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Mallinckrodt Ruling Holds Creditor Lessons for IP Sellers

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In late December, the U.S. District Court for the District of Delaware issued an opinion in In re: Mallinckrodt PLC affirming the Mallinckrodt[1] bankruptcy court's November 2021 decision that the debtor could discharge certain post-petition, post-confirmation royalty obligations for the sale of the company's Acthar gel.

The district court's affirmation serves as a reminder to holders of intellectual property that a debtor's fresh start under the U.S. Bankruptcy Code could trump royalty obligations that are found to be contingent claims arising as of the time of the transaction.

Parties should heed the district court's warning and give careful consideration when crafting corporate transactions to protect their rights to future payments.

As background, in 2001, Mallinckrodt and Sanofi-Aventis U.S. LLC executed an asset purchase agreement under which Sanofi sold Mallinckrodt certain intellectual property, including trademarks and regulatory rights, relating to Acthar gel, a therapeutic treatment for inflammatory and autoimmune conditions.

As a component of the purchase price, Mallinckrodt agreed to pay Sanofi annual royalties equal to 1% of all Mallinckrodt's net sales of Acthar gel that exceeded $10 million per year.

On Oct. 12, 2020, Mallinckrodt filed for Chapter 11 bankruptcy protection in the U.S. Bankruptcy Court for the District of Delaware, seeking to resolve several billion dollars of legal liabilities related to the opioid epidemic and Acthar gel rebates.[2]

One year into the bankruptcy, Sanofi filed a motion seeking a determination that either the asset purchase agreement was not executory and Mallinckrodt could not discharge the royalty payment obligations under the asset purchase

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agreement in its Chapter 11 cases, or, in the alternative, if the asset purchase agreement was executory and Mallinckrodt did reject it, Mallinckrodt could no longer sell Acthar gel.

On Nov. 8, 2021, the bankruptcy court held that the asset purchase agreement was not executory, but that claims for post-petition breaches of the asset purchase agreement, including for Mallinckrodt's failure to pay any royalties to Sanofi as a component of the purchase price, constituted prepetition unsecured claims that are dischargeable upon confirmation of Mallinckrodt's Chapter 11 plan.

Sanofi appealed the bankruptcy court's ruling. On appeal to the district court, U.S. Circuit Judge Thomas L. Ambro of the U.S. Court of Appeals for the Third Circuit, sitting by designation, focused on two questions:

- Are Sanofi's claims for post-petition royalties dischargeable in Mallinckrodt's bankruptcy because they were contingent claims that arose when the asset purchase agreement was executed preprepetition; and
- Alternatively, does Sanofi retain a property interest in the Acthar gel intellectual property requiring Mallinckrodt to pay royalties when it sells the Acthar gel post-petition and post- confirmation?

In its analysis of the dischargeability issue, the district court began with a strict textual examination of the Bankruptcy Code, beginning with Section 1141(d)(1)(A), which provides that a plan of reorganization "discharges the debtor from any debt that arose before the date of such confirmation."[3]

The Bankruptcy Code defines "debt" as a "liability on a claim" and, in turn, a "claim" is defined therein as a "right to payment whether or not such right is reduced to judgment, liquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[4]

The district court concluded that the plain text of the Bankruptcy Code supported the conclusion that "a contingent right to payment arising before the date of a plan's confirmation may be discharged by that confirmation."[5]

Despite the clarity of the statutory text, however, the district court also engaged in a survey of case law regarding the dischargeability of unliquidated or contingent future claims under the Bankruptcy Code.

Analogizing to case law involving injuries related to asbestos exposure, the district court first adopted an expansive view of dischargeability to include unliquidated future claims.[6] Applying this framework, the district court found Sanofi's royalty obligations to be clearly contingent, despite the fact that their contingent nature depended in part on Mallinckrodt's action or inaction.[7]

The district court then proceeded to analyze whether Sanofi's royalty claims arose at the time of the signing of the asset purchase agreement, or,

alternatively, if and when the requisite Acthar gel intellectual property sales threshold was reached each year.

Looking to case law providing that claims for indemnity under an indemnification agreement arise at the time the agreement is signed, and not over time, the district court summarized its analysis by concluding that context is important.[8]

Here, the district court found the contextual application to be straightforward:

Sanofi's contingent claim for future royalties arose at the time of the sale of the Acthar Gel [intellectual property] under the asset purchase agreement. It is at that moment the parties fixed their rights against each other: Sanofi sold full title to the intellectual property, it received a right to future contingent payments in return, and having done so, it assumed the risk of Mallinckrodt's creditworthiness.[9]

Regarding whether Sanofi retained a nonseverable property interest in the Acthar gel intellectual property requiring Mallinckrodt to pay royalties post-confirmation, the district court declined to adopt Sanofi's theory.

Sanofi argued that the language in the asset purchase agreement providing that the sale of the intellectual property was "subject to the terms and conditions of the [asset purchase agreement]," including the royalty obligations, created a property interest similar to a covenant "running with the land."

The court swiftly disagreed, finding that even if such a property right in intellectual property could theoretically be created, the boilerplate language of the asset purchase agreement did not do so.

Mallinckrodt reinforces the need for sellers of intellectual property to bolster their creditor status with respect to purchasers in the event they file for bankruptcy. As the court pointed out in its conclusion, any question of fundamental fairness is two-sided.

While it may be arguably unfair to allow a purchaser to continue to sell an entity's intellectual property without paying royalties, allowing royalties to survive discharge in contravention of the Bankruptcy Code would bestow sellers with "special treatment over other unsecured creditors for which [the sellers] did not bargain."[10]

On Jan. 17, Sanofi appealed the district court's decision to the Third Circuit. Pending the outcome of the appeal, however, sellers should heed the district court's suggestion and protect themselves by taking a security interest in the assets sold to secure royalty payments, structuring the transaction as a license rather than a purchase or forming a joint venture to retain part ownership of the assets.[11]

Sellers that fail to take any action to secure their royalties, retain ownership of their intellectual property, or structure their transaction as a license that a debtor must assume or reject in whole may unfortunately find that their

purported royalty stream is no match for the fresh start provided by the Bankruptcy Code.

[1] Sanofi-Aventis U.S. LLC v. Mallinckrodt plc, Civ. No. 21-1636-TLA (D. Del. Dec. 20, 2022).

[2] In re Mallinckrodt plc, Case No. 20-12522 (JTD) (Bankr. D. Del. 2020).

[3] 11 U.S.C. § 1141(d)(1)(A).

[4] 11 U.S.C. §§ 101(12); 101(5).

[5] Opinion at 4.

[6] Id. at 5 (citing In re Grossman's, Inc., 607 F.3d 114, 125 (3d Cir. 2010))

[7] Id. at 6.

[8] Id. at 8 (citing Olin Corp. v. Riverwood Int'l Corp. (In re Manville Forest Products Corp.), 209 F.3d 125, 129-30 (2d Cir. 2000) and Employees' Ret. Sys. Of the State of Haw. V. Osborne (In re THC Fin. Corp.), 686 F.2d 799, 803-04 (9th Cir. 1982)).

[9] Id.

[10] Id. at 11.

[11] Id.

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