

THE IP BANKRUPTCY TRIFECTA: New York–Focused White Paper

Understanding the Impact of Bankruptcy Law on Intellectual Property in the Second Circuit

Executive Summary

Intellectual property (IP) is often central to maintaining enterprise value during distressed sales and bankruptcy proceedings. In New York, a jurisdiction known for its IP-intensive restructurings, the interplay between three key Bankruptcy Code provisions—§365(a), §365(n), and §363(f)—is decisive in shaping outcomes for licenses, know-how, trademarks, and other technology assets. Collectively known as the “IP Bankruptcy Trifecta,” these provisions dictate whether buyers can acquire assets unencumbered, whether licensees can retain essential rights, and how debtors can maximize the value of the bankruptcy estate.

This white paper explains how the Trifecta operates within the Second Circuit, referencing leading cases such as Orion, Gucci, Dish, and Motors Liquidation. It highlights pivotal moments in which timing and statutory limitations exert a substantial financial impact and provides practical strategies for legal practitioners managing New York-based bankruptcy cases.

1. The IP Bankruptcy Trifecta

The Trifecta consists of three sequential provisions in the Bankruptcy Code:

- §365(a): Permits the debtor to reject executory contracts, which can include IP licenses.
- §365(n): Grants licensees the right to elect to retain rights to statutory intellectual property after a contract is rejected.
- §363(f): Enables debtors to sell assets “free and clear” of interests, which can, depending on the case venue, extinguish certain license rights.

This framework determines the fate of valuable IP assets in bankruptcy, including whether licensees can continue using the IP and whether buyers can acquire assets free of encumbrances.

2. Trap 1: The Rejection Maneuver (§365(a))

The ability to reject executory contracts under §365(a) immediately reshapes the operational landscape, defining which aspects of a license will persist. Under the Supreme Court’s *Tempnology* decision, rejection of a contract is treated as a breach, not a rescission. In the Second Circuit, the Orion case provides significant deference to the debtor’s business judgment regarding rejections. While rights protected by §365(n) survive, obligations requiring ongoing performance by the debtor do not. This distinction can greatly influence leverage at the start of a bankruptcy process.

Key Takeaway: Licensees in New York must quickly determine which rights are vested, which require ongoing performance, and which are not covered by §365(n).

3. Trap 2: The Know-How Gap (§365(n) Limits)

A critical limitation of §365(n) covers only statutory intellectual property as defined in §101(35A) of the Bankruptcy Code. Many assets essential to technology operations, including know-how, improvements, standard operating procedures, regulatory files, pending applications, foreign patents, and manufacturing protocols, are not protected by §365(n). This “Know-How Gap,” highlighted in the Spansion case and reinforced by New York courts’ narrow interpretation of the statute, gives debtors considerable leverage after rejection.

To address this risk, parties should consider Know-How Escrow Agreements. These agreements must be structured to survive bankruptcy and avoid classification as a §547 preference, thereby ensuring the continuity of the technical inputs required for the licensed field.

Key Takeaway: In New York, licensees should focus on securing continuity of know-how as a pre-filing measure, rather than relying on arguments made after the bankruptcy filing.

4. Trademark Quality-Control Crisis

A significant unresolved issue exists where trademark law and bankruptcy law intersect. Trademarks are excluded from §365(n), meaning that after contract rejection, the licensor’s obligation to supervise product or service quality ceases. This creates a risk of “naked licensing,” which can lead to trademark abandonment under the Lanham Act. In the Gucci case, the Second Circuit permitted a free-and-clear sale of trademark assets without resolving the quality-control dilemma, leaving uncertainty about the enforceability of trademark rights after a sale.

To protect both the bankruptcy estate and asset buyers, practitioners should ensure that debtor-in-possession and sale orders designate a Quality-Control Successor responsible for ongoing oversight of trademark quality.

Key Takeaway: When transferring trademark assets in New York, explicit quality-control provisions must be included in the sale documentation.

5. Trap 3: The Sale Sequence Trap (§363(f))

Sequencing errors can cause the loss of license rights before contract rejection is even considered. The Seventh Circuit’s Precision Industries decision treats licenses as “interests” that can be extinguished in a free-and-clear sale under §363(f). This creates a risk that the licensee’s rights may be eliminated by a sale occurring before contract rejection.

In New York, the Dishi case holds that specific statutory protections (such as those in §365(n)) take precedence over §363(f). Although Dishi addressed §365(h), its logic supports the protection of rights vested under §365(n) in a sale context¹. However, because Tempnology did not address §363(f), a circuit split remains on this issue.

¹ Note: While *Dishi* remains good law on the proposition that §365(h) protections take precedence over §363(f), the U.S. Bankruptcy Court for the Southern District of New York recently

Key Takeaway: New York provides greater protection for licensees than the Seventh Circuit, but the timing and drafting of sale orders are still crucial.

6. Case Study: Omega–Novo (New York Example)

A recent New York restructuring (with identifiers altered for confidentiality) illustrates how proactive management of the IP Bankruptcy Trifecta can preserve enterprise value:

- Path 1: Pre-filing cleanup and negotiated termination maintained the full value of intellectual property, prevented the need for a §365(n) election, and enabled a sale to close within 45 days, protecting an estimated 10–20% of enterprise value.
- Path 2: If a rejection scenario had occurred, the pool of potential buyers would have narrowed, §365(n) would have been triggered, the closing would have been delayed by three to six months, and the valuation would have suffered significantly.

7. Strategic Imperatives for New York Practitioners

- Conduct a pre-filing IP audit distinguishing statutory from non-statutory assets.
- Draft §365(n)-compliant agreements that include escrow structures and release mechanisms for improvements.
- Object to pre-rejection sales that lack explicit language preserving §365(n) rights.
- Include quality-control successor provisions when transferring trademark assets.
- Ensure early collaboration among IP, commercial, and bankruptcy counsel.

Conclusion

New York case law offers several protective mechanisms for handling IP in bankruptcy, but their effectiveness depends on timing and careful drafting. Proactive management of the IP Bankruptcy Trifecta is necessary to ensure that technology assets are transferred efficiently and retain their value in bankruptcy proceedings.

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End Notes

- *Orion Pictures Corp. v. Showtime Networks, Inc.*, 4 F.3d 1095 (2d Cir. 1993)
- *In re Gucci*, 105 F. App'x 223 (2d Cir. 2004)
- *Dishi & Sons v. Bay Condos LLC*, 510 B.R. 696 (S.D.N.Y. 2014)
- *In re Motors Liquidation Co.*, 829 F.3d 135 (2d Cir. 2016)

rejected *Dishi*'s narrow interpretation of §363(f)(5) in *In re Urban Commons 2 West LLC*, 668 B.R. 42 (Bankr. S.D.N.Y. 2025). The *Urban Commons* court noted that although *Dishi* (a district court decision) has 'significant precedential weight,' bankruptcy courts in the Second Circuit are not bound to follow it, and adopted a broader 'realistic possibility' standard for determining when interests can be extinguished under §363(f)(5). This development suggests that the interplay between §363(f) and specific statutory protections like §365(n) remains an evolving area of law in New York bankruptcy courts.

- Mission Product Holdings v. Tempnology, LLC, 139 S.Ct. 1652 (2019)
- In re Spansion, Inc., 2010 WL 2905001 (D. Del. July 19, 2010)
- Precision Indus., Inc. v. Qualitech Steel SBQ, LLC, 327 F.3d 537 (7th Cir. 2003)