

How to Protect Your IP When Your Licensee is Facing Financial Difficulties

by *Edmund J. Walsh*

In the current economic times, there may be many companies pondering the question: “My licensee may be facing financial difficulties, but what can I do to help protect my IP?”

Is Termination Best Approach?

If you have a financially distressed licensee, the first step is deciding whether to terminate the license. A distressed licensee can devalue your IP and limit your ability to grant licenses to other, potentially better performing parties. If the license is exclusive, all avenues to monetize the IP may be blocked. Even if not exclusive, other existing or future licensees may be deterred from paying because they would be disadvantaged in competing with a licensee who is not paying.

Additionally, it may be important to terminate if the licensee’s precarious position creates a risk that competitors to whom you would never have licensed could get access to your technology through voluntary M&A activity or bankruptcy. This may be particularly important where trade secrets are involved, although courts in some states will issue orders protecting trade secrets to prospectively block such harmful releases of trade secrets.

If termination is necessary, be vigilant in complying with any pre-termination requirements. Plan ahead before bankruptcy looms, as a bankruptcy filing prior to effective termination can limit your ability, at least temporarily, to terminate. Don’t rely on provisions

for automatic termination of the license upon insolvency or bankruptcy, as bankruptcy law protects the debtor, making such provisions difficult or impossible to enforce.

Once the license is terminated, approach any money owed as any other unsecured creditor, possibly even filing a collection suit. Be aware, however, that such a suit carries a risk the licensee may challenge the validity of the licensed IP. If the licensee cannot pay, such a suit may only make a bad situation worse.

Other Approaches

If the licensee is not technically in default, buying back the license or even acquiring the licensee may be either an opportunity or a necessity.

Conversely, if you want the license to continue, the normal rules of dealing with distressed parties apply, such as making collections promptly. In addition, pushing the licensee into bankruptcy may force the trustee to ratify the license, giving you a better chance to collect post bankruptcy royalties—though there are costs and pitfalls to weigh.

Opportunity to Renegotiate License

The licensee’s default may provide leverage to renegotiate, gaining protections from the licensee or other creditors. You might obtain a high priority security interest in the proceeds of licensed sales or a right to terminate if the licensee’s sales slip below some

floor. In some circumstances, more creative options may be possible, such as restructuring the transaction so you sell and receive payment for the licensed product, with the licensee as a supplier.

To avoid the license passing to an undesirable party, negotiate a fixed end date, subject to renewals of a limited term if you approve of the licensee’s status at renewal. You may be able to negotiate a right-of-first refusal to buy the licensee or non-transferability and change of control provisions to hinder the bankruptcy court in selling the license with the company. You can also seek greater control over the licensee’s handling of trade secret information.

In these harsh times, licensors should review their licenses and take protective action.



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