Use that non-exclusive license to control your supplier's Chapter 11 bankruptcy restructuring

Stephen M. Gross | Tuesday, March 3, 2020

The changes and issues facing both the automotive and aerospace industries are beginning to be felt in their supply bases, especially at the Tier 2, Tier 3, and lower levels. In aerospace, production is being slowed or put on hold due to the 737 Max situation. In automotive, tariffs and other issues—such as the coronavirus—have interrupted the flow of raw materials component parts and led to increased prices. This is occurring while the auto industry dramatically changes the parts required to produce vehicles as the industry moves to electric and more automated vehicles. When combined with the over-leveraged balance sheets many suppliers are facing, it is only a matter of time until some suppliers in the auto and aerospace industries are forced to seek bankruptcy protection under Chapter 11. When this happens, a little known section of the Bankruptcy Code, when combined with the standard terms and conditions of most purchase orders, can give the customer a formidable weapon to influence the supplier's restructuring or sale in a way that significantly benefits the customer.

In the aerospace and auto industries, customers typically grant their suppliers a non-exclusive license to use the customer's technology, processes, and tooling to produce parts for the customer. This makes these contracts far different than the usual supply contracts in a bankruptcy case. Typical supply contracts can be assumed (retained) by the supplier and assigned (sold) even where the non-debtor counterparty objects, so long as the supplier or assignee can provide adequate assurance that it will cure defaults promptly and can perform under the supply contract into the future. But section 362(c)(1) of the Bankruptcy Code has been held by a majority of the relevant courts to apply to non-exclusive license agreements in a way that prohibits the assumption **or** assignment of the supply contracts with non-exclusive licenses of intellectual property unless the non-debtor counterparty consents. Period.

In other words, a supplier seeking to keep (or sell) a contract with a non-exclusive license cannot do so unless the customer consents. The customer can withhold consent for any or no reason. If the outstanding purchase order or long term contract is necessary to the supplier's viability, this provides significant leverage over the other constituents, including lenders that are underwater. This leverage can be used by the customer to renegotiate terms, to terminate the agreement if the customer desires to move the work, or simply to end the relationship with the supplier.

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