subject to cross-licensing agreements with a number of other semiconductor manufacturers. These agreements were 'common in the semiconductor industry to avoid infringement risks caused by the "patent thicket" resulting from the overlapping patent rights of some 420,000 patents in the semiconductor industry'.[6]

During 2007 and 2008, prices for PC-based DRAM technology collapsed. Despite efforts to restructure, Qimonda entered German insolvency proceedings in January 2009. The Munich court overseeing the proceeding appointed Dr Michael Jaffé as Qimonda's insolvency administrator. Dr Jaffé subsequently sought and obtained recognition for Qimonda's German insolvency proceeding in the United States under Chapter 15 of the US Bankruptcy Code.

Dr Jaffé's proposed worldwide treatment of Qimonda's cross-licensing agreements

Contemporaneously with Quimonda's Chapter 15 proceeding, Dr Jaffé sent letters to licensees of Qimonda's

Notes

1 11 USC § 1507.
2 11 USC § 1522.
3 11 USC § 1506.
4 *See In re Fairfield Sentry Ltd.*, 714 F.3d 127, 140 (2d Cir. 2013) (appealing creditor 'cannot establish that unfettered public access to court records is so fundamental in the United States that recognition of [a] BVI liquidation [in which court record access restricted] constitutes one of those exceptional circumstances contemplated in Section 1506'); *In re ABC Learning Centres Ltd.*, 728 F.3d 301, 311 (3d Cir. 2013) (refusing to find an Australian winding up proceeding contravened American public policy where, under Australian law, secured creditors were permitted to satisfy their claims directly from collateral, then turn the excess proceeds over to the debtor) ('Australian legislators selected a different method to prioritize secured creditors. Rather than manifestly contravene our policy, Australian law established a different way to achieve similar goals. Recognition of the Australian liquidation proceeding does not manifestly contravene public policy'.).
5 737 F.3d 14 (4th Cir. 2013).
6 737 F.3d at 17.

patents under its cross-licence agreements, declaring that, under § 103 of the German Insolvency Code, the licences granted under Qimonda patents (including the licences under the company's 4,000 U.S. patents) 'are no longer enforceable'. As Dr Jaffé later indicated to the bankruptcy court, he intended to re-license Qimonda's patents for the benefit of Qimonda's creditors, replacing licences paid for in-kind with cross-licences with licences paid for with cash through royalties.[7]

Both the German Insolvency Code and the US Bankruptcy Code address the administration of executory contracts. But each statute addresses executory contracts differently.

At the time of Qimonda's insolvency, the German Insolvency Code offered the intellectual property licensees of a bankrupt licensor no protection against a decision, by the administrator of the bankrupt licensor, not to perform under an intellectual property licence. Section 103 of that statute instead simply provided that the administrator may (i) elect performance of contractual obligations; or (ii) elect non-performance, thereby affirming that the licence remains unenforceable against the estate.

By contrast, the US Bankruptcy Code – specifically, section 365(n) – limits a trustee's ability to reject unilaterally licences of the debtor's intellectual property by giving non-debtor licensees the option to retain their rights under those licences.

The US Bankruptcy Court's reaction to Dr Jaffé's proposed treatment of Qimonda's cross-licensing agreements

Predictably, these differences in German and American treatment of intellectual property licences ultimately generated different results in German and American insolvency courts. While the Munich court overseeing Qimonda's main proceeding authorised Dr Jaffé's approach to monetising Qimonda's intellectual property assets, the US Bankruptcy Court ultimately[8] conditioned this relief with the additional requirement that Dr Jaffé afford the licensees of Qimonda's US patents the treatment they would have received in the United States under section 365(n).

The US Bankruptcy Court's reasons for imposing this requirement were rooted in the interaction between domestic US insolvency law and the US Bankruptcy Code's cross-border provisions:

> 'After balancing the interests of Qimonda's estate with the interests of the licensees of its [US] patents, the bankruptcy court concluded that the application of [Bankruptcy Code section] 365(n) was necessary to ensure, as required by [section] 1522(a) [of chapter 15 of the Bankruptcy Code], that the licensees were "sufficiently protected," even though it would adversely affect Qimonda's [German bankruptcy] estate. The bankruptcy court also concluded, pursuant to [Bankruptcy Code section] 1506, that allowing [Dr.] Jaffé to cancel unilaterally Qimonda's licenses of U.S. patents "would be manifestly contrary to the public policy of the United States," recognizing "a fundamental U.S. public policy promoting technological innovation," which would be undermined if it failed to apply [section] 365(n) to the licenses under Qimonda's U.S. patents.'[9]

Dr Jaffé's appeal, and the Fourth Circuit's ruling

Dr Jaffé sought, and was granted, a direct appeal of the US Bankruptcy Court's ruling to the Fourth Circuit Court of Appeals. In that appeal, he argued that the lower court erred in its construction of Chapter 15 and abused its discretion in applying it.

Dr Jaffé's appeal was based on three primary arguments, which the Court of Appeals addressed in turn:

– Dr Jaffé argued, first, in essence, that the Bankruptcy Court should not have imposed the conditions of section 365 upon him where Dr Jaffé had not first requested relief under that section. The Court of Appeals, while acknowledging the narrow scope of Dr Jaffé's request, also noted that relief had been sought under section 1521, which is discretionary in nature – and which is limited by section 1522's the requirement that the Bankruptcy Court ensure sufficient protection of the creditors and the debtor.[10]

Notes

7 *Ibid.*

8 In fact, the US Bankruptcy Court addressed this issue twice, initially ruling in Dr Jaffé's favor without reference to Section 1506. *In re Qimonda AG*, 2009 WL 4060083 (Bankr. E.D. Va. Nov. 19, 2009). On appeal, however, the US District Court remanded this ruling for a specific consideration of whether the 'public policy' exception applied. *In re Qimonda AG Bankr. Litig.*, 433 B.R. 547 (E.D. Va. 2010). Following a four-day bench trial on remand, the Bankruptcy Court found that, in fact, the 'public policy' exception precluded the relief Dr Jaffé requested, and therefore limited that relief by imposing the protections of Bankruptcy Section 365(n). *In re Qimonda AG*, 462 B.R. 165 (Bankr. E.D. Va. 2011). The District Court certified Dr Jaffé's subsequent appeal directly to the Fourth Circuit of Appeals. *In re Qimonda AG*, 470 B.R. 374 (E.D. Va. 2012).

9 737 F.3d 14, 18 (4th Cir. 2013)

10 737 F.3d at 26.

– Second, Dr Jaffé contended that the Bankruptcy Court's application of section 365 was, in any event, analytically flawed: According to him, any 'creditors' protection' triggered by section 1521 was merely procedural, not substantive. Creditors, he argued, ought to be able to participate in Qimonda's cross-border bankruptcy process on an equal footing – but that 'equal footing' did not permit certain (US) creditors to avail themselves of substantive protections unique to US law. Dr Jaffé suggested that in its desire to provide 'sufficient protection' for Qimonda's US creditor-licensees, the US Bankruptcy Court had in fact provided comparatively *less* protection to their German counterparts.

  Recognising both the logic of Dr Jaffé's argument and the fundamentally 'universalist' nature of the UNCITRAL Model Law on Cross–Border Insolvency (on which chapter 15 of the US Bankruptcy Code is based), the Fourth Circuit nevertheless pointed out that the Model Law's drafters specifically contemplated the imposition of discretionary safeguards designed '*to ensure the protection of local interests* before assets are turned over to the foreign representative'.[11] The Fourth Circuit elaborated:

  > 'The [Model Law's] Guide to Enactment separately indicates that [Model Law] Article 22 is designed to "protect the interests of the creditors (in particular local creditors), the debtor and other affected persons." ... Finally, the Guide states, "*[i]n addition to [Article 22's] specific provisions*," Article 6 of the Model Law "*in a general way* provides that the court may refuse to take an action governed by the Model Law if the action would be manifestly contrary to the public policy of the enacting State." *Id.* ¶ 36, at 314 (emphasis added). Informed by the [Model Law] Guide to Enactment's description of the relationship between Articles 22 and 6 of the Model Law (§§ 1522 and 1506 in the U.S. Bankruptcy Code), we do not share [Dr.] Jaffé's view that § 1506's public policy exception forecloses use of a balancing analysis under § 1522 ... And we also agree that § 1506 is an additional, more general protection of U.S. interests that may be evaluated apart from the particularized analysis of § 1522(a). In reaching this conclusion, we join the Fifth Circuit, which interpreted § 1522(a) similarly, based largely on the language in the Guide to Enactment. *See In re Vitro S.A.B. de C.V.*, 701 F.3d 1031, 1060, 1067 n. 42 (5th Cir.2012); *see also In re Int'l Banking Corp. B.S.C.*, 439 B.R. 614, 626–27 (Bankr.S.D.N.Y.2010); *In re Tri–Cont'l Exch. Ltd.*, 349 B.R. 627, 637 (Bankr.E.D.Cal.2006).'[12]

– Third (and finally), Dr Jaffé claimed that whatever analytical merit the Bankruptcy Court's application of section 365 may have had, that Court gave undue deference to 'the risk to the [US] Licensees' investments made in reliance on the cross-license agreements ...'.[13] This argument was essentially an economic one based on the structure of Qimonda's industry: The patent licences at issue, Dr Jaffé claimed, were little more than insurance against future litigation. Because the semi-conductor industry is one in which manufacturers enter into cross-licensing agreements primarily to afford themselves appropriate design freedom and to avoid the risk of subsequently infringing on one another's work, Dr Jaffé argued that the 'protection' sought by US licensees was, in fact, protection against nothing but purely speculative, future potential harm.

  The Fourth Circuit refused to gainsay the Bankruptcy Court, noting that the trial judge had arrived at an assessment of the parties' relative harms after four full days of evidence on the issue:

  > 'We find the bankruptcy court's thorough examination of the parties' competing interests to have been both comprehensive and eminently reasonable ... At bottom, we affirm the decision of the bankruptcy court, finding reasonable its exercise of discretion in conducting the balancing analysis under § 1522(a) and concluding that attaching the protection of § 365(n) was necessary when granting [Dr.] Jaffé the power to administer Qimonda's U.S. patents. *See In re Vitro S.A.B. de C.V.*, 701 F.3d at 1069 (noting in the course of affirming a bankruptcy court's decision not to enforce the reorganization plan adopted in a foreign main proceeding that "[i]t is not our role to determine whether the above-summarized evidence would lead us to the same conclusion" and adding that "*[o]ur only task is to determine whether the bankruptcy court's decision was reasonable*" (emphasis added)).'[14]

Notes

11 737 F.3d at 28 (internal quotations omitted, emphasis in original).
12 737 F.3d at 28-29.
13 737 F.3d at 29 (emphasis in original).
14 737 F.3d at 30-31.

The lessons of *Jaffé*

In *Jaffé*, the Fourth Circuit Court of Appeals – like the Fifth Circuit Court of Appeals in an earlier decision[15] – confined itself to provisions of chapter 15 other than section 1506's 'public policy exception'. This is due, at least in part, to the fact that the appellants in both cases confined *themselves* to grounds of appeal other than this statute.

Nevertheless, *Jaffé* helps shed further light on the 'additional assistance' available to administrators under chapter 15. Specifically, *Jaffé* further highlights a growing tension between the 'sufficient protection for creditors' standard of section 1507 and 1522, on the one hand, and section 1506's 'manifestly contrary to public policy' standard on the other: It is unclear how these two standards work together – or if they should work together at all.

On the one hand, some observers have suggested that section 1506 imposes a sort of 'outer limit' to the Bankruptcy Court's discretion in providing 'additional assistance' to administrators, while sections 1507 and 1522 further limit that discretion.[16] Those same observers have wondered aloud whether this construction is really correct, noting in particular that if sections 1507 and 1522 are truly as restrictive as the Circuit Courts have read them to be, section 1506's 'outer limit' is effectively an irrelevancy.[17] Others have wondered whether *Jaffé* (and the Fifth Circuit's decision in *Vitro*) signals courts' willingness to use sections 1507 and 1522 to 'import' other provisions from the US Bankruptcy Code wholesale into the provisions of chapter 15.[18]

Proponents of the more restrictive view of sections 1507 and 1522 would likely very deny such a tension. But as of this writing, those proponents are not relying on the power of debate. They have gone directly to the US legislature:

> '[O]n December 5, the House of Representatives passed the Innovation Act, H.R. 3309. That bill would add a new section (e) to section 1522 and apply section 365(n) to all Chapter 15 cases. While both solutions protect licensees of intellectual property, the difference between the two approaches is that the judicial approach involves the exercise of discretion whereas the legislative one imposes an absolute rule.'[19]

A similar bill has been introduced in the US Senate. Meanwhile, the proper application of section 1506 remains unclear. Though no court has discussed it, it is noteworthy that section 1506, on its face, appears drafted not to *limit* otherwise *permissible* actions, but instead to *exempt* Bankruptcy Courts from otherwise *mandatory* relief:

> 'Nothing in this chapter *prevents the court from refusing to take an action governed by this chapter* if the action would be manifestly contrary to the public policy of the United States.'[20]

Under this alternative reading, it is at least arguable that section 1506 is *not* an 'outer limit' to the 'additional assistance' provisions of section 1507 and 1522 – and, in fact, does not necessarily interact with those statutes at all. Rather, it is a 'release valve' to be used in the event chapter 15's mandatory provisions (e.g., 1509(c), 1513, 1517, 1520) bring federal law into direct conflict with clear national interests.

Notes

15 *See In re Vitro S.A.B. de C.V.,* 701 F.3d 1031, 1069-70 (5th Cir.2012) (upholding Bankruptcy Court's refusal to enforce judgment entered by Mexican court confirming a Mexican *Concurso* plan, but refusing to find that the plan ran afoul of section 1506's 'public policy exception') ('As already discussed, this court holds that the Bankruptcy Code precludes non-consensual, non-debtor releases. … Nevertheless, not all our sister circuits agree, and we recognize that the relief potentially available under § 1507 was intended to be expansive. At the same time, § 1506 was intended to be read narrowly, a fact that does not sit well with the bankruptcy court's broad description of the fundamental policy at stake as 'the protection of third party claims in a bankruptcy case'. Because we conclude that relief is not warranted under § 1507, however, and would also not be available under § 1521, we do not reach whether the *Concurso* plan would be manifestly contrary to a fundamental public policy of the United States'.).

16 Prof. G. Ray Warner, *Is Section 1506 Manifestly Irrelevant?*, Nat'l. Law Rev., December 20, 2013 (Westlaw cite: 2013 WLNR 31808849) ('In addition to the outer limit set by section 1506, Chapter 15 sets a more restrictive standard for the court's exercise of discretion'.).

17 *Id.* ('One might wonder whether the recent Court of Appeals decisions interpreting Chapter 15 have read section 1506 out of the law because they seem to reject the application of foreign bankruptcy principles based on a simple balancing test, rather than rejecting only those requests that are "manifestly contrary to the public policy of the United States" as section 1506 suggests'.).

18 George Shuster and Benjamin W. Loveland, *In re Qimonda AG: Fourth Circuit Upholds US Patent Licensee Protections In Chapter 15 Cross-Border Bankruptcy Case*, Mondaq, December 20, 2013 (Westlaw cite: 2013 WLNR 31820600) ('It remains to be seen whether other courts outside the Fourth Circuit will follow [Jaffé], and whether courts in and outside the Fourth Circuit will limit the application of the Fourth Circuit's ruling to the narrow circumstances at issue in [Jaffé], or whether they will view the holding more broadly as support for applying Section 365(n) in other contexts (because the Section 1522(a) balancing of interests is a fact-based exercise). It is also possible that courts could view the decision as support for imposing on foreign representatives other US Bankruptcy Code provisions-such as lessee protections under Section 365(h) or even the absolute priority rule under Section 1129(b) – that may also be deemed necessary to satisfy Section 1522(a)'s balancing of interests'.).

19 *Overkilling Qimonda*, Legal Monitor Worldwide, January 18, 2014 (Westlaw cite: 2014 WLNR 1563626).

20 11 U.S.C.A. § 1506 (emphasis supplied).

Conclusion

With one statute (section 1522) subject to possible amendment, and another (section 1506) left unapplied by any appellate court, the extent of 'assistance' available to foreign administrators through US courts remains a matter of evolving decisional law. *Jaffe v Samsung Electronics Co., Ltd.* offers important insights which will help to shape that evolution.

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