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I. INTRODUCTION

A new way of working in the American economy is developing, and it is time for the law to catch up. A new kind of worker, the “gig worker,” is rapidly growing in prominence. Gig workers go by many other names, but are perhaps most popularly exemplified by drivers for Uber Technologies, Inc. (“Uber”).¹ Uber and other companies doing business in the “access economy”² see themselves not as employers, but as conduits between those who need jobs done on-demand and those who can and will do work on an ad hoc basis.³ Gig workers themselves are gravitating toward this method of work because the trappings of traditional employment have become undesirable to them.⁴ This new way offers entrepreneurial opportunity to those who will take it.

A noisy minority of gig workers are unsatisfied with the consequences of starting a micro-business because they want the flexibility of entrepreneurialism without the sacrifice.⁵ Taking advantage of outmoded laws that determine whether a worker is properly classified as an employee or an independent contractor, these frustrated freelancers are putting at risk an experiment about which so many others are enthusiastic, including gig workers, gig firms, consumers, and venture capitalists.⁶ Litigation over gig worker misclassification highlights the absurdity of forcing “square pegs” into “one of two round holes.”⁷

The binary choice between classification as either an employee or

² Gina M. Eckhardt & Fleura Bardhi, The Sharing Economy Isn’t About Sharing at All, HARV. BUS. REV. (Jan. 28, 2015), https://hbr.org/2015/01/the-sharing-economy- isnt-about-sharing-at-all (clarifying that “access” is a more appropriate term than “sharing” or “peer” where goods and services are being commercially bought and sold, rather than exchanged freely).
⁷ Cotter, 60 F. Supp. 3d at 1081–82.
an independent contractor, under traditional concepts, is a forced dichotomy that ought to be rendered false. One proposed method for achieving this end is for creative legislators to develop a third designation. 8 Some commentators call for this new “dependent contractor” status,9 while others argue for modifications to the existing tests for employment status. 10 The tests that are currently applied by the courts are convoluted, contrived, and simply inappropriate for gig workers.11

Media coverage sensationalizes the ways that gig work is not right for everyone by presenting the pitfalls so dramatically as if to say that it should not be a choice at all.12 Surely common sense dictates that one cannot expect to become independently wealthy simply by testing the waters of gig work. Micro-entrepreneurs should not be exempted from the risks that are attendant with any new business venture. Effort should of course be made to ensure fairness, but also informed decision-making. Contracts presented in click-wrap agreements that are easy to enter do discourage mindfulness,13 and other bargaining inequalities need to be considered.14 Even so, these concerns should provide no excuse for irresponsibility on the part of entrants to the gig workforce wanting conduit companies to pay handsome rewards and absorb all the risks.15

Gig workers should be allowed to operate as companies in their own right, engaging in freelance jobs to the degree they desire. The range spans from developing a hobby or earning supplemental income, up to fashioning a new career or creating a gig subcontractor firm and anywhere in between.16 Forcing employment status on gig workers will

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9 Id.
11 See generally Cotter, 60 F. Supp. 3d at 1067; O’Connor v. Uber Tech., Inc., 82 F. Supp. 3d 1133 (N.D. Cal. 2015).
14 Aloisi, supra note 1, at 7–11.
15 See id. at 8–9.
not only destroy the financial incentives that allow these fledgling businesses to obtain capital, but will obviate the raison d’être for gig work: freedom from employer control. Few companies will pay the price of employment without exerting maximum control in order to recognize an adequate return on that investment.

The current but outdated method of worker classification essentially creates a vague definition of an independent contractor as anyone who is not an employee. This allows numerous ways that a worker can be overprotectively pigeonholed into employee status. This is true because the concept of independent contract work is based on a stale model. It was once sensible that the independent contractor designation was limited to skilled laborers who provide a finished product, free from interference in the process. No longer should this be; “independent” need not equate to working entirely without sensible guidelines or restrictions.

There is a strong need for small jobs to be done frequently by workers who have the time, tools, ability, and desire. Market inefficiency is the problem that the still-developing “access economy” is designed to address. Allowing conduit companies to provide streamlined methods in support of effective branding is good for the gig worker, who could not otherwise reach the same audiences with the same consistency. Some aspects of gig work should be developed through the science of business, rather than by confused jurors or inflexible statutes. Successful companies will be those that manage to satisfy the people on both ends of the transactions they facilitate: gig workers and those that pay for the goods and services offered.

This comment will first discuss the existing rigid division between employees and independent contractors, and how it applies to gig workers and the companies that connect them with ad hoc jobs. Thematically, the argument that follows will be that the “access economy” method of connecting the supply of service providers with demanding consumers is indeed something new that should be treated as such. Culturally familiar notions of work should not prevent change that keeps pace with the needs and desires of society. Some level of worker protection is valuable, but ever-expanding entitlements
unreasonably constrict the free market flow of labor.\textsuperscript{23} Gig work has only begun to tap the potential of unused resources that can eliminate inefficiencies and promote growth.

Gig workers, particularly millennials, want the freedom to experiment and develop their own styles and combinations of work and personal life.\textsuperscript{24} Consumers crave on-demand services (Uber for everything!\textsuperscript{25}) to fulfill a growing set of needs and desires. Firms want to facilitate the connection between gig workers and consumers. The surface of possibilities in this arena has barely been scratched, yet a dissatisfied few want to risk throwing the gig work baby out with the murky bathwater of regulations and preposterous common law tests.\textsuperscript{26}

\textbf{II. BACKGROUND}

\textbf{A. Gig Work—What it is, Who is Doing it, and Why}

First, understand that gig work is not about sharing.\textsuperscript{27} Second, there are many different kinds of work that people are doing on an ad hoc basis, and there is room for more. Some do not require any special skill; others do.\textsuperscript{28} There is potential for gig workers to develop and refine new skills, discover new talents and passions, or just subsidize some other expanding or changing part of their lives. Whether by working in a single job genre or a combination of several, not everyone who does gig work wants to make a career out of it.\textsuperscript{29}


\textsuperscript{27} Eckhardt & Bardhi, supra note 2.


1. Gig work is not about “sharing”

The term “sharing economy” is used appropriately when referring to peer-to-peer networks that facilitate the optimal use of a resource that cannot be fully consumed by one individual alone.\(^\text{30}\) Ridesharing, for example, still exists where two or more people, typically strangers who become acquainted only by the use of a virtual network, pile into one car for a daily commute,\(^\text{31}\) or even a single trip. Some altruism, even if directed at environmental rather than philanthropic concerns, is necessarily present in the properly termed “sharing economy.”\(^\text{32}\) This is also sometimes referred to as “collaborative consumption.”\(^\text{33}\)

A different dynamic is present when the goods consumed, or the services provided, are offered only in exchange for compensation.\(^\text{34}\) The term “access economy” has been proffered\(^\text{35}\) and is more apt to describe what is discussed here, that being ad hoc jobs or “gig work” for pay. Whatever the ideal terminology may be, references to “sharing” will be minimized here to avoid giving the impression that gig workers are not at all concerned about getting paid, despite the truth that money is not the only, or even always the most critical, motivation for every person who decides to do gig work.\(^\text{36}\)

2. Gig work genres: “there’s an Uber for that”\(^\text{37}\)

Uber is presently one of the most ubiquitous firms offering gig work.\(^\text{38}\) “Uber for X” is a common way to describe a burgeoning type of on-demand service,\(^\text{39}\) particularly if it is based on the use of a software application most commonly accessed via smartphone (an “app”). Thus, Airbnb is Uber for lodging, where consumers can use the app to rent out couches, rooms, or whole apartments and homes as if they were hotels.\(^\text{40}\) VRBO, Homeaway, and Flipkey make similar

\(^{30}\) Eckhardt & Bardhi, supra note 2.

\(^{31}\) See, e.g., About Rideshare, The Rideshare Company (Nov. 21, 2015, 5:00 PM), http://www.rideshare.com/About_Rideshare/.

\(^{32}\) Id.

\(^{33}\) See, e.g., Cheng, supra note 12, at 55.

\(^{34}\) Eckhardt & Bardhi, supra note 2.

\(^{35}\) Id.

\(^{36}\) Hall & Krueger, supra note 4.


\(^{38}\) Aloisi, supra note 1, at 16.


\(^{40}\) About Us, AIRBNB, https://www.airbnb.com/about/about-us (last visited Feb. continued . . .
offerings for longer term vacationers. Homestay takes this a step further by combining lodging with local insider information offered by knowledgeable, interactive hosts. Sidecar and Lyft are Uber’s competitors. Postmates is Uber for delivery of “anything,” including meals from restaurants that do not deliver. Handy is Uber for household cleaning. TaskRabbit is Uber for handyman services (e.g., minor home repairs and remodeling), cleaning, moving, shopping, and more.

Some gig work isn’t quite so Ubersque. Etsy workers sell their own handmade goods, vintage items, or craft supplies, often developing their own brand identities. The list goes on: sitters for babies, dogs, and houses; education, tutoring, and coaching; blog writing, marketing, accounting, and legal services. While extensive, this sampling is not exhaustive, nor will it remain comprehensive for long after it is written. The possibilities are endless.

Synergistic combinations also abound. A car driver could easily deliver meals via Postmates between providing Uber rides, or simultaneously if she is particularly savvy with existing technology. A TaskRabbit tasker could be writing blog content or advertising copy while he waits for someone else’s laundry to finish drying. These are but two of the many obvious examples of what can already be done now, in the infancy of gig work opportunities. As new apps offering services crop up, new combinations will be imagined. This begs the question of why gig workers would expect to be paid an hourly rate when their services may not be exclusively dedicated to any one gig firm.

12, 2016).

49 Uber seems prepared to capture this overlap under its own service umbrella. See James Covert, Uber Is Taking on Postmates with New Delivery Service, N.Y. POST (Oct. 14, 2015, 8:00 AM), http://nypost.com/2015/10/14/uber-is-taking-on-postmates-with-new-delivery-service/.
3. Who is doing gig work and why

“[M]edia assertions about the peer economy range from the romantic to the condescending . . . .”\textsuperscript{50} Accounts of gig workers either extoll the “wildly successful” or sympathize with those “who feel victimized.”\textsuperscript{51} The focus on these extremes draws attention away from the majority of gig workers who are pleased with their experiences and happy to have new options.\textsuperscript{52} Satisfaction is not sensational, so these workers “are not part of public consciousness,” but these tales of only wealth or woes “do not move a worker support agenda forward.”\textsuperscript{53}

One bleakly painted picture of gig work describes “Zoe,” a hypothetical woman in her late twenties who supplements the income from her almost-full-time job by taking on gig work through TaskRabbit, Uber, and Airbnb.\textsuperscript{54} With all these jobs, poor Zoe still struggles financially, yet remains convinced that taking on student loans to finish college would not help.\textsuperscript{55} Her story laments the passing of an aging social contract that once provided a baseline of financial security to most employees, who then worked in full-time salaried positions.\textsuperscript{56}

Zoe’s tale sets up a proposal for providing the benefits of employment through a program analogous to Social Security.\textsuperscript{57} Without discussing the merits of that proposal, suffice it to say that the authors agree that the solution to Zoe’s income struggle is not to dampen or eliminate “the efficiencies and flexibility that companies like TaskRabbit and Uber bring to the market,”\textsuperscript{58} even though they portray an extremely negative caricature of a gig worker.

The problem of income inequality in the United States is not to be dismissed. However, it was not created by, nor has it been exacerbated by, the independent contractor classification of gig workers, and it certainly will not be resolved by forcibly redefining them as employees.\textsuperscript{59} Notably, “[f]ifteen times as many driver-partners said [in a survey that] Uber had made their lives better, rather than worse, by giving them more control over their schedule (seventy-four percent
versus five percent).” A similar number said they would prefer a flexible schedule and self-employment to a steady nine-to-five schedule with some benefits and a definite salary.

“More than a third of U.S. workers now identify as freelancers, according to a recent study by the Freelancers Union, with over thirty million identifying as either ‘independent’ or ‘diversified’ workers who work for multiple employers. That number is expected to grow.”

Who is doing gig work? How, when, and why are they choosing ad hoc jobs? Each is a question with plethoric answers. There is no typical gig worker profile. Methods and motivations vary as much as personality and circumstance, as any given gig worker’s ways may not remain static for long. Gig work can provide an option for semi-retirement or to supplement a fixed retirement income. For those who are tired of waiting for baby boomers to make room so that gen-Xers can rise as millennials enter the workforce, gig work presents a flexible salve. Millennials transitioning from college and high school are often uninterested in committing to a cubicle, and may find their niche in or through gig work.

Gig work is universally a source of income, but not everyone imagines it will be the primary source, or even wants that to be the case. Etsy celebrates producers who quit their day jobs, and that’s a laudable goal for some. Yet, gig work can serve purposes other than replacing career employment. Gig work can be a substitute for hard to find internships, which frequently pay little or nothing. In professional and other skilled arenas, it could serve as a vehicle for apprenticeship. Moonlighters supplement traditional employment with

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60 Id. at 11.
61 Id.
63 See Cheng, supra note 12, at 25.
65 Leavitt, supra note 24.
66 See FREELANCERS UNION, supra note 16, at 4 (noting that just “one in three (36%)” of surveyed moonlighters “said they’ve thought about quitting to freelance full-time.”).
Others diversify and derive income from multiple sources, adding gig work to other jobs, whether temporary, part or full time, or freelance. Gig workers can also fit the traditional concept of independent contractor by offering skilled services, but can significantly expand their own access to markets for their services by taking advantage of the tremendous networks of buyers that are harnessed by mobile apps and websites. Freelancers sometimes even own their own businesses and employ or subcontract with others, although some gig apps may not currently allow for this variation.

B. Employee or Independent Contractor: An Outdated Distinction

“[T]here are myriad ways to describe a worker” who is not an employee including “contingent worker, freelancer, micro-entrepreneur, and small business [owner/operator].” Unfortunately, “through legal goggles, there are only two: the employee and the independent contractor.”

Traditional employment laws are based on a nineteenth century concept that no longer holds the same relevance in the twenty-first century. Designed to allocate responsibility for the tortious injuries to third parties by workers, the doctrine of respondeat superior (“let the master answer”) led to the definition of an employee as wholly distinct from an independent contractor. An employee was one whose work was done at the direction and under the control of the master. A non-employee, today’s independent contractor, performed work that was tangential to the master’s business and under his own direction and control. Put simply, the widget company employs the widget maker, but not the painter who puts a fresh coat on the widget factory. When a widget maker injures a third party while working, the widget company is responsible; if a painter injures that same third party while painting,

69 See FREELANCERS UNION, supra note 16, at 5.
70 Id.
71 Id. at 5.
72 Id.
73 Sarah Kessler, The Gig Economy Won’t Last Because It’s Being Sued to Death, FAST COMPANY (Feb. 17, 2015, 6:00 AM), http://www.fastcompany.com/3042248/the-gig-economy-wont-last-because-its-being-sued-to-death (describing two sisters who teamed up first to complete jobs and then to sue Handy for worker misclassification).
74 See Cheng, supra note 12, at 70.
75 Id.
76 See Sprague, supra note 10, at 7–8.
77 See id. at 7.
78 Id. at 7–8.
the painter is responsible—not the widget company.

The employee/independent contractor distinction served a meaningful purpose in the context of torts, but the definitions borne out of this division of liability have permeated other areas of the law beyond a point that can be easily explained.79 Statutory, administrative, and judicial tests for employment status are widely varied from each other, and are convoluted even standing alone.

The Internal Revenue Service’s (“IRS”) test for distinguishing between the two, for the purpose of determining tax liability, weighs in at a hefty twenty factors.80 The Fair Labor Standards Act (“FLSA”), 81 the National Labor Relations Act (“NLRA”), 82 the Civil Rights Act (“CRA”), 83 the Employment Retirement Income Security Act (“ERISA”),84 Title VII, the Age Discrimination in Employment Act (“ADEA”), and the Americans with Disabilities Act (“ADA”) each include the maddeningly circular description of an employee as “an individual employed by an employer.”85

Statutes like these were designed “in the middle of the [twentieth century], with a particular version of employment in mind.”86 Drafters “envisioned physical worksites, one-to-many relationships between employers and employees, and lengthy employment durations. Modern work displays the opposite trends, and, in fact, crowdsourcing’s very appeal is that it seems to make the [twentieth century] concept of employment obsolete.”87

Common law tests for employment vary by jurisdiction and are no more helpful than codified definitions.88 Controversy over Uber and Lyft driver classification illustrates the inconsistent results of applying different tests.89 The California Labor Commission found that one driver was an employee, in opposition to its own 2012 ruling on another driver.90 New York City’s Taxi and Limousine Commission found that

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79 Id. at 8–9.
86 Felstiner, supra note 13, at 178–79.
87 Id.
88 Id. at 180–83.
90 Id.
Uber drivers are independent contractors—for now.\(^1\) Oregon’s Bureau of Labor and Industries has concluded that Uber drivers are employees under the “economic realities” test that considers such factors as control, dependency, permanency, skill, and opportunity.\(^2\) The Florida Department of Economic Opportunity reversed itself on appeal and found that one Uber driver was an independent contractor.\(^3\) Agencies in nine other states have sided with Florida and Uber on this point.\(^4\)

## III. ANALYSIS

### A. Gig Work Does Not Fit the Traditional Molds

1. **Gig work is something new and different**

Gig work is undeniably different than traditional employment. Despite the vitriol that has been spouted against Uber and other companies accused of misclassification, the fact that strong arguments can be made both for and against classification of gig workers as independent contractors, with no clear winner, is evidence that gig work defies existing definitions. “The Supreme Court said that no one factor—neither the common law test, the economic realities test nor [a] hybrid test—should be the single determinant of worker classification. Neither should two legal classifications—and their accompanying resources—fit all work realities.”\(^5\)

One way of showing that gig workers are not clearly employees is to consider ways that gig firms lack control over the relationship. Control is an important, if not dispositive, factor that is present in all iterations of the employment test.\(^6\)

The question is not whether a company actually exerts control over

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\(^3\) Davey Alba, *Florida Says Uber Driver Isn’t an Employee After All*, WIRED (Oct. 1, 2015, 6:20 PM), http://www.wired.com/2015/10/florida-uber-decision-reversal/.

\(^4\) Id.

\(^5\) Cheng, *supra* note 12, at 85.

\(^6\) *See, e.g.*, Cotter v. Lyft, Inc., 60 F. Supp. 3d 1067, 1075 (N.D. Cal. 2015).
its workers, but whether it holds the power to control. 97 Successful gig companies are those with strong brand images; 98 brands require consistency of product or service execution, 99 so these companies craft guidelines for gig workers to use. Companies call them suggestions, but they can and do enforce many of them like rules. 100

The ability to terminate a gig worker’s access to the network as a punishment for failure to follow the rules has been seen as a sign of power to control. 101 But this termination of access is unlike a firing in that it is actually an end to a series of repeated contracts that produced unsatisfactory results. By comparison, no individual or firm who hires an outside lawyer or accountant would be prevented from ending a dissatisfactory relationship no matter how many times the contract had been repeated. 102 Lawyers might be needed sporadically, and accountants perhaps only annually or quarterly. Typical gig work is done faster than either of these and therefore can be repeated more frequently, but this compression of time should not negate the voluntary contractual agreement that was reached before any work was ever done.

Gig workers actually retain more control over their relationships with gig companies than is true of the reverse. Uber can cut off a worker’s access to the network of consumers at any time and for any or no reason, 103 but any gig firm’s strongest motivation to do this is to ensure consistent brand quality. By contrast, a gig worker can start, stop, or pause and restart the relationship at any time. 104 Traditional employers sometimes do give employees minor influence over when and where they work, but these are the exception. Even though many jobs could be done at a distance and at any hour, employers still

97 See, e.g., id. at 1075–76.
98 See Jonathan Salem Baskin, The Five Keys to Uber’s Valuation, FORBES (Dec. 5, 2014, 4:34 PM), http://www.forbes.com/sites/jonathansalembaskin/2014/12/05/the-5-keys-to-ubers-valuation/ (“Uber isn’t a business with a successful brand, as much as it is a brand that is a successful business.”).
100 O’Connor v. Uber Tech., Inc., 82 F. Supp. 3d 1133, 1149–50 (N.D. Cal. 2015).
101 Id. at 1151.
102 See id.
103 Id. at 1149–50.
104 See, e.g., Driving Jobs vs Driving with Uber, UBER, https://www.uber.com/driver-jobs (last visited Feb. 1, 2016) (“[I]f you’re interested in taking time off when you need it, and not having to ask permission to spend more time with your kids, maybe you should learn more about partnering with Uber . . . . With Uber, you’ll get to be your own boss, set your own schedule and only drive when you feel like it.”).
overwhelmingly prefer centralized operations.\textsuperscript{105}

Traditional employers do not allow employees to come to work at utterly random intervals—e.g., an hour this week, forty the next and none at all for three weeks, no pattern and no explanation necessary. At-will employment does allow both employer and employee to end the relationship at any time, for (very nearly) any reason, or no reason at all.\textsuperscript{106} But gig workers can punctuate their schedules with impunity, taking a hiatus whenever and for however long they wish. It is not insignificant that gig workers retain the ability to return without missing a beat—needing no permission from the company to do this time and again. Yet, courts have given this level of worker control short shrift

Gig work is also not entirely consistent with the traditional notion of an independent contractor; the classic paradigm is a worker with a special skill or trade. Many gig jobs require minimal skill, such as driving a car. Not all independent contractors, though, are licensed professionals. They can be highly skilled accountants, lawyers, professors, and cosmetologists, or comparatively unskilled house painters, exotic dancers, and newspaper carriers. Painting a house is really no more or less complicated than navigating traffic in a busy city. What’s more, taxicab drivers have long been classified as independent contractors and not employees.\textsuperscript{108}

Courts acknowledge that Uber drivers are not exactly taxicab drivers,\textsuperscript{109} but courts also conclude that Uber offers transportation services comparable to taxi companies.\textsuperscript{110} At any rate, the basic skills

\textsuperscript{105} See Emma Plumb, Working Through the Snow, U.S. NEWS & WORLD REP. (Feb. 26, 2015, 10:20 AM), http://www.usnews.com/opinion/economic-intelligence/2015/02/26/2015-record-breaking-winter-prove-benefits-of-teleworking (citing several studies to support the conclusion that “remote work is [still] far from the norm.”).

\textsuperscript{106} RESTATEMENT OF EMPLOYMENT LAW § 2.01 (2015).

\textsuperscript{107} O’Connor v. Uber Tech., Inc., 82 F. Supp. 3d 1133, 1149–52 (N.D. Cal. 2015).


\textsuperscript{109} See, e.g., Bos. Taxi Owners Ass’n, Inc. v. City of Bos., 84 F. Supp. 3d 72, 81 (D. Mass. 2015) (holding that “TNCs operate in a fundamentally different manner from traditional taxicabs” and “there are significant distinctions between their business models, of which the Court only scratches the surface, that permit state or local authorities to treat them differently”).

\textsuperscript{110} See, e.g., Cotter v. Lyft, Inc., 60 F. Supp. 3d 1067, 1078 (N.D. Cal. 2015).
required for taxi and Uber drivers are essentially the same. Taxis, though, have developed a poor reputation for customer service among riders. Uber facilitates a better experience by communicating the high standards of customer service that consumers value and expect, arguably a greater skill than simply driving. For holding drivers to their contractual obligations to provide a satisfactory service, Uber is accused of worker misclassification.111

2. Gig work combines the virtual and the physical

Gig work can be readily compared to its virtual counterparts, where firms post digital tasks called “cognitive piecework” to an online platform where individual workers can accept and complete one or more tasks.112 This is sometimes referred to as crowdsourcing, and is exemplified by Amazon’s Mechanical Turk platform.113 Amazon, like the typical crowdsourcing vendor, “serves as a conduit for the worker to submit the completed work, and for the firm to pay the worker.”114 Amazon takes a commission for having provided the service of connecting firms with workers, but is not an employer.115 Workers are independent contractors, not employees.116

Consider the comparison of Transportation Network Companies (“TNCs”) like Uber and Lyft to Amazon’s Mechanical Turk workers. Uber and Lyft have argued that the service they provide is a conduit platform much like Amazon’s Mechanical Turk.117 California courts have rejected this argument based on the type of service offered—providing transportation to riders.118 The tests weigh against independent contractor status, noting a supposed lack of specialized skill required to be a driver,119 yet many crowdsourced computer driven tasks require even less skill than operating a motor vehicle—e.g., tagging photos.120 In fact, the “vast bulk of the [tasks] posted on [Amazon’s Mechanical Turk] can be performed by almost anyone of

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112 Felstiner, supra note 13, at 148.
113 Id.
114 Id.
115 See id. at 161–63.
116 Id. at 163.
118 See O’Connor, 82 F. Supp. 3d at 1141; Cotter, 60 F. Supp. 3d at 1078.
119 See Cotter, 60 F. Supp. 3d at 1069; O’Connor, 82 F. Supp. 3d at 1139.
120 Felstiner, supra note 13, at 148.
any skill level, in roughly the same manner and period of time.”121

Amazon’s Mechanical Turk “contains no opportunity or method for negotiation” between workers and firms.122 Amazon explicitly asserts that its role is as a venue only, and that it has no control over the quality of the services provided by workers.123 And yet, Amazon does regulate some important terms of the relationship between firms and workers, including the right to reject work without payment.124 Amazon also forbids “parties from contracting independently” thus “ensur[ing] that Amazon will receive its service fee.”125 Amazon’s unilateral contract demands that workers “perform services as independent contractors and not as employees” and informs them that they “will not be entitled to any employee benefits, and will not be eligible to recover worker’s compensation if injured.”126 Amazon claims and receives vendor-only status because it is “not involved in the actual transaction” between workers and firms, yet it is able to mandate and enforce the terms of the transaction with impunity.127

The contract between firms and workers using Amazon’s Mechanical Turk is not negotiated between the parties; rather, each “learn[s] their obligations to one another by consulting the click-wrap agreement they have both been compelled to execute with the vendor.”128 “The vendors, in binding both workers and firms to their click-wrap, have, in essence, prospectively filled in the content of the worker–firm contract.”129 Aside from agreement on the rate of pay “and the specifics of the task, there exists no true privity between the workers and their employer.”130 Amazon, unlike Uber and Lyft, is able to operate under this model, treating workers’ tasks “as a string of independent contracts. . . .”131

Amazon’s arrangement with its workers on Mechanical Turk is very much like Uber with its drivers, except that Mechanical Turk workers provide their services virtually rather than in a vehicle. Amazon operates many different businesses, making it seem much different than Uber and other streamlined businesses. Yet, the Mechanical Turk

121 Id. at 177–78.
122 See id. at 162.
123 Id.
124 Id.
125 Id.
126 Id. at 163.
127 Id. at 163–64.
128 Id. at 171.
129 Id.
130 Id. at 172.
131 Id.
enterprise is nothing without its workers,\textsuperscript{132} just as Uber is nothing without its drivers.

One significant difference between Uber and Amazon is in the rate of pay, where Mechanical Turk workers can only choose whether or not to accept an offer made by a firm, and Uber drivers can only be selective about when and where they accept rides but cannot set their own rates.\textsuperscript{133} Still, Uber drivers earn a great deal more on average\textsuperscript{134} than Mechanical Turk workers, even after subtracting expenses and taxes.

The majority of workers who use Amazon’s Mechanical Turk do not see it as a significant source of income.\textsuperscript{135} The rate of pay for work on this platform is often paltry—as low as $0.01 for a unit of work.\textsuperscript{136} At any rate of speed, even for the smallest of tasks, that is far below minimum wage.\textsuperscript{137} This makes it “essentially impossible to earn a living as a full time” worker using Amazon’s Mechanical Turk.\textsuperscript{138} “But this does not prevent [workers] from using the platform to earn some much-needed supplemental income.”\textsuperscript{139}

Even though Amazon does not control the pay rate for any individual task, it does require that the rate be for piecework and not time.\textsuperscript{140} Amazon also requires prepayment, and can force payment when firms delay.\textsuperscript{141} When a worker is removed from the platform, it can even seize balances, resulting in the equivalent of unpaid wages.\textsuperscript{142}

Control “in the context of a virtual work environment may mean something very different from control in a physical worksite.”\textsuperscript{143} One important measure of control asserted by Amazon over its virtual workers is that it be the exclusive venue, at least between any worker and firm who ever connect through its platform.\textsuperscript{144} Additionally, Amazon’s contract is one that mandates arbitration for all disputes, without exception.\textsuperscript{145} Significantly, Amazon reserves the right to
terminate a worker’s contract at any time, and in doing so ends that worker’s ability to ever perform work for firms via the platform.\textsuperscript{146} This same power, when wielded by Uber, amounted to a firing under employment at will, and was fatal to that company’s argument that its drivers are independent contractors.\textsuperscript{147}

“Amazon . . . maintains records of work already accepted and completed . . . [including] rejection percentages. These figures function as a virtual resume, which [firms] then rely on in dealing with the [worker].”\textsuperscript{148} Uber’s star ratings perform a similar role; consistently low ratings can result in fewer connections with riders or even ejection from the platform.\textsuperscript{149}

Some argue that Uber is not just a technology company, not only because it facilitates rides in vehicles, as announced in \textit{O’Connor v. Uber Technologies},\textsuperscript{150} but also because “its revenues do not depend on the distribution of its [platform], but on the amount of rides generated by drivers.”\textsuperscript{151} Amazon’s Mechanical Turk derives a commission from each task, and therefore also depends on the amount of work performed. But, strangely, it is deemed a mere conduit as a technology company because all of the work is done virtually. If the argument is for fair labor standards, the distinction between virtual and physical work ought to be of no moment. The relationship between Uber and drivers is much the same as between Amazon and Mechanical Turk workers. It does not follow that, simply because drivers must step out from behind a desk, they deserve greater protection. Perhaps this serves as an argument for better standards to be applied to virtual workers, but the point here is that the firms and workers of each are operating in a nearly identical relationship, except that Uber drivers’ computers are attached to vehicles.

The speed at which work is done has been radically compressed since the origin of independent contractor status. A revolution of transactional efficiency was set in motion by the computer, followed by the internet, then cell phones, and now the combination of these into smartphones. Cars may soon be driverless. Other technological advancements yet to be imagined will surface. Jobs will continue to be altered by these changes including who (or what) does the work, how,

\begin{itemize}
  \item \textsuperscript{146} Id.
  \item \textsuperscript{147} See O’Connor v. Uber Tech., Inc., 82 F. Supp. 3d 1133, 1139 (N.D. Cal. 2015).
  \item \textsuperscript{148} Felstiner, supra note 13, at 194.
  \item \textsuperscript{150} See O’Connor, 82 F. Supp. 3d at 1135.
  \item \textsuperscript{151} Aloisi, supra note 1, at 17.
\end{itemize}
and why. The choice between independent contractor and employee, under current standards, is no longer sufficient to describe what is actually happening in the workforce. There is a need for either newly refined definitions of the two, or a third category.

B. Statutory Benefits of Employment

When a worker is wholly dependent on a single organization, and reciprocally invested in the success of that organization, it stands to reason that the worker should be protected from certain harms. This is especially true where employment is at-will, meaning that either party can choose to end the arrangement at any time and for any or no reason (as long as it is not an illegal reason). Employee classification entitles workers to statutory benefits that are unavailable to independent contractors. These include: Social Security; Medicare; workers’ compensation; short-term disability (in certain states); unemployment compensation; and time off to vote, serve as a juror or under military duty, for family and medical leave purposes, and for religious observances. Additional federal and state protections are in place against various forms of discrimination, and for minimum wage payment. All of these are expensive and administratively burdensome for employers—which explains the economic incentive for firms to engage independent contractors whenever possible.

When a worker is free to come and go as she pleases, and is only invested to the degree of a single transaction, it does not stand to reason that the same protections should apply. Even if that same transaction is repeated often, the gig worker still holds all of the power to determine its frequency. Independent contractors epitomize exactly this kind of freedom. It is thus absurd to award the ad hoc worker a windfall of entitlements through employment classification, foisting the cost on the organization, and to simultaneously expect that the organization will not be inclined to reap the benefits of that investment.

In arguing that Amazon Mechanical Turk workers should be able to demand rights as employees, commentator Alek Felstiner recommended that workers unite around Amazon as a joint employer in order to “substantially simplify litigation and enforcement . . . .” Coalescing around the biggest target with the deepest pockets is not a new strategy by any means, but the fact that a tactic is common does not

152 RESTATEMENT OF EMPLOYMENT LAW § 2.01 (2015).
154 Id.
155 See id. § 4:3; id. § 6:2.
156 Felstiner, supra note 13, at 187.
make it necessarily fair or justifiable. Recent arguments in favor of expanding the definition of a joint employer have gained traction with the National Labor Relations Board ("NLRB") but run contrary to "precedents that had allowed lots of flexible contracting arrangements in the labor market."\(^{157}\)

If a company is disallowed the use of independent contractors, and thus made to give its workers all the benefits, protections, and entitlements of employment, then that company will expect the worker to behave like an employee. That is, the company will exert the maximum level of control for which it has paid. For example, gig workers should not be constrained from earning income from multiple sources simultaneously. But gig firms cannot be expected to pay workers on an hourly basis when worker time is not exclusively dedicated to a job obtained through that firm. If gig workers are made employees, this efficiency and increased earning potential will be lost. People who choose to do gig work overwhelmingly do so because they want something different than they’ve had before. They want freedom from offices, desks, cubicles, bosses, coworkers, and perhaps most importantly, rigid mandatory schedules. Gigging offers flexibility to skilled and unskilled workers alike. It can allow an unskilled worker to identify or develop a skill or talent, if that is a goal for that individual’s journey. Freedom to explore will be significantly constrained if gig workers cannot function as independent contractors because fewer firms will form where that arrangement is unavailable, and those that do will behave like traditional employers.

C. Worker Classification Tests Bewilder Juries, Obscure and Delay Answers

Companies should be able to predict, to a reasonable degree of legal and therefore financial certainty, their answer to the question of whether or not a worker is properly classified as an employee or an independent contractor. Those who argue that gig workers are obviously employees should recognize that companies accused of misclassification have strong, legitimate arguments in the opposite direction. Companies should not be required to gamble with classification by risking jury trials.

Defaulting to classification of workers as employees simply because that is the safer route is not a plausible solution for most gig firms. An

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exception to that rule is Managed by Q, Inc. ("Managed by Q"), a firm that caters to workplaces by offering cleaning, supply stocking, and maintenance services on-demand. 158 Managed by Q chooses to employ its workers, but admits that its “employment model will be hard to scale as the company grows . . . and is currently embraced by only a handful of early-stage, on-demand startups . . . .” 159 Significantly, Managed by Q caters to businesses rather than the general consumer market and also offers subscription services, 160 presumably in an effort to predict and steady the cash flows it must need to be able to afford employee benefit expenses.

Vilification of companies like Uber overlooks the unfairness to the organization that develops in good faith a business model that relies on independent contractor classification. Startups with incredible ideas will simply not start because they cannot risk the litigation expense, even if they believe they could win years down the road. FedEx drivers claimed misclassification between 2000 and 2007; the protracted litigation eventually settled in 2015 for $228 million. 161 The Ninth Circuit found that summary judgment was proper because FedEx retained too much control over drivers to justify the independent contractor classification. 162 One important and hotly disputed control measure was scheduling—the drivers successfully argued that while FedEx was not allowed “to set its drivers’ specific working hours down to the last minute,” the company had created guidelines that effectively dictated when work had to be done. 163 Any hope for precedential analogy between drivers for FedEx and TNCs is wasted given the factual dependency of the analysis. 164

Uber and Lyft cases illustrate the complexities of judicial tests for employment when applied to TNCs. O’Connor v. Uber Technologies, a recent California decision, certified a class action suit involving drivers who have driven for Uber directly since 2009. 165 These drivers

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158 Maya Kosoff, Companies Like Uber Could Learn a Thing or Two from This Office Cleaning Startup, Where the Workers Are as Happy as the Clients, BUS. INSIDER (Mar. 10, 2015, 12:41 PM), http://www.businessinsider.com/managed-by-q-hires-cleaners-as-employees-2015-3.
159 Id.
160 Id.
162 Slayman v. FedEx Ground Package Sys., Inc., 765 F.3d 1033, 1043 (9th Cir. 2014).
163 Id.
164 See id. at 1043; Wood, supra note 161.
claimed violations of California’s Labor Code because they were misclassified as independent contractors, instead of as employees.\textsuperscript{166} The court noted that when California’s \textit{Borello} test for employment was applied “at the summary judgment stage, the Court [then] determined that . . . Uber drivers . . . are . . . presumptive employees as a matter of law.”\textsuperscript{167} In finding uniformity sufficient to support a class action, the Court also reviewed Uber’s policies under \textit{Borello}, looking first to the extent of Uber’s control over its drivers, then to a laundry list of secondary factors.\textsuperscript{168}

The control factor focuses on power held, rather than power actually wielded.\textsuperscript{169} Media coverage has latched onto the “presumptive” aspect at the summary judgment stage, glossing over the inconclusiveness of leaving the issue for a jury to decide.\textsuperscript{170} Truly enough, Uber was deemed to hold significant power, whatever the amount it actually exerts, over its drivers because the company: (a) sets the rate of pay unilaterally; (b) maintains star ratings while monitoring driver performance and compliance with heavy-handed suggestions and other requirements; and importantly, (c) retains the right to terminate drivers’ contracts without cause.\textsuperscript{171} However, weighing against these employment signals and in favor of independent contractor status were the facts that Uber does not at all (d) restrict drivers from driving for direct competitors; (e) control drivers’ routes or territories; or (f) control drivers’ schedules, in any way.\textsuperscript{172}

As if this list weren’t enough to confuse any juror, add to this the \textit{Borello} test which provides eight of its own factors, and approves of five more, but leaves the weight of any combinations up to the bewildered factfinder.\textsuperscript{173} The thirteen secondary factors add to the bulk of material to consider, but do little to illuminate the most sensible result. Assuming that the court’s assessments are accurate, some support the independent contractor designation while others do not, but

\textsuperscript{*37} (N.D. Cal. 2015) (leaving room for the Plaintiffs to later develop a subclass that could include additional drivers who worked for Uber indirectly).

\textsuperscript{166} \textit{Id.} at *1.

\textsuperscript{167} \textit{Id.} at *5. (citing O’Connor v. Uber Tech., Inc., 82 F. Supp. 3d 1133, 1141–1145 (N.D. Cal. 2015)).

\textsuperscript{168} \textit{Id.} at *16–30.

\textsuperscript{169} O’Connor v. Uber Tech., Inc., 82 F. Supp. 3d 1133, 1139 (N.D. Cal. 2015).

\textsuperscript{170} E.g., Heather Somerville, \textit{Former Uber Driver Was an Employee, Rules California Department,} \textit{REUTERS} (Sept. 9, 2015, 11:44 PM), http://www.reuters.com/article/2015/09/10/uber-tech-california-ruling-idUSL1N11F1KT20150910#1rWLSgYSYmXImCkr.97.

\textsuperscript{171} \textit{Uber Tech, Inc.}, 2015 WL 5138097, at *17, *19; \textit{See also O’Connor}, 82 F. Supp. 3d at 1133.

\textsuperscript{172} \textit{Id.}

\textsuperscript{173} O’Connor, 82 F. Supp. 3d at 1139–40.
none is particularly meaningful alone, and there is no formula for what combinations of factors mean more when found together.

Judge Edward M. Chen, like Judge Vince Chhabria in Cotter v. Lyft,174 believes that a TNC like Uber or Lyft is disingenuous when arguing that it is a technology company and not a car service.175 In the O’Connor opinion, Judge Chen declared fundamental the fact that “Uber simply would not be a viable business entity without its drivers . . . “176 Again, the same is true for Amazon’s Mechanical Turk, which would also be nothing without its largely unskilled virtual workforce.177

Judge Chen appeared relieved that he would not be the ultimate factfinder, concluding the opinion with an indictment of this forced and false dichotomy:

The application of the traditional test of employment—a test which evolved under an economic model very different from the new “sharing economy”—to Uber’s business model creates significant challenges. Arguably, many of the factors in that test appear outmoded in this context. Other factors, which might arguably be reflective of the current economic realities (such as the proportion of revenues generated and shared by the respective parties, their relative bargaining power, and the range of alternatives available to each), are not expressly encompassed by the Borello test. It may be that the legislature or appellate courts may eventually refine or revise that test in the context of the new economy. It is conceivable that the legislature would enact rules particular to the new so-called “sharing economy.” Until then, this Court is tasked with applying the traditional multifactor test of Borello and its progeny to the facts at hand.178

The Court thus made its “preliminary finding that Uber drivers are presumptive employees” under California law, but assailed the “ambiguous result” of applying its own many-factored test in this context.179

In Cotter v. Lyft, Judge Chhabria was unconvinced that Lyft is “simply connecting random users of its platform.”180 Finding the

175 See generally O’Connor, 82 F. Supp. 3d at 1141–42.
176 Id. at 1142.
177 Felstiner, supra note 13, at 195.
178 O’Connor, 82 F. Supp. 3d at 1153.
179 Id.
argument to be “not a serious one,” Judge Chhabria explained his view that:

Lyft tepidly asserts there is no need to decide how to classify the drivers, because they don’t perform services for Lyft in the first place. Under this theory, Lyft drivers perform services only for their riders, while Lyft is an uninterested bystander of sorts, merely furnishing a platform that allows drivers and riders to connect, analogous perhaps to a company like eBay. But that is obviously wrong.\(^1\)

Lyft’s assertion may not be obviously right, but it is not obviously wrong, considering the similarities between its operating model and that of Amazon’s Mechanical Turk.\(^2\) Yet, the court seems to make a silent distinction where the service provided takes place in a physical, rather than a virtual space.\(^3\) This would make sense if applying, for example, the computer employee exemption\(^4\) under the FLSA, but Amazon’s Mechanical Turk typically requires low to no special skills, and workers earn far below the minimum wage—nowhere near the minimum weekly salary or hourly rate for exempt computer employees.\(^5\)

A comparison of Lyft and Uber to cab companies is more persuasive,\(^6\) yet courts have also been able to recognize that neither is a cab company—instead, that both are something new and different—by embracing the TNC designation\(^7\) initiated by the California Public Utilities Commission.\(^8\)

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1. Id.
5. 29 C.F.R. § 541.400 (2015).
7. See, e.g., Cotter, 60 F. Supp. 3d at 1078; O’Connor v. Uber Tech., Inc., 82 F. Supp. 3d 1133 (N.D. Cal. 2015).
8. Order Instituting Rulemaking on Regulations Relating to Passenger continued . . .
Judge Chhabria swatted away the “mere platform” argument, but recognized fully that Lyft did have strong support for its position that drivers could properly be classified as independent contractors. Near the end of the opinion, Judge Chhabria expressed his frustration at being hamstrung by laws that must be applied, but that make little sense in the workforce dynamic at issue:

As should now be clear, the jury in this case will be handed a square peg and asked to choose between two round holes. The test the California courts have developed over the [twentieth century] for classifying workers isn’t very helpful in addressing this [twenty-first century] problem. Some factors point in one direction, some point in the other, and some are ambiguous. Perhaps Lyft drivers who work more than a certain number of hours should be employees while the others should be independent contractors. Or perhaps Lyft drivers should be considered a new category of worker altogether, requiring a different set of protections. But absent legislative intervention, California’s outmoded test for classifying workers will apply in cases like this. And because the test provides nothing remotely close to a clear answer, it will often be for juries to decide. That is certainly true here.

Entrepreneurs, managers, lawyers, accountants, and others generally involved in business operations should not be expected to guess what a confused jury might say. Faced with tremendous uncertainty, most would cry uncle and run for the safe cover of defaulting to employment classification. That unfortunate choice would result in some would-be firms never obtaining enough capital to get off the ground, while those that do form would struggle to keep enough cash flowing to sustain the on-demand model. Instead of waiting for legislators to get creative, perhaps “[c]ourts should adjust existing doctrines, and create new ones as appropriate, to confront the utterly novel set of questions upon which they will increasingly be asked to rule.”

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189 Cotter, 60 F. Supp. 3d at 1078.

190 Id. at 1081–82.

191 Felstiner, supra note 13, at 200.
D. Developing the Definition of an Independent Contractor

Stories of struggle paint a grim picture of what it looks like when a person tries to make a full time living out of gig work. But these stories are slanted and wrongly assume that full time work is what most gig workers want out of the arrangement. It is too early in the experiment to determine that gig work can’t be done without granting employee status, whether by cloudy common law or stale statute.

Without further refinement of the current classification standards, gig companies and others that wish to use independent contractors must roll the dice or pay a hefty price for peace of mind. As it stands, companies can choose to risk worker misclassification in order to save enormous expense, or take the costly but safe route of treating workers as employees. The risks include at least enforcement actions, litigation initiated by plaintiff workers and predatory class action law specialists, and restitution for underpayment of taxes.

If the picture remains unclear, or if gig workers truly become presumptive employees because of confused jurors, then capital investments will be increasingly difficult to obtain. Creative ideas will be squelched. The losers will not be limited to the Travis Kalanicks of the world; gig workers of all kinds will be frustrated. Consumers of gig-generated services will be turned away. Market experimentation will be whittled even further down, simply to preserve a concept of employment that is falling out of favor and fading in relevance.

1. Changes in the law

One proposed solution is to reverse the dependency test for employment status. The question now is whether or not the worker is dependent on the employer. In the gig economy, relatively few

192 See Hanauer & Rolf, supra notes 54–58 and accompanying text.
193 See supra notes 50–54 and accompanying text.
195 Id.
197 See Sprague, supra note 10, at 19–23.
198 Id. at 19.
workers may depend on a single employer. In fact, “the majority of Task Rabbit ‘Taskers’ and Uber drivers, unlike FedEx drivers, appear to be the antithesis of dependent workers—relatively few are solely economically dependent on one ‘employer.’” ¹⁹⁹ This is one factor that clearly supports the independent contractor designation. Finding this result unacceptable because gig workers would be vulnerable and therefore deserving of all traditional employment protections and entitlements, Robert Sprague looks for a way to make the square peg round. ²⁰⁰ Thus, in order to reach an opposite result, the reversed question would be whether the employer is dependent on its workers for the function those workers fulfill.²⁰¹ If the workers’ efforts are central to the business of the company, then the workers would be classified as employees.²⁰²

The widget company’s primary business is widgets; it does not depend on painters to sustain this business, so painters are independent contractors because they do not make widgets. But what happens when companies diversify their functions so that no single business is central? That is not a hyperbolic question—Amazon is best known for its internet retail business, but that is far from all that it does (e.g., Mechanical Turk crowd work facilitation).²⁰³ Sprague assumes that gig workers are vulnerable, and that the best route to protection is to make them all employees.²⁰⁴ Contrary to the sensationalist media coverage that portrays all gig workers as abused and begging to be made employees, many gig workers are very happy with this new way of approaching work.²⁰⁵ Oftentimes, they selected gig work because it allows them to escape the very relationship they found so constricting: employee of an employer (still, in some ways, servant to a master).²⁰⁶ If companies are forced to treat gig workers as employees, they will not maintain the status quo of power. They will exert the maximum control because they are being made to pay for it, and this will destroy the very reason so many workers have gravitated to gig work.

Another idea is for a third classification called “dependent contractor” to capture the “people who are borderline” [between

¹⁹⁹ Id. at 20.
²⁰⁰ Id.
²⁰¹ See id. at 21.
²⁰² Id.
²⁰³ See Felstiner, supra note 13, at 160–61.
²⁰⁴ Sprague, supra note 10, at 23.
²⁰⁶ See FREELANCERS UNION, supra note 16.
employee and independent contractor] and economically dependent on one employer.”207 That concept has not found roots in the United States, partly because “[e]mployers would need explicit guidance about which protections would be extended from the patchwork of laws that currently govern employment” and because regulators have had more pressing and fruitful enforcement concerns.208

Birthing a new category would indeed be a complicated affair. Yet, there are better reasons for rejecting changes that focus on worker dependency. An independent contractor should not be transformed into an employee simply because he puts all his working eggs in one contractual basket. Making this possible would only encourage all companies to divide work between more independent contractors and splinter otherwise satisfactory relationships simply to avoid hiring unwanted and unneeded employees.

It is much too early in the development of the gig work model to pull the plug. Companies that are sprouting in response to the access economy idea are moving quickly. That frightens some and confuses others. Just like any new business that needs time to work out the kinks before it becomes established, these gig businesses need room to mature. Instead of jumping to the conclusion that some poor workers ought to have their unrealistic expectations met by making them employees, the focus should be on how to help gig workers and companies flourish.

Employment blogger Doug Haas proposes a first step toward reformation with an “intermediate dependent contractor classification” under the FLSA that would set the stage for “better protect[ion of] sharing economy and other ‘alternative’ workers without destroying either the business model or workers’ choices to participate in it.”209 Haas explains:

Under the current regulatory dichotomy that strongly favors employee classification, only some of the for-profit parts of the sharing economy would likely survive, albeit with a dramatically different cost structure, killing off most of the benefits of the sharing-driven model in


208 Id.

the first place. The other probable alternative, a *Lochner*-style substantive due process challenge by contractors and members of sharing cooperatives who object to being forced into employment, is no improvement. Using economic dependence to label a worker an employee against his or her will does arguably violate substantive due process, at least as applied to contractors who present credible evidence that they have made a voluntary decision to contract.210

Instead of further manipulating these already overwrought tests for employment, it should be acknowledged that gig work is not just a new name for something old. A different kind of work has emerged, and new rules need to be developed. This is not to say that gig workers will not fight for some of the same protections and entitlements that employees now enjoy. However, gig workers should not expect employee styled treatment without making employee commitments and sacrifices. Gig workers need to understand the new model before entering that workforce.

Millenials are probably the most likely to comprehend and accept the differences211 because the phenomenon is coming of age alongside them. The next generation may wonder what this fuss was all about. Members of Generation X are leading gig firms, and their cohort admires the entrepreneurial spirit they signify.212 It is not ageist to recognize that generational differences can hinder understanding and delay positive growth. Members of the baby boomers and earlier generations are more likely to hold fast to what they know—the employment of the past.213 This is unfortunate for many who would benefit from gig work, particularly those that are reluctant to leave the workforce because absolute retirement holds little appeal.

Independent contractors are essentially defined in the negative as

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211 See, e.g., Rob Asghar, *Study: Millennials are the True Entrepreneur Generation*, FORBES (Nov. 11, 2014, 8:32 PM), http://www.forbes.com/sites/robasghar/2014/11/11/study-millennials-are-the-true-entrepreneur-generation/ (“A full 77% of millennials say that flexible work hours are a key to boosting productivity within their generation . . .”).

212 Id.

213 See, e.g., John B. Becton, Harvell J. Walker & Allison Jones-Farmer, *Generational Differences in Workplace Behavior*, 44 J. APPLIED SOC. PSYCHOL. 175, 182 (2014) (noting “that there are significant job tenure mean differences between Boomers and Gen X and between Boomers and Millennials when controlling for relative age and the interaction between relative age and generation.”).
workers who are not employed by an employer.\textsuperscript{214} Traditionally, an independent contractor is not subject to significant control by an employer, and is not wholly dependent on any one employer.\textsuperscript{215} Gig workers fit this basic concept, and legislators have an opportunity to recognize that defining independent contractors only by what they are not has left an enormous hole in the law. Unpredictability is a natural part of doing business, but some answers ought to be knowable, including who is and who is not an employee. Firms and workers alike would appreciate and enjoy the confidence to go forward with their relationships free from doubt over what each owes to the other.

A positively formed definition of who is an independent contractor should include gig workers. Statutory codification of independent contractor definitions should be molded to accommodate the current realities of working, which are far different than they once were. Legislators may have supposed that gig work would turn out to be a passing trend. While the market waits for them to realize that it is not, there are steps that can be taken to help gig workers fit more neatly into the role of independent contractor.

2. Market solutions that may develop freely if allowed

Uber drivers do not want to be classified as employees.\textsuperscript{216} Gig workers want to avoid the oppression of employer control and enjoy the freedom of flexibility.\textsuperscript{217} Like crowd workers for Amazon, the “primary advantage” of being a gig worker “is the freedom to choose when and where to work, how long to spend, and what work to perform.”\textsuperscript{218} The best solutions will be discovered, proposed, negotiated, formed, and implemented by and between gig workers and gig firms. They will not be borne of any administrative, legislative, or judicial means.

Gig firms can take some actions that would help gig workers thrive while supporting the independent contractor designation by relinquishing control in ways that can benefit both sides. The possibilities include but should not be limited to the following: (a) make certain that each newly established relationship is as clear as possible, from its very inception; (b) offer tools for micro-entrepreneurial success, including financial literacy; (c) encourage and support

\textsuperscript{214} See Sprague, supra note 10, at 6–8.

\textsuperscript{215} See id.

\textsuperscript{216} Danny Vinik, \textit{Uber Drivers: We Aren’t Employees},\textit{ POLITICO} (June 17, 2015, 6:14 PM), http://www.politico.com/agenda/story/2015/06/uber-drives-consider-themselves-independent-contractors-000093.

\textsuperscript{217} See id.

\textsuperscript{218} Felstiner, supra note 13, at 154.
synergistic combinations across gig firms; (d) allow gig workers to set their own rates of pay; (e) permit subcontracting; (f) let portable reputations replace terminations; and (h) engage in constructive dialogue with workers’ rights groups.

(a) Be clear from the start. Gig firms and “most crowdsourcing vendors” alike each “make some effort to impose a default structure on the employment relationships.” Mandatory and nonnegotiable “terms of use tend either to specify explicitly that providers of crowd labor will serve as independent contractors or otherwise require that workers waive any rights that might flow from the employment relationship.” Becoming a gig worker might be too quick and easy for some. Enforceability of click-wrap or click-through agreements is a topic for another paper, but gig firms ought to consider taking steps to ensure that new workers fully understand the nature of the relationship they are forming when they sign up as independent contractors.

The startup costs for a gig worker consist of a computer, or a smartphone that may even be provided gratis, and “a reasonably fast internet connection.” The barriers to entry and the costs and risk associated with exit are very low for both firms and workers. This kind of “flexibility would have been unprecedented in the job market of the twentieth century, and remains quite rare today[,]” although it is gaining popularity. Easy access to the gig workforce is a good thing, but getting started should be accompanied by some small measure of education about independent contract work, delivered in plain language. At the very least, this would strengthen the argument that all workers entered a contractual relationship voluntarily.

(b) Offer tools for success. Pitfalls such as failing to plan, save for, and pay quarterly taxes can be avoided if workers are exposed to important concepts that may never have reached their awareness, particularly if they have only ever worked as traditional employees.

“The independent contractor status privileges the archetypical freelancer, who is a skilled professional with moxie. Archetypical freelancers are aware of the hurdles, and they know at least to expect the unexpected. This sort of mental preparation makes all the difference.” Gig work can supplement traditional employment, but

219 Id. at 151.
220 Id.
221 Id. at 154.
222 See id.
223 Id.
224 Cheng, supra note 12, at 71.
it can also provide a transition to true entrepreneurship.\textsuperscript{225} Struggling gig workers may need to increase their own personal financial literacy in order to become and remain successful.\textsuperscript{226}

Further, the idea that a new entrant into a business field should be immediately profitable goes against the very concept of entrepreneurialism. No realistic person starts a fledgling business expecting to be in the black within the first year or couple of years. Micro-entrepreneurs should not expect a golden ticket, and those who elect to enter the gig job market should not be rewarded for being ill-informed and for misapprehending the nature of gig work. Those that decry the loss of traditional employment are crying wolf about the absolute disappearance of jobs they see as normal and acceptable. They are also deluded about the permance of those jobs that once were secure and offered the opportunity to flourish in a single employer career.

Gig firms can help potential new entrants to the gig workforce by offering informational tools that would encourage hopeful and ambitious workers to be knowledgeable about what is possible and what is realistic. Resisting the temptation to overstate earning potential could go a long way to prevent disappointment that might spark litigation.

\textit{(c) Encourage synergies.} Perhaps it is true that, at the moment, it is very difficult to cobble together a lucrative and satisfying career from a patchwork of different jobs. Yes, journalists have ventured out into the gig economy for as much as a month to prove that point,\textsuperscript{227} but struggling in the early stages is universal to the entrepreneurial experience. No one who is starting a business expecting to turn a tidy profit after only one month should move forward. It seems likely that the loudly complaining minority of gig workers is part of this group. Starting a business requires commitment, perseverance, and sacrifice. Some gig workers haven’t made as much as they hoped as soon as they imagined, but we do not know and should not presume that this is because they are being treated unfairly. The disappointed group of gig workers can only claim surprise if they went into the business blindly. This behavior should not be rewarded, but it happens and should be acknowledged.

People do not stay with one employer or even in one career for very

\textsuperscript{225} See id. at 79.
\textsuperscript{226} See id. at 94, 104.
long anymore.228 Many do not want to. Companies know this, and are understandably reluctant to be forced into collectively insulating nomadic employees from the economic risks that come along with frequent change.229 Gig work makes it possible for a person to hop from one job, or kind of job, to another and back and forth, as they please. Notably, this kind of flexibility could also allow gig workers to multi-task and earn money from two different jobs at one time. Companies that facilitate this should not be expected to treat these workers as if they were dedicated and continuous members of a cohesive workforce.

Gig firms can help workers identify job combinations that are complementary (e.g., driving for Uber and providing courier service; producing handmade goods for Etsy while renting out space at home via Airbnb).230 It should be clear that working for more than one app is acceptable and even encouraged. For the gig workers that do wish to forge a diverse “career” out of several flexible jobs, or who just need a steady stream of income, the pairings might not be obvious but could be a boon. Diversification of a freelancing portfolio would serve to improve the prospect of building a viable business out of so-called odd jobs.

(d) Permit subcontracting. Vilma Zenelaj cleaned houses using the Handy app until she was caught subcontracting cleaning work to her sister Greta.231 The sisters presented themselves as class representatives in a suit against Handy.232 The bulk of the claims were sent to arbitration in accord with the unambiguous terms of the contract, despite the sisters’ argument that the cleaners were unsophisticated parties.233 Handy’s rule against bringing anyone along on a job234 was likely meant to protect customers more than to control workers, but highlights a potential improvement on the gig model.

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228 See, e.g., Becton et al., supra note 213, at 178.
230 See Covert, supra note 49 and accompanying text.
232 Id.
If gig workers want to maximize efficiency by sharing jobs, gig firms should build this option into their apps. Workers must of course understand that firms will want to capture every possible commission and thus will require transparency when subcontracting. Firms that allow the option would benefit from greater satisfaction among workers and consumers. They would also provide one more avenue for gig workers to achieve full time income from freelancing, where desired, and another legitimate argument against employment classification.

**(e) Allow individual rates of pay.** Amazon’s Mechanical Turk workers perform some task for rates far below the minimum wage. Circumventing minimum wage is not an honorable goal, but gig firms are understandably reluctant to pay an hourly wage when they cannot control the productivity, or exclusive attention to one job, of any worker. In every situation where it is possible for workers to set their own rates for jobs, this should be what happens. Uber riders would not be confused for long; riders might even relish the opportunity to pay a lower rate to a driver who is further away in exchange for waiting an additional few minutes, and vice versa. Transactional negotiations like these would make gig workers more clearly independent contractors than employees.

**(f) Let portable reputations replace terminations.** However inexpensive the independent contractor arrangement might seem, there are significant costs for gig firms that are contributing to the blurring of lines where control of workers is concerned. Like crowd workers, “[e]ven the most committed [gig] worker will have less at stake than a formal employee, especially when any positive reputation a [gig] worker may build has limited currency outside the platform.” Because of this lowered commitment, gig firms are likely to find that some gig workers are “less concerned with meeting specifications and adhering to policies.” Naturally, the temptation for gig firms is to find a way to set and maintain standards. This is where gig workers begin to lose some of the freedom they were seeking and gig firms start to look like employers.

In order to ensure product or service quality, digital crowdsourcing vendors have shifted the risk back to workers by drafting contracts

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235 See generally id.
236 See Felstiner, supra note 13, at 165, 167.
237 See Kessler, supra note 73.
238 See id.
239 Felstiner, supra note 13, at 153.
240 Id. at 152.
allowing firms to reject deficient work without having to pay.\textsuperscript{241} Gig firms have responded in a similar fashion by promulgating guidelines and suggestions that have been viewed as rules where violations result in an end to the relationship between firm and worker.\textsuperscript{242} An alternative approach would be to allow gig workers to carry their service reputations with them wherever they go,\textsuperscript{243} and use their ratings to promote themselves for other gig work even when multiple jobs overlap in time and function. Workers would thus be incentivized to perform well in order to attain a potential reward, rather than to avoid a threatened punishment. This would certainly bolster a gig firm’s argument that it does not have significant control over its workers, whose freedom would extend that much further beyond flexible scheduling.

“[P]roblems with reputation portability may reveal themselves only after the worker has invested a significant time and energy on the platform and wishes to capitalize on that investment.”\textsuperscript{244} These workers “ought to be able to take their reputations with them,” so that the experience and positive feedback they have accumulated performing crowd labor does not evaporate once they leave the platform.”\textsuperscript{245} Uber drivers and other gig workers would benefit from the ability to use their ratings as reputational currency. Certainly, this might enable them to succeed through competitor platforms, but Uber seems unconcerned with that risk and does not prohibit working for competitors. More importantly, a driver’s gleaming resume, as written by riders, could just as easily encourage someone to hire them for other unrelated tasks and services, from courier to house cleaning and far beyond. A cleaner working through Handy may be able to market herself better as a tasker via TaskRabbit if consumers using that app could easily see her individual history of consistent five-star Handy ratings. Gig firm apps should be able to speak to each other in this manner so that a gig worker’s reputation would translate and serve as a virtual resume.

When a gig worker consistently performs poorly, terminating the contract by cutting off access to the platform app resembles a traditional firing too closely for classification comfort.\textsuperscript{246} Instead, gig firms should maximize the impact of reputations developed by ratings from service

\textsuperscript{241} Id. at 153.
\textsuperscript{242} O’Connor v. Uber Techs., Inc., 82 F. Supp. 3d 1133, 1142–43 (N.D. Cal. 2015).
\textsuperscript{244} Id. at 157–58.
\textsuperscript{245} Id. at 202.
\textsuperscript{246} Id. at 193–94.
purchasers. By clearly and appropriately allowing negative reviews to surface and impact a worker’s reputation, consumers will avoid that individual service provider, and an exit can happen organically. Letting a bad reputation replace terminations would swing the pendulum away from employer control and back toward independent contract status.

(g) Engage worker groups. Gig workers are already finding ways to make their voices heard through various websites (e.g., Freelancers Union, Peers, and UberPeople) and they will probably only get louder. Leading gig firms can engage in a constructive dialogue with these groups to learn what it would take to have a more satisfied and more effective, perhaps even less litigious, workforce. Future firms might learn what mistakes to avoid by reaching out directly, or by simply doing a little bit of reconnaissance on worker group websites. Until gig workers can be definitively classified as independent contractors, unionization will remain a goal for some. Proactive use of these forums by gig firms could provide an advantage over companies that choose to ignore the complaints of workers, perhaps by addressing some frustrations before they become class action lawsuits.

IV. CONCLUSION

Workers are gravitating toward a new and flexible relationship with firms that help them to produce income. Traditional employment dynamics are too constraining for both gig workers and gig firms. The antiquated ideal of independent contractors as only including skilled professional specialists does not capture this modern form of work. Gig work defies existing definitions, causing expensive uncertainty in the labor market. Firms need to accurately predict costs by knowing that they can properly classify workers. Workers want to find the freedom that freelancing promises, but need to be adequately informed and prepared for the challenges of micro-entrepreneurialism. Both sides

benefit from streamlined processes, but must be careful to let guidelines guide and not control. The legal concept of an independent contractor ought to be challenged for its dependence on the egregiously labyrinthine tests for employment. Instead, independent contractors should be afforded a positive definition, to include the new freelancing that is gig work. Until such time, gig firms would be wise to adjust their models to more clearly align gig workers away from employment status, thereby avoiding the significant risks attendant with misclassification.
A JUKEBOX FOR PATENTS: CAN PATENT LICENSING OF INCREMENTAL INVENTIONS BE CONTROLLED BY COMPULSORY LICENSING?

Ralph D. Clifford†

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I. INTRODUCTION

According to the classical understanding of how patents work, a company takes each of its patents, sees if it reads onto the competitor’s product and, if it does, either commences negotiations to establish royalty payments or files patent litigation to claim the appropriate damages, royalties, or injunction.1 Similarly, as a new product is developed, the company examines the universe of relevant granted patents to make certain that no infringement will be triggered by the new product.2 If a covering patent is found, the company—at least if it is a “good” actor—will attempt to negotiate a license to use the patented technology and, if that fails, either design the new product around the patent so that infringement will be avoided3 or abandon the product development effort.4

The idealized model described above does not match the reality of the modern patent system, as a focused examination of a product in comparison to the relevant universe of patents is much less likely to occur now than in the past.5 This article examines this disconnect between the reality of how patents are being used today and the underlying principal of patent law that a monopoly is granted in

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3 See, e.g., State Indus. Inc. v. A.O. Smith Corp., 751 F.2d 1226, 1235–36 (Fed. Cir. 1985) (acknowledging that “design[ing] around’ a competitor’s product” is part of the patent system).

4 Julie Bennett, From Idea to Market, ENTREPRENEUR (Sept. 20, 2010), http://www.entrepreneur.com/article/217332 (advising those who find an existing patent for their product to “stop right there,” instead of funding product development for a product that already exists).

5 See infra Part II.
exchange for the disclosure of new technologies. Specifically, it will address two problems that plague the current patent system: the use of “haystack” patent portfolios rather than individual patents and the overwhelming abundance of newly issued patents.

A possible solution to these problems is proposed in the form of a compulsory licensing system for most patents. This solution is described as a method of identifying the types of changes that would be needed to overcome the problems and not with an expectation that it could be adopted easily or that it would not raise issues within international norms.

II. THE CURRENT PATENT SYSTEM AS A MARKET FAILURE FOR A MAJORITY OF ISSUED PATENTS

A. Patent Portfolios as “Haystacks”

Recently, a practicing patent attorney used an interesting analogy for how he uses his company’s patent portfolio when either negotiating

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7 Id. at 224–26 nn.4–7.

8 Id.

9 It is highly unlikely that the current Congress would be receptive to the proposal as the countervailing policies that need to be balanced in a patent provision appear to freeze Congress in place. Cf. Tom Risen, Congress, Silicon Valley Spar on Tackling Patent Trolls, U.S. NEWS & WORLD REP. (July 14, 2015 6:49 PM), http://www.usnews.com/news/articles/2015/07/14/congress-silicon-valley-spar-on-how-to-tackle-patent-trolls.

10 It is not clear that compulsory licenses would comply with the obligation under existing treaty obligations to make patent rights enforceable. See Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), art. 28(1)(a), Apr. 15, 1994, 1867 U.N.T.S. 154, available at http://www.wto.org/english/docs_e/legal_e/27-trips_01_e.htm (“[W]here the subject matter of a patent is a product, to prevent third parties not having the owner’s consent from the acts of: making, using, offering for sale, selling, or importing (6) for these purposes that product . . . .”). It is an open question whether the compulsory licenses described in this article can serve as “owner’s consent.” In any case, the legally binding nature of the treaty is far from clear. See 19 U.S.C. § 3512 (2012) (“No provision of any of the Uruguay Round Agreements, nor the application of any such provision to any person or circumstance, that is inconsistent with any law of the United States shall have effect.”). See also David A. Gantz, A Post-Uruguay Round Introduction to International Trade Law in the United States, 12 ARIZ. J. INT’L & COMP. L. 1, 9 (1995).

11 The attorney works as in-house patent counsel for a large computer firm. As the talk he gave was not a public presentation, his and his company’s anonymity is preserved.
or litigating against a competing firm. He constantly referred to his company’s patent portfolio as a “haystack.” As his talk developed, it became clear that analogy was quite apt, but was not the one that immediately sprang to mind. Typically, a “haystack” is a reference to the proverbial “needle in a haystack.” On first impression, one could assume that his work for his company involved finding the patent needle within the haystack of his firm’s thousands of patents. He soon made it clear, however, that this is not what he meant.

Much of the licensing work that he was doing had nothing to do with an identified technological product that read on to an identified patent; instead, with the tens of thousands of patents in each company’s portfolio, the odds were high that at least some of them would be relevant. In other words, both companies now assume that the needle patent—one that actually does read onto the technology—is in the portfolio somewhere but, like the needle in the haystack, no one has the time or interest to actually read the patents and find the relevant sharp.

Thus, he stated, it is not important to have an identified patent that reads onto the competitor’s product; rather, it is important to have a haystack of patents that is so large that no competitor would ever have the time to sort through the haystack to find out if the needle is actually there. The threat of using the haystack was enough, as a practical matter, to force the surrender of the competitor because its size would present an overwhelming burden of comprehension (and expense, if litigation occurs). Under the haystack theory, a thousand patents—even if all of them are likely to be found invalid if challenged in court—is better than one good one. No one, after all, can afford to challenge a thousand patents, but may easily be able to fund the challenge of

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13 “Reading on” is the term of art for the process of comparing the claims in a patent to an allegedly infringing device as, in most cases, if there is an identity between the claims and the device, infringement has occurred. See, e.g., Rice v. Schutte, 38 App. D.C. 175, 177–78 (D.C. Cir. 1912).
14 See Justin R. Orr, Note, Patent Aggregation: Models, Harms, and the Limited Role of Antitrust, 28 BERKELEY TECH. L.J. 525, 526 (2013) (discussing aggregating weak patents into portfolios as a market tactic). As a practical matter, there are likely to be relevant patents to any product if a company owns thousands of patents within the same art. Cf. id.
15 Id.
17 According to a survey conducted by the American Intellectual Property Law Association in 2013, the cost to defend a patent suit runs from an average of continued...
one.

Of course, the patent law definitional model established in the United States is built on the use of needles, not haystacks. Although some modifications to the litigation system may encourage a partial return to a needle over a haystack design parameter within the patent system, more systematic change appears necessary to make this universal.

B. More Than a Quarter of a Million New Patents a Year

The patent system is dependent on its users understanding the entire portfolio of patented technology within the relevant area as well as absorbing advancing technology once it is disclosed in newly granted patents. Any company that is developing a new product is expected, after all, to design it in a way that does not infringe existing or newly issued patents. A failure to meet this requirement results in liability for infringement. Consequently, to protect a company against suit, its patent attorneys must appreciate the entire set of existing patents and must keep abreast of newly issued ones. The reality today, however, is that both of these tasks are practical impossibilities.

Currently, there are an estimated 3 million active utility patents,
many of which could read onto a new product. This number is not static as record numbers of new patents are being issued each year.\textsuperscript{26} In 2013, nearly 278,000 new utility patents were issued.\textsuperscript{27} In 2014, the number of newly issued utility patents increased to over 300,000.\textsuperscript{28} To process just these new 300,000 patents, you would need to read and understand 144 of them per business hour for eight hours per day on every business day—which is the equivalent of reading and understanding a new patent every twenty-five seconds.\textsuperscript{29} Even if a hypothetical patent attorney could work twenty-four hours a day, seven days a week, more than thirty-four patents an hour would need to be evaluated.\textsuperscript{30} Under the best of circumstances, it takes more than twenty-five seconds (or even two minutes) to read and understand a patent.

Even if it is assumed that the relevant newly issued patents can be found, read, and understood at this rate, failure is still probable. No time is left to review the 3 million patents that have already been issued. Understanding the technology disclosed in existing and newly issued patents thus appears to be a Sisyphean burden.\textsuperscript{31}

\textsuperscript{26} Dennis Crouch, U.S.P.T.O. Grants and Applications Both Down (Slightly) for FY2015, PATENTLYO (May 26, 2015), http://patentlyo.com/patent/2015/05/applications-slightly-fy2015.html [hereinafter Crouch, U.S.P.T.O. Grants]. Some are predicting that 2014 is a peak year in the number of patents issued. Id. Even if the predicted drop in issued utility patents occurs, it is expected to be by only 2\%, approximately 2,000 fewer patents from a base of over 300,000. Id.


\textsuperscript{28} Id.

\textsuperscript{29} This calculation uses the federal definition of a business hour, which determines that there are 2,087 hours in the average work year. See U.S. OFF. OF PERSONNEL MGMT., Fact Sheet: Computing Hourly Rates of Pay Using The 2,087-Hour Divisor, http://www.opm.gov/policy-data-oversight/pay-leave/pay-administration/fact-sheets/computing-hourly-rates-of-pay-using-the-2087-hour-divisor/ (last visited Mar. 7, 2016). The number of hours is based on a forty-hour work week, and does not include vacation or sick time. Id. Additionally, the formula determines that there are almost 261 business days in the average year. See id.

Dividing the 300,000 patents by 2,087 gives just under 144 per hour. Looking at the inverse, this would give someone approximately twenty-five seconds to read and understand each patent. Since the federal figure excludes things like vacation time, the task would actually be more difficult than this calculation shows.

\textsuperscript{30} There are 8,760 clock-hours in a non-leap year (365 days times twenty-four hours).

\textsuperscript{31} Sisyphus, a Greek mythological character, was ordered by Hades to repeatedly roll a heavy boulder up a hill, only to see it roll back down as soon as he reached the summit. “In modern usage, a Sisyphean task is one that is exhausting, continued . . .
Some relief could be had by hiring more patent attorneys to do the work; after all, if one attorney would have to process 144 patents in an hour, two would cut that number in half to 72 patents an hour, four to 36 an hour, and so on. Ultimately, however, throwing more bodies at the problem is also likely destined to fail. As Dr. Brooks demonstrates, adding labor only shortens complicated tasks somewhat as additional time will be needed to coordinate the work of the larger workforce. More significantly, extra labor can result in the overall project failing as the complex interactions involved in the project become significantly less likely to be detected. Although there are obvious differences between designing large-scale computer systems and reading and understanding massive numbers of patents, both seem equally technologically complex since neither will succeed in the absence of complete information flow. The point, after all, is not just to read patents; it is to read, understand, and apply them to a company’s developing product line, including appreciating how multiple patents interface with each other.

Another way the above estimates may slightly overstate the problem is that not all companies are involved in a multitude of industries; indeed, some companies, particularly new start-up companies, may be involved with a single major project. Even with that limitation, however, if the company is involved with any leading technology, there would still be over 5,200 new patents a year to read and absorb on average. This equates with reading and understanding two and a half

unceasing, and, ultimately, aimless.” LUKE ROMAN & MONICA ROMAN, ENCYCLOPEDIA OF GREEK AND ROMAN MYTHOLOGY, 443–44 (2010).

32 See FREDERICK P. BROOKS, JR., THE MYTHICAL MAN-MONTH: ESSAYS ON SOFTWARE ENGINEERING 25 (2d ed. 1995) (“Oversimplifying outrageously, we state Brooks’s Law: Adding manpower to a late software project makes it later.”) (emphasis added). Similarly, throwing more patent attorneys at the problem of reading and understanding patents could result in a greater amount of work. See id. at 13–19.

33 See id. at 17 (“In tasks that can be partitioned, but which require communication among the subtasks, the effort of communication must be added to the amount of work to be done.”).

34 See id. at 18–19, 212.

35 See id. at vii (“In many ways, managing a large computer programming project is like managing any other large undertaking—in more ways than most programmers believe.”).


37 The average number of new patents issued in 2014 for the fifty most popular art units was 5,257. See Part II, Patent Counts by Class By Year, U.S. PATENT &
patents per business hour, every hour, every day. Further, most products are built from technologies that are protected by more than one class of patents, which could greatly increase the number of patents that must be processed and understood.

C. The Result: Market-Driven Patent System Fails

Consequently, it has become a practical impossibility for a company to protect itself against infringing patents by a regularized comprehensive review of issued patents. Even the “good actors” in the marketplace cannot reasonably be expected to know the technology disclosed in the 3 million active patents, much less keep track of the new disclosures in the 300,000 annually issued new patents. Unfortunately, the patent system continues to operate with this expectation. In In re Seagate Technology, LLC, for example, the Federal Circuit noted that willfulness on the part of an accused infringer is not needed to establish liability, but it does serve to give the court the right to enhance damages that are to be paid for the infringement. The determination of willfulness is not simple; indeed, the Federal Circuit has identified nine factors that are relevant to the determination:

(1) [W]hether the infringer deliberately copied the ideas or design of another; (2) whether the infringer, when he knew of the other's patent protection, investigated the scope of the patent and formed a good-faith belief that it was invalid or that it was not infringed; (3) the infringer's behavior as a party to the litigation . . . . (4) [d]efendant's size and financial condition . . . (5) [c]loseness of the case . . . (6) [d]uration of defendant's misconduct . . . (7) [r]emedial action by the defendant . . . (8) [d]efendant's

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38 5,200 divided by 2,087. For the most popular art class, 257, approximately seven and a half patents would need to be processed every hour.

39 Consider the television. Its broad art class is 348, the tenth most common class in 2014. At the same time, seven of the remaining top ten classes could easily impact the design of a new TV. Only the seventh and eighth categories, drugs (514) and molecular biology (435), are completely separate from television technology. Almost 90,000 patents are indexed under the eight TV-relevant classes. See USPTO Patent Counts, supra note 37.

40 See Crouch, supra note 25; Crouch, USPTO Grants, supra note 26.

motivation for harm . . . (9) whether defendant attempted to conceal its misconduct. 42

Under this test, it is questionable if a defendant can avoid a finding of willfulness and its consequential multiple damages if its explanation of how the infringement occurred was that searching existing and newly issued patents was impractical. 43 “Ostrich-like” behavior can be evidence of willfulness. 44 Consequently, although the explosion in the number of potentially relevant patents renders the search task a practical impossibility, companies must nevertheless attempt it or could be found reckless and thus subject to multiple damages. 45 With the number of issued patents in existence, there is “an objectively high likelihood” 46 that at least one of them will read onto any new product, thereby mandating an expensive, but fruitless search for something that is unlikely to be found. Alternatively, of course, the current system could be changed to resolve the Hobson’s choice between expensively attempting to conduct an impossible search or “willfully” failing to engage in a futile effort, only to have multiple damages awarded as a result.

The kinds of failure being discussed here are not without precedent as another intellectual property system has faced similar issues: copyright law. In a variety of copyright areas, both statutory and societal solutions to similar market failures have been developed. 47 The next section will explore the major solutions that have been applied in copyright law. Following this, some common themes will be extracted in order to propose techniques that can help resolve the failures of the patent system being discussed in this article.

42 Liquid Dynamics Corp. v. Vaughan Co., 449 F.3d 1209, 1225 (Fed. Cir. 2006) (citing Read Corp. v. Portec Inc., 970 F.3d 816, 826–27 (Fed. Cir. 1992)).
43 See id. (imposing an affirmative duty on the infringer to investigate the scope of another’s patent once the infringer has knowledge of the patent’s existence).
45 See In re Seagate, 497 F.3d at 1371 (“[W]e . . . hold that proof of willful infringement permitting enhanced damages requires at least a showing of objective recklessness . . . Accordingly, to establish willful infringement, a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent.”).
46 Id.
47 See infra Part III.A–E.
III. COMPULSORY AND SITE LICENSING UNDER COPYRIGHT LAW

The examples from copyright law address the use and distribution of music and how it addresses performances, particularly those that occur through the electronic media. Primarily, these special copyright rules were established either because individualized license negotiations to use the expressive work would be impractical or because market power between the author and the users of the work was significantly out of balance in a way that would prevent the appropriate dissemination of the work. Copyright law, after all, has to deal with a significantly higher number of works than are claimed under the patent law. In each case, Congress attempted to establish a specialized balance for the compensation of authors that differs from that which would occur if the market were allowed to operate without special rules. Examining these rules briefly will provide the background for a similar specialized balancing provision for patents.


Copyright royalty payments for music played on a jukebox have special rules in the Code. Under the system in force today, direct...
negotiation between the jukebox operator and the copyright holder is preferred; but if they do not occur or if they fail, Copyright Royalty Judges can set rates for the license pursuant to Chapter 8 of the Copyright Act.

As originally enacted in the 1976 Act, jukeboxes had a more particular set of compulsory royalty provisions than the current law provides. Under the original 1976 provision, an annual royalty was set for each jukebox, which was paid to the Copyright Office. The money that was collected under this provision would then be distributed to copyright holders who could prove that their work had been performed on a jukebox. Not surprisingly, “prov[ing] entitlement” to royalties could be extraordinarily challenging considering that jukeboxes are distributed throughout the United States, and are often in locations that are not readily available for copyright holders to inspect.

Despite the practical difficulties, the initially enacted compulsory license for jukeboxes was a step forward for music copyright holders, as the 1909 Copyright Act provided no compensation for copyright holders when a work was performed on a jukebox. Indeed, the market disturbance that Congress was attempting to correct with the jukebox compulsory license provision in the 1976 Copyright Act was the very fact that no compensation was being provided to holders of music copyrights when the works were played on a jukebox. The drafters of

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53 This would include the holder of the copyright in each musical work available in the jukebox as well as the holder of the copyright in each performance.

54 See 17 U.S.C. § 116(b). See generally id. §§ 801–05 (2012) (creating Copyright Royalty Judges and establishing the compulsory royalty rate setting procedures). The rates established are published at: Compulsory License Fees for Coin-Operated Phonorecord Players, 37 C.F.R. § 254.3 (2015). Since the 1990s, a privately negotiated set of rates has been in force. Id.


57 Costs incurred by the Copyright Office and the Royalty Tribunals were to be deducted from the amounts collected. See id. § 116(c)(1)-(4).

58 Id. § 116(c)(4)(A)-(B).


60 Copyright Act of 1909, Pub. L. No. 60-349, § 1(c), 35 Stat. 1075, 1075–76 (“The reproduction or rendition of a musical composition by or upon coin-operated machines shall not be deemed a public performance for profit unless a fee is charged for admission to the place where such reproduction or rendition occurs.”), repealed by Copyright Act of 1976, Pub. L. No. 94-553, § 116, 90 Stat. 2541, 2564 (codified as amended at 17 U.S.C. § 116 (2012)).

the 1976 Act determined that the step from requiring no compensation by the jukebox industry to requiring normal, fully negotiated copyright compensation was too extreme, so a compulsory license was appropriate.62 There was also a practical problem of the number of negotiations that would be necessary as the jukeboxes of the era could each store one-hundred distinct songs.63


The provisions of section 111 grant compulsory licenses that allow, among other similar uses,64 a cable television company to rebroadcast over-the-air television signals to its subscribers.65 The basic system establishes royalty rates, which are paid by the cable company based on its gross receipts from its subscribers.66 Subsequently, any copyright

Whatever justification existed for it in 1909 exists no longer, and one class of commercial users of music should not be completely absolved from liability when none of the others enjoys any exemption.”). Of course, by the time the fix was made, jukeboxes were no longer as important in the distribution as they had been through the middle of the twentieth century. See TAYLOR COWEN, IN PRAISE OF COMMERCIAL CULTURE 164–66 (2000) (noting that three-fourths of the records produced in the 1940s were used in jukeboxes); The Jukebox, it Seems, Is a Hit of the Past, N.Y. TIMES (July 21, 1982), http://www.nytimes.com/1982/07/21/garden/the-jukebox-it-seems-is-a-hit-of-the-past.html (noting a decline in the number of jukeboxes by more than fifty percent from the early 1950s to the 1980s). See also KERRY SEGRAVE, JUKEBOXES: AN AMERICAN SOCIAL HISTORY 164–66 (2002) (discussing the same).

62 See H.R. REP. No. 94-1476, at 89 (“Unlike other commercial music users, who have been subject to full copyright liability from the beginning and have made the necessary economic and business adjustments over a period of time, the whole structure of the jukebox industry has been based on the existence of the copyright exemption.”).


64 This section of the Copyright Act of 1976 is among its most complex provisions. See Am. Broad. Co., Inc. v. Aereo, Inc., 134 S. Ct. 2498, 2506 (2014) (“Section 111 creates a complex, highly detailed compulsory licensing scheme that sets out the conditions, including the payment of compulsory fees, under which cable systems may retransmit broadcasts.”); H.R. REP. NO. 94-1476, at 88 (“The complex and economically important problem of ‘secondary transmissions’ is considered in section 111. For the most part, the section is directed at the operation of cable television systems . . . [h]owever, other forms of secondary transmissions are also considered, including apartment house and hotel systems, wired instructional systems, common carriers, nonprofit ‘boosters’ and translators, and secondary transmissions of primary transmissions to controlled groups.”).


holder who claims to have a work that was rebroadcast must make a claim for compensation by filing a claim under the Copyright Royalty system set forth in Chapter 8 of the Copyright Act and can be awarded a proportionate share of the revenues collected.\textsuperscript{67} Again, as was the case with jukeboxes, if the parties claiming royalties can agree on how the money should be distributed, Congress supports that agreement.\textsuperscript{68}

The cable television compulsory royalties system initially was made necessary by the failure of the Copyright Act of 1909 to require cable systems to provide any compensation for the rebroadcast of the signals.\textsuperscript{69} After making the determination that cable television providers should pay royalties, the lack of such a requirement under the 1909 Act suggested that transitional provisions, rather than immediately using an open market system, would be necessary.\textsuperscript{70} Beyond the transitional issue, there was congressional doubt that retransmission royalties could be adequately addressed by the open market:

The Committee recognizes . . . that it would be impractical and unduly burdensome to require every cable system to negotiate with every copyright owner whose work was retransmitted by a cable system. Accordingly, the Committee has determined . . . to establish a compulsory copyright license for the retransmission of those over-the-air broadcast signals that a cable system is authorized to carry pursuant to the rules and regulations of the FCC.\textsuperscript{71}

C. The “Cover” of a Music Performance Provision—17 U.S.C. § 115

Under section 115, a performer is granted a compulsory license for making a phonorecord\textsuperscript{72} of a copyright-protected musical work as long as the work is not performed in public or transmitted by cable systems to subscribers who are not physically within the range of the normal broadcast signal. See id. § 111(d)(1)(B).

\textsuperscript{67} See id. § 111(d)(4)(B).
\textsuperscript{68} See id. § 111(d)(4)(A).
\textsuperscript{69} See H.R. REP. NO. 94-1476, at 89.
\textsuperscript{71} H.R. REP. NO. 94-1476, at 89.
\textsuperscript{72} “Phonorecord” is defined under the Copyright Act to mean, “material objects in which sounds, other than those accompanying a motion picture or other audiovisual work, are fixed by any method now known or later developed, and from which the sounds can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device.” 17 U.S.C. § 101 (2012). See also London-Sire Records, Inc. v. Doe 1, 542 F. Supp. 2d 153, 170–71 (D. Mass. 2008) (“The Copyright Act thus does not use materiality in its most obvious sense—to continued . . .
as that work has already been performed on a phonorecord.\textsuperscript{73} A prior phonorecord-captured performance authorized by the copyright holder is a prerequisite, and no compulsory license is available for music that has not been rendered on a phonorecord with the copyright holder’s consent.\textsuperscript{74}

Unlike the two compulsory licenses discussed above, this license existed under the 1909 Act.\textsuperscript{75} Congress continued the license after determining that it was needed to appropriately balance the market for recorded music.\textsuperscript{76} The modified license found in the 1976 Act clarified some aspects of its applicability\textsuperscript{77} and made it subject to the royalty determination provisions in the 1976 Act that allowed for non-legislative modifications of the rates.\textsuperscript{78} This continues today under the procedures established in Chapter 8 of the Copyright Act.\textsuperscript{79} As is typical, however, Congress expressly supports private understandings about copyright compensation and gives a private agreement preference over Chapter 8 defined rates.\textsuperscript{80}


Public broadcasters are given a compulsory license to use published non-dramatic musical, pictorial, graphic and sculptural works in Section 118 of the Copyright Act.\textsuperscript{81} Royalties for use are set by Copyright

\textsuperscript{73} See 17 U.S.C. § 115(a)(1) (2012); H.R. REP. NO. 94-1476, at 107 (“Under [Section 115], . . . a musical composition that has been reproduced in phonorecords with the permission of the copyright owner may generally be reproduced in phonorecords by another person, if that person notifies the copyright owner and pays a specified royalty.”). The current defined royalties can be found at Royalty Rates for Making and Distributing Phonorecords. 37 C.F.R. § 385.3(a) (2015).


\textsuperscript{76} Cf. H.R. REP. NO. 94-1476, at 107 (citing H.R. REP. NO. 83, 90th Cong., at 66–67 (1967), which discussed the dispute between maintaining the license to support the existing market for recorded music while acknowledging that “the special antitrust problems existing in 1909” no longer existed).

\textsuperscript{77} See id. at 107–08.


\textsuperscript{79} See id.

\textsuperscript{80} See id. § 115(c)(3)(B). The reality today is that compulsory license royalty rates serve as a cap as most music performances that cover prior works are negotiated. See 2 NIMMER & NIMMER, supra note 59, § 8.04(1).

Royalty Judges under Chapter 8.\textsuperscript{82} This license is the one that is most directly designed to satisfy a need for the distribution of copyrighted works because it is in the public interest even though market economics may prevent this from happening:

The Committee is cognizant of the intent of Congress, in enacting the Public Broadcasting Act on November 7, 1967, that encouragement and support of noncommercial broadcasting is in the public interest. It is also aware that public broadcasting may encounter problems not confronted by commercial broadcasting enterprises, due to such factors as the special nature of programming, repeated use of programs, and, of course, limited financial resources. Thus, the Committee determined that the nature of public broadcasting does warrant special treatment in certain areas.\textsuperscript{83}

\textsuperscript{82} See 17 U.S.C. \textsection{}118(b)(4) (2012). In the typical arrangement, a private agreement will be enforced over the rates set by the Royalty Judges. See \textit{id.} \textsection{}118(b)(4); \textit{id.} \textsection{}118(c).

E. Performing Rights Organizations—Collective Site Licenses

Performing Rights Organizations such as ASCAP and BMI allow musicians to collect royalties where it would otherwise be difficult or impossible. Equally, the organizations allow facilities such as concert halls to lessen the likelihood that performance of a copyrighted work at the facility will be infringing because the catalog of works held by the organizations is quite broad. Each organization negotiates a license agreement with entities that commonly use multiple copyrighted works, such as night clubs, concert halls, radio and television broadcasters, etc. By entering into the license agreement, the entity is given a site license to use all compositions within the ASCAP or BMI catalog of music. For example, if a musical group performs a copyrighted song in a performance at a concert hall, the hall itself will not be considered an infringer, as it will have a license for the performance; otherwise, the hall could have copyright liability regardless of the responsibilities of the musicians. The compensation that is paid to the Performing Rights Organization is distributed to the

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84 See What is ASCAP?, ASCAP, http://www.ascap.com/about/ (last visited Mar. 7, 2016) (“[T]he American Society of Composers, Authors and Publishers (ASCAP) [is] a membership association of more than 525,000 US composers, songwriters, lyricists and music publishers of every kind of music . . . . We protect the rights of ASCAP members by licensing and distributing royalties for the non-dramatic public performances of their copyrighted works.”).

85 See generally Our Role, BMI, http://www.bmi.com/about (last visited Mar. 7, 2016) (“BMI supports businesses and organizations that play music publicly by offering blanket music licenses that permit them to play more than 10.5 million musical works.”).


87 See id.


90 See, e.g., Broad. Music, Inc. v. Niro's Palace, Inc., 619 F. Supp. 958, 961 (N.D. Ill. 1985) (“Copying can take many forms. The most straightforward type of copying is the public performance of another's musical composition. Moreover, not only is the performer liable for infringement, but so is anyone who sponsors the performance.”) (internal citation omitted)).
actual copyright holders by the organization.91

IV. THE UNIFYING CONCEPTS BEHIND THE COPYRIGHT COMPULSORY AND PERFORMING RIGHTS LICENSES AND THE MATCHING THEMES IN MODERN PATENT PRACTICE THAT JUSTIFY DEVELOPING SIMILAR MANDATORY PATENT LICENSES

When the licensing methodologies discussed in part III above are analyzed, several common concepts emerge, most of which are applicable to solving issues arising in modern patent use. These themes segment into four major areas: (1) open market negotiations not being a realistic expectation; (2) enforcement against infringement being at best problematic, or at worst impossible; (3) an holder’s assertion of intellectual property rights is overly self-centered, imposing costs that are significantly higher than the value returned by the work’s creation; and (4) a need to protect a newly created market for a developing kind of work. Each of these will be discussed in turn.

A. Expecting the Parties to Engage in an Open Market Negotiation is not Realistic

The most common theme that interconnects the five copyright compulsory or collective site licenses is that a face-to-face negotiation for the rights to use a particular kind of copyrighted work is often not practical. For jukeboxes, it would be impractical to expect the operator of each box to discuss royalty payments with every artist represented on a record within the box as over 100,000 songs can now be found on a modern jukebox.92 A similar, but more complex problem is raised by a cable television system’s rebroadcast of a show, as each show could involve independently owned and controlled copyrights in the dramatic script and its performance as well as the music and other copyrighted works that are incorporated.93 For both record covers and nonprofit


uses, the negotiation difficulty is a result of inherent market imbalances as neither a typical singer nor a public broadcasting system can obtain the copyright clearances needed to function because of their limited financial means. 94 Finally, for performance venues, negotiating for permission for each song that is going to be performed would be impractical; after all, the venue may not even know in advance what songs are going to be performed by a performer. 95

The inability to negotiate is typical in the modern patent system as well. As discussed in Part II above, patent enforcement is no longer based on the reading on process that theoretically underlies the system as doing so is no longer practical. 96 Whether the root cause of this transformation is based on the overwhelming quantity of patents being issued or on market players’ decisions to use their patent portfolios in ways not designed by the law does not matter, as the reality is that open market negotiations for most patents is an unrealistic expectation. 97

B. Enforcing Against Infringement is Problematic

A second common theme that ties copyright licenses together is that practical enforcement of rights is often difficult to impossible. For example, the holder of the rights to a song or its performance may find it close to impossible to know if those rights are infringed by a jukebox located in a private club, or by a concert given in a church recreation hall. 98 First, few copyright holders have the resources to survey all of the possible infringers around the country. 99 Even if the copyright


95 See Daun, supra note 93, at 262 (discussing blanket licenses).


97 As is discussed in more depth below, pioneering patents that develop a new technology require separate consideration.


holder could locate every jukebox that contains a phonorecord of a copyrighted song or performance, infringement does not occur until the phonorecord is played, which could be at any hour of the day or night. Mere possession of a legitimate phonorecord does not constitute infringement. Similarly, a concert in a church hall may only be open to members of the church and never be advertised to the public, yet it remains an infringing “public performance” under the Copyright Act. The use of mandatory royalties and collective societies cannot eliminate these problems of enforcement, particularly by smaller entities, but can significantly limit the problem among more commercial users of copyrighted music.

In many patent-intensive industries, similar enforcement problems occur. For software- or business method-based inventions, in particular, it can be difficult or impossible to know whether a competitor is using a claimed invention, as it is likely to be incorporated into a complex software system or hidden in the back-office business processing of a company. For software, although it is theoretically possible to reverse engineer a computer program to determine how it is designed and whether it practices a patented invention, the reality is often different. In the best of circumstances, reverse-engineering software is technologically challenging, but even if it should prove possible, many products are distributed using purported licensing agreements that

(noting the same).

100 17 U.S.C. § 501(a) (2012) (explaining that infringement occurs when any exclusive rights of the copyright holder, provided in section 106, are violated); 17 U.S.C. § 106(6) (2012) (listing the right to play a phonorecord as an exclusive right of the copyright holder).


102 A performance is considered public under the Copyright Act when it is “perform[ed] . . . at a place open to the public or at any place where a substantial number of persons outside of a normal circle of a family and its social acquaintances is gathered.” 17 U.S.C. § 101 (2012) (emphasis added). As a non-human, churches have no family or social acquaintances. Cf. Columbia Pictures Ind., Inc. v. Redd Horne, Inc., 749 F.2d 154 (3d Cir. 1984).


prohibit reverse-engineering from being attempted, making an attempt to discover potential infringement a breach of contract. For business-based patents, the problem can be even more intractable. Some business patents are practiced in front of the customer, potentially allowing the technology to be observed—for example, one can see how French fries are prepared at most fast food restaurants—but others are completely hidden—one cannot see how a brokerage determines proxy voting rights for shares held in a street name without access to the company’s back office.

C. Avoiding Excessively Selfish Assertions of an Intellectual Property Right is Required

With some uses of copyrighted music, requiring a one-on-one negotiation for the use of the work will lead to circumstances that can be best described as a failure of intellectual property law to achieve its primary goal: the wide dissemination of the copyrighted work. For example, the holder of a copyrighted musical composition may wish to prevent anyone save himself or herself to sing a copyrighted song in a public performance. Theoretically, insisting on this methodology could maximize the financial return to the holder, particularly if the composition is popular. If the public wants to hear a performance of the song, the copyright holder gains compensation for both the music and the performance rather than just the music alone. This model of distribution, however, discounts the reality of how music tends to spread. After all, if people hear a new song that strikes their fancy, they are likely to leave “whistling the tunes and everything” with the corresponding demand for more performances than the copyright holder can satisfy. The cover license provision in the Copyright Act works against this consequence by giving, in effect, the copyright holder only the first opportunity of releasing the song on a phonorecord but, having


106 See 1 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 1.03[A] (Matthew Bender ed., 2007).


done so, all others may also, paying the copyright holder what is determined to be a fair royalty for the privilege of using the underlying music.\textsuperscript{109}

In the world of patents, this overly selfish assertion of rights is also seen. As a primary example, a patent holder can exercise a patent to prevent all others from making, using or selling the patented invention even though the holder is not planning on using the invention.\textsuperscript{110} In effect, the patent holder is using the patent to injure others by preventing their use of the invention for no return.\textsuperscript{111}

The early days of the electronics industry serve as an example of how the strong assertion of patent rights can have a significantly negative effect on the development of a technology. John Fleming, the first individual to obtain a patent in what became the electronics space, was granted a patent on the vacuum-tube diode.\textsuperscript{112} Less than two years later, Lee de Forest was issued a patent on the vacuum-tube triode.\textsuperscript{113} Although the triode has functions that are quite different than the diode—fundamentally, a diode transforms electricity from alternating to direct form while a triode can amplify signals\textsuperscript{114}—a triode can also be used as a diode and, more critically, a triode reads on to the Fleming diode patent.\textsuperscript{115} Unfortunately, both Fleming and de Forest strongly asserted their patents, resulting in a significant delay in the development of electronic technology as no one could safely license the technology from either of the parties.\textsuperscript{116}

Today, the use of a patent to prevent anyone from using a technology has been associated strongly with a “patent troll,” often now

\begin{flushleft}
\textsuperscript{111} See id.
\textsuperscript{112} U.S. Patent No. 803,684 (filed Apr. 19, 1905).
\textsuperscript{113} U.S. Patent No. 841,387 (filed Oct. 25, 1906).
\textsuperscript{115} See Marconi Wireless Tel. Co. of Am. v. De Forest Radio Tel. & Tel. Co., 243 F. 560, 565 (2d Cir. 1917). See also Deepa Varadarajan, Improvement Doctrines, 21 GEO. MASON L. REV. 657, 688 (2014) (discussing how an earlier “blocking” patent can prevent use of an improvement patent).
\textsuperscript{116} See Peter E. Mayeux, Fleming, Sir John Ambrose 1849–1945 British Electrical Engineer; Inventor of the Vacuum Tube, 2 ENCYCLOPEDIA OF RADIO 972 (Christopher H. Sterling ed., 2004) (“Litigation of the de Forest and Fleming patents continued for years. Court decisions in 1916 tied most companies into knots.”).
\end{flushleft}
called a “non-practicing entity” or “NPE.”117 What is being identified in this article, however, is narrower than a NPE; instead, a distinction is being made between a NPE that actively seeks to allow others to use a patented invention by entering into license agreements118 and one that seeks to prevent a technology from being used although no attempts are made to market the technology. Where patent rights are used solely to prevent use rather than to enable it, the “licensing” protocol equates to the third theme underlying copyright compulsory licenses.119

D. Protecting a Newly Emerging Market

The final common theme that underlies these copyright licenses is the need to respond to a newly developing market. Sometimes this new market for copyrighted works was a result of the prior law leaving the use free from copyright restrictions.120 Other times, the market developed because of a novel technology.121 In both cases, Congress determined that an open, one-on-one negotiation between the copyright holders and the new users would be ruinous to the development of the newly emerging distribution method.122

The primary example of a market being protected is the jukebox provision in the 1976 Copyright Act.123 The 1909 Act left the use of music by a jukebox completely free from copyright limitations.124 Congress felt that the transition from not having to pay any compensation to having to negotiate a royalty provision for each song was likely to cause the extinction of the jukebox industry.125

A good example of the second type of market-protection need is shown by the cable television provisions.126 This industry was developing at the time the 1976 Act was being crafted.127 Congress was fearful that the parties controlling copyrighted works on the existing broadcast media would be likely to prevent the use of their copyrights

118 For example, most universities would fit into this category. See Mark A. Lemley, Are Universities Patent Trolls?, 18 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 611 (2008).
119 See infra Part IV.D.
120 See supra Part III.A.
121 See supra Part III.B.
124 See supra note 60.
125 See id.
126 See 17 U.S.C. § 111 (2012); supra Part III-B
127 See supra Part III-B.
by the cable industry as a way of preventing the cable industry itself from growing.128

Unlike the first three common themes that unify the copyright mandatory license provisions, patent law differs somewhat dramatically. It is an acceptable motive, as a general matter, for the holder of a patent to use it to prevent a competitor from entering a marketplace.129 The basic legal right given by each system explains this difference. A copyright holder has the affirmative right to use the copyrighted work;130 a patent holder does not, and can only prevent others from using the invention.131 More fundamentally, however, is the purpose of the patent system—the development of new technology, broadly defined.132 As the law of patents is specifically designed to regulate the entry of new technologies into society, the overall system is not affected adversely by new inventions in the way the copyright system often is.133

V. APPLYING COMPULSORY LICENSING TO PATENTS

A. Why Patent Licenses Are Needed

The current patent system does not, in general, use compulsory licenses, and patent holders—outside of a few narrow areas134 or where

128 See supra Part III-B.
130 See 17 U.S.C. § 106 (2012) (“[T]he owner of copyright under this title has the exclusive rights to do and to authorize any of the following . . . .”) (emphasis added).
131 See 35 U.S.C. § 154(a)(1) (2012) (“Every patent shall . . . grant to the patentee . . . the right to exclude others from using, offering for sale, or selling throughout the United States . . . .”) (emphasis added).
132 See U.S. CONST. art. 1, § 8, cl. 8 (“To promote the Progress of Science . . . .”).
133 New technologies that can preserve artistic expressions have historically been responsible for causing then existing copyright provisions to become non-functional. Jessica D. Litman, Copyright Legislation and Technological Change, 68 OR. L. REV. 275, 276–77, 281–82 (1989). For example, piano rolls, an early form of recorded music, were not within the scope of protection found in the Copyright Act when they were first developed, leaving that version of a musical expression without copyright protection for decades. See White-Smith Music Publ’g Co. v. Apollo Co., 209 U.S. 1, 13 (1908).
134 See, e.g., Clean Air Act, 42 U.S.C. § 7608 (2012) (allowing the attorney general to require the owner of any patent that is not “reasonably available” to license the patent if such licensing is necessary to comply with certain aspects of the
required as a remedy\textsuperscript{135}—can choose when and if to authorize others to use their patented technology.\textsuperscript{136} As discussed above, however, the current way in which businesses are using patents introduces significant problems, and results in the redefinition of the underlying principle of the patent system of rewarding disclosure with the ability to monopolize the technology.\textsuperscript{137} Numerous articles have been written that attempt to address some of these problems.\textsuperscript{138} It may be time to acknowledge, however, that the actors who operate the patent system, as well as those who gain its benefits, have insufficient motivation to do anything but preserve the status quo.\textsuperscript{139} Consequently, in order to restore its operating principles, alternative mechanisms need to be explored to redirect the system to serve society’s requisites. The basic thesis expressed here is that mandatory licenses patterned after the ones used in the copyright system would serve to re-equilibrate the system and, in particular, would resolve the two primary problems that were identified for solution in Part I of this paper: using patent portfolios as “haystack clubs;” and overcoming disabling numerosity.

\textit{1. Haystack Clubs}

Using a patent portfolio, rather than individual patents, as a...
litigation club presents the same kind of system failure as that which justified the special copyright rules for jukeboxes and cable television. For both of these copyright systems, individual negotiations would be impractical because there are too many rights holders involved and the odds are too great that a mistake regarding coverage will result in liability. Consequently, automatic negotiations in the form of a statutory license are used.

Allowing the use of a haystack of patents causes a similar failure. Just as an operator of a jukebox or cable system cannot realistically deal with thousands of individual rights negotiations to be allowed to engage in its everyday operation, a company cannot do so when faced with hundreds or thousands of patents. Without a viable mechanism to determine if each of a thousand patents reads onto a company’s product, the company is left with no harbor to avoid potential infringement. Like the copyrighted music in a jukebox or television shows being rebroadcast by a cable system, the reality is that individual patent-by-patent analysis for the ones in a haystack portfolio is impossible.

2. Disabling Numerosity

While the haystack club is a tactical business approach that has been adopted to maximize the economic return from a patent portfolio—often beyond the legally justifiable return from the individual patents contained within it—numerosity is a problem inherent in the current patent system. With 300,000 newly issued patents each year on top of the base of 3 million active patents, it has become impossible to absorb newly disclosed technology, particularly within the most innovative fields. The most similar copyright problem is the public performance of music as there are millions of public performances of copyrighted music on an annual basis. The primary copyright

\[\text{continued} \ldots\]
response to this is the recognition of the performing rights societies. These groups allow one negotiation to occur which results in the authorized use of large catalogs of protected works. The user of copyrighted music can be assured that the use of any of the multitude of works within the catalog will be authorized, including new works developed after the original negotiation with the performing rights society was concluded.

For patents, no system is available to acquire rights to use a patent by entering into a collective licensing agreement with multiple patent holders. Although this absence does not affect the licensing of all patents—a patent that pioneers a new field is particularly appropriate for one-on-one licensing—for a vast majority of them, it creates a significant impediment. Specifically, the market value associated with the license of a patent that claims a minor advancement in a technological area should be correspondingly small. In reality, however, the value that can be claimed is greatly enlarged because of the costs associated with litigating patent rights.

B. How Mandatory Patent Licenses Would Work

1. Establishing Field Licenses

To implement the proposed system, there would need to be two classifications for patents. Most patents—likely the ones that add a minimal amount to the known technology—would be subject to the

defined broadly to include personal or transmitted performances to groups other than one’s family and friends. Id. Consequently, public performances are quite common and are somewhat in conflict with a layperson’s understanding of what is a public performance. See Am. Broad. Cos., Inc. v. Aereo, Inc., 134 S. Ct. 2498, 2507–10 (2014); Red Baron-Franklin Park, Inc. v. Taito Corp., 883 F.2d 275, 278–79 (4th Cir. 1989); Columbia Pictures Indus., Inc. v. Redd Horne, Inc., 749 F.2d 154, 158–59 (3d Cir. 1984).

147 17 U.S.C. § 101 (2012). There is also a strong resemblance with jukeboxes. See id.

148 See supra Part IV.E.


151 As is well recognized in the literature, many of these patents are, in fact, invalid because they are either anticipated or obvious. See, e.g., id. at 3092–94; Wagner, supra note 139, at 2138–39. The cost of licensing a non-patentable technology should be zero.

152 See supra note 17. For an invalid patent, any licensing fee is presumably associated with the costs of litigating the invalidity. Cf. id.
mandatory licensing system. This type of patent will be referred to as a “field-licensed patent.” The others that do, in fact, more significantly advance knowledge, could be excluded from the mandatory licensing system, thereby requiring an individually negotiated license. These will be termed as an “individually-licensed patent.”

The determination of which license class a patent is placed would be made by the holder of the patent rights. For the system to be effective, the decision to choose the individually-licensed class would have to be at a high enough cost that an holder would be incentivized to choose an individually-licensed patent only where significant returns should be expected because of its pioneering nature.

\[a. \; Determining \; Field-License \; Royalties\]

For the field-licensed patents, a neutral magistrate\(^{153}\) would define a royalty rate for all patents within a particular field of technology. Once the rate for the field is established, a company could buy a license to use all of the patents within a particular field. In other words, the mandatory license would allow others to “make[, use[, offer[] to sell, or sell[]”\(^{154}\) a product that practices anything claimed by a patent within the field upon payment of the required license fee. The fees collected for these licenses would be distributed to all who own a field-licensed patent within the relevant field. As a result, the inventor receives compensation for the use of the invention—potentially more than would have been received without this proposed licensing system functioning\(^{155}\)—thus satisfying the system’s fundamental purpose of rewarding inventors for disclosing their inventions\(^{156}\) while giving product developers an effective safe harbor against a multitude of patent claims, whether by patent trolls or by more legitimate companies.

It is important to note that no attempt need be made to determine that a particular product reads on to a particular patent within the field or even, for that matter, whether a patent was improperly granted. If the product practices an art within the field, the mandatory license would

\[\text{continued . . .}\]

\(^{153}\) This would presumably be an administrative judge operating a system of adjudication similar to that established in the Copyright Act. See 17 U.S.C. §§ 801–05 (2012).


\(^{155}\) In fact, most inventors are likely to receive more compensation under this system than they do now as most patents fail to achieve any financial remuneration. See Mark A. Lemley & Carl Shapiro, Probabilistic Patents, 19 J. ECON. PERSPS. 75, 75 (2005) (noting that “[m]ost issued patents turn out to have little or no commercial significance”).

apply and the compensation paid for the field-license would make the use of any field-licensed patent non-infringing.

There are numerous ways that a patent’s “field” could be defined for the purpose of mandatory licensing. The easiest approach would be to use the patent office’s “class” definitions, which designate a patent’s technological field.\(^\text{157}\) For some of these classes, however, the Code covers an immense amount of technology that differs more than the single class implies.\(^\text{158}\) Consequently, if considering the most commonly patented technologies, the sub-classes defined by the patent office may be more appropriate.\(^\text{159}\) In contrast to this, of course, are the least popular Patent and Trademark Office (“PTO”) classes where subdividing beyond the primary class definition would seem to be a colossally over defined.\(^\text{160}\) Consequently, it may be more appropriate to give regulatory authority to the Patent Office to define and potentially redefine the “fields” that are used for mandatory licensing. This would allow the system to be responsive to the different sizes of each patent class as well as their relative popularity, and would allow the PTO to keep the system responsive as technology changes.

\(b.\) Electing Out of Field-Licensing

Although field-licensing would work better than the current system for most patents, an exception would be necessary for certain types of patents. When an inventor creates something in a broad field of technology—a pioneering invention—field-license compensation


\(^\text{158}\) See USPTO Classifications, supra note 157 (push the “go” button next to 705) (Class 705 Data Processing: Financial, Business Practice, Management, or Cost/Price Determination has over 100 sub-classifications and is associated with numerous patents). See also USPTO Patent Counts, supra note 37 (class 054 Harness for Working Animal has far fewer subclasses and accounts for few modern patent applications).

\(^\text{159}\) See USPTO Classifications, supra note 157.

\(^\text{160}\) Id. (noting that only thirteen patents were issued in class 054 in 2014).
would be an insufficient reward. The patent system has long recognized that the quantity of the reward provided needs to be dependent on the scope of the invention, giving a greater reward to the inventor of a more significant invention.\textsuperscript{161} Consequently, some way is needed to exempt a patent from the field-licensing system. Two basic methods are possible: an attempt can be made to globally define what constitutes a pioneering invention so that this occurs automatically or, alternatively, the inventor could be allowed to decide for him or herself that the invention is a major transformation of existing technology.

The first approach is likely to be extraordinarily difficult to achieve, as the breadth of technology that is subject to patent is effectively illimitable, including technological fields that have yet to be conceived.\textsuperscript{162} It would indeed be hard, if not impossible, to define what a pioneering invention is, since this can often only be determined in hindsight.\textsuperscript{163} Additionally, any definitional approach is likely to introduce significant uncertainty about whether the field-license applies to a particular patent, thus removing one of the principle justifications for creating them.\textsuperscript{164}

If the alternate approach of self-definition is taken, the decision to exclude a patent from the field-licensing system cannot be without cost to the inventor. After all, if all inventors elect out of the system, the patent system returns to the status quo and will not gain the benefits obtained by field-licensing. Consequently, the inventor must pay a cost to elect out of field-licensing that is expensive enough that the inventor is expressing a high degree of confidence that more compensation will be obtained from individually negotiated license fees than would be earned from field-license royalties. The opt-out system would take

\textsuperscript{161} See Eibel Process Co. v. Minn. \& Ontario Paper Co., 261 U.S. 45, 63 (1923) ("In administering the patent law, the court first looks into the art, to find what the real merit of the alleged discovery or invention is, and whether it has advanced the art substantially. If it has done so, then the court is liberal in its construction of the patent, to secure to the inventor the reward he deserves. If what he has done works only a slight step forward, and that which he says is a discovery is on the border line between mere mechanical change and real invention, then his patent, if sustained, will be given a narrow scope, and infringement will be found only in approximate copies of the new device.").

\textsuperscript{162} See Diamond v. Chakrabarty, 447 U.S. 303, 309 (1980) (noting that "anything under the sun that is made by man" is potentially patentable).

\textsuperscript{163} See supra note 114 and accompanying text. A good example demonstrating this can be found in the early days of electronics. Although Fleming is credited with inventing the vacuum tube diode having started his work in 1895, there is strong evidence that Thomas Edison had practiced one in 1883. Edison failed to appreciate the value of what he had conceived an abandoned the device. \textit{Id.}

\textsuperscript{164} ROBERT GOLDSHEIDER, LICENSING BEST PRACTICES: THE LESI GUIDE TO STRATEGIC ISSUES AND CONTEMPORARY REALITIES 129 (2002).
advantage of an inventor’s appreciation of the risks associated with obtaining potentially higher compensation against the surety of obtaining compensation at a lower level.

Of the two approaches, therefore, the second seems more likely to be effective. Development of a predictive algorithm that could reliably determine which inventions are pioneering is extraordinarily unlikely. Just as defining obscenity is problematic, determining when a patent is pioneering is likely to require its effect in the marketplace to be measured. On the other hand, if it is assumed that inventors as a class are likely to be rational market actors, their collective decisions about whether to treat their patents as pioneering will be a relatively reasonable predictor of that fact.

The second approach is dependent on establishing an appropriate opt-out fee. The fee forces each inventor to engage in a cost-benefit analysis with respect to each patent. If the patent remains part of the field-licensing system, its royalty return will be limited by the modest rate that is likely to be defined for each field and by the number of patents that claim inventions within the field. On the other hand, a field-licensed patent holder is effectively guaranteed a royalty return of some amount unless the field itself is not of interest to any operating company. Similarly, the cost of enforcing patent rights should be significantly less than the current system as it should be in the economic interest of most developers of technology to obtain field-licenses in the fields in which their operations lie.

2. Determining Royalty Rates for Field-Licenses

The hardest aspect of implementing the proposal for field-licenses would likely be the establishment of an appropriate rate to be paid for each license. The payment must serve as sufficient compensation to the group of inventors with a patent in the field so that advancements to the specific technology represented within the field are properly

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165 See Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (“I shall not today attempt further to define the kinds of material I understand to be embraced within [obscenity] . . . [b]ut I know it when I see it . . .”).

166 As will be more fully developed, the royalties paid to obtain a field-license will be split among all holders of a patent within the field. See supra part V.B.1.a.

167 There have been no patents filed in the “typecasting” field (class 199) since before 1993. See USPTO Patent Counts, supra note 37. Error! Main Document Only. As the technology of typecasting is now obsolete and computer generated typesetting has replaced the old physical technologies, see Mark Collard, The History of Typesetting, Professional Reports, http://www.professionalreports.co.uk/the-history-of-typesetting/ (last visited July 27, 2015), no company is likely to obtain a field license covering it.
incentivized, while costing an amount that will encourage others to obtain a field-license rather than using the technology in the hopes of not being sued.

To begin the analysis, it is necessary to carefully articulate exactly what would be acquired if a field-license were to be purchased. A field-license is, effectively, a license similar to the site licenses used by the copyright performing rights organizations.\(^{168}\) By having one, its holder would have the right to practice any invention that has a claim within a particular field, unless the patent has been properly excluded from the field-licensing system.\(^{169}\) The practice could be a one-time occurrence—to overcome the limitations of the experimental use defense,\(^{170}\) for example—or could be used to distribute millions of products that practice a covered claim. In each case, the field-license royalty would be the compensation to which the patent holder is entitled.

As the rate is set, therefore, the typical economic importance of a non-pioneering patent needs to be determined. Several factors are important to this analysis; some favor a high royalty rate, while others suggest otherwise. Ultimately, administrative judges would need to balance:

**Rewarding Inventors:** The first and broadest factor favors establishing a high rate for a field-license. The underlying purpose of the patent system is to reward inventors for disclosing inventions.\(^{171}\) The holders of a patent have a monopoly granted by the PTO based on its determination that the statutory requisites have been met.\(^{172}\) Consequently, as the patentees have disclosed a technology that was not yet within the prior art, it is important to ensure that the reward provided is significant enough to serve as a motivation for future inventors to continue both inventing and disclosing new technology.\(^{173}\)

**Encouraging More Innovation:** The second factor also favors

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\(^{168}\) See ASCAP Licensing, supra note 89.

\(^{169}\) See supra Part V.B.1.


\(^{171}\) See, e.g., United States v. Univis Lens Co., 316 U.S. 241, 250 (1942) (“The declared purpose of the patent law is to promote the progress of science and the useful arts by granting to the inventor a limited monopoly, the exercise of which will enable him to secure the financial rewards for his invention.”).

\(^{172}\) See 35 U.S.C. § 101–03 (2012). This paper will not address the underlying quality problems that have been identified within the U.S. patent system and assumes that all active patents were granted appropriately and are thus entitled to be enforced. But see Ralph D. Clifford, *Is it Time for a Rule 11 for the Patent Bar?*, 53 THE INTELL. PROP. L. REV. 351 (2013); Clifford et al., supra note 6; Guerrini, supra note 150 and accompanying text.

setting higher rates. It recognizes that although most new inventions do not move technology forward in a significant manner, they do represent an economically valuable improvement to the technology. A good example of this is the intermittent wiper on automobiles.\textsuperscript{174} That feature is not needed to operate an automobile, not even when it is raining. At the same time, it created a better way of responding to a light rain in an automobile as is demonstrated by its universal adoption. Further, it was shown to have considerable economic value before it expired.\textsuperscript{175} Royalty rates for field-licenses, therefore, need to be responsive to the likely economic value of a patent within the field.

\textit{Field of Innovation:} The third factor—the specific technology included within the field—could affect the compensation in either direction. Whatever rates are established need to be sensitive to the differing economic value that an invention has based on the technology being developed. A new design for a horse-and-buggy could certainly qualify for a patent, for example; but it is unlikely to be of any significant value in modern society. On the other hand, a new telecommunication invention like Bluetooth\textsuperscript{176} could be of significant economic value. Consequently, the rates would need to be set by each field rather than globally.\textsuperscript{177}

\textit{Low Value of Most Patents:} Not all factors favor setting a high rate. In reality, the open-market economic value of many—if not most—patents is negligible.\textsuperscript{178} For the non-exceptional patent, the holder never collects any royalties.\textsuperscript{179} This fact serves to suggest that a low rate of field-license royalty would be appropriate and serves to contradict the other factors that favor higher rates.\textsuperscript{180} As a consequence of this, rate setting within a field would need to be sensitive to the number of patents currently issued in the field and the proportion of them that fail to achieve any return.

\textit{Age of the Patent:} The current patent term is twenty years from the

\begin{footnotesize}
\footnotesize\textsuperscript{175} See Kearns v. Chrysler Corp., 32 F.3d 1541, 1544 (Fed. Cir. 1994) (noting that Ford was ordered to pay $5,163,842 in royalties and upholding a $18,740,465.43 judgment against Chrysler).
\footnotesize\textsuperscript{177} This re-emphasizes the importance of carefully defining the fields to be used in the system. See supra Part B.2.
\footnotesize\textsuperscript{178} See Bronwyn H. Hall, The Use and Value of Patent Rights, U.S. PATENT & TRADEMARK OFF. (June 2009), www.uspto.gov/sites/default/files/aia_implementation/ipp-2011nov08-ukipo-2.pdf (“Most patents are worth very little and a few are worth a lot.”).
\footnotesize\textsuperscript{179} See Lemley & Shapiro, supra note 155, at 84.
\footnotesize\textsuperscript{180} Id. at 75–76, 82, 89, 93, 95.
\end{footnotesize}
application date. 181 For many technologies, however, a patented invention is not equally valuable throughout its duration. 182 Some technologies, such as data processing equipment, can become obsolete quickly. 183 For these types of patents, a higher rate would be appropriate early in the patent’s existence, but would be of declining value thereafter. For other technologies, often legacy technologies that are no longer at the leading edge of development, 184 lowering the value with the passage of time would be less appropriate.

Projected Use by the Licensee: The final distinction that the system should consider is one based on how the licensee is expecting to use the patents. At one extreme, where a licensee wishes to experiment within a technological area, either to develop new products or for any reason that is just more than idle curiosity, 185 but does not intend to widely practice any patent within the field, a lower fee would seem appropriate. If, however, patents within the field are likely to be practiced constantly—through the distribution of products that likely practice one or more of the patents in the field, for example—a broader and consequently more expensive license for the technology would be appropriate. 186

181 See 35 U.S.C. § 154(a)(2) (2012) (enumerating a variety of circumstances in which the duration of a patent will be extended). See also 35 U.S.C. § 154(b) (2012); id. § 156.
183 See GOPALASWAMY RAMESH & RAMESH BHATTIPROLU, SOFTWARE MAINTENANCE 6 (2006) (noting that there is a “shrinking life cycle[] of [software] technolog[y]”). Cf. Why Your New Smartphone is Already Obsolete, MY PHONE MD (July 16, 2012), http://myphonemd.net/blog/2012/07/16/why-your-new-smartphone-is-already-obsolete/ (noting that the average life span of a cell phone is less than two years).
185 See Madey v. Duke Univ., 307 F.3d 1351, 1362 (Fed. Cir. 2002) (“[T]he experimental use defense is very narrow and strictly limited . . . to actions performed for amusement, to satisfy idle curiosity, or for strictly philosophical inquiry. Further, use does not qualify for the experimental use defense when it is undertaken in the guise of scientific inquiry but has definite, cognizable, and not insubstantial commercial purposes.” (internal citations and quotation marks omitted)).
186 By analogy, the scope of a copyright site license would be considerably cheaper for a small church hall than for a large, commercial concert hall. Compare Church Licensing Fees, CHRISTIAN COPYRIGHT SOLUTIONS, https://www.christiancopyrightsolutions.com/purchase-license.aspx?svc=pm (last continued . . .
VI. CONCLUSION

Patent law is designed to encourage the transfer of technology from being solely within the knowledge of an inventor to being part of the common knowledge of society.\textsuperscript{187} The main methods by which this is achieved is by publishing patents with their specifications and by incentivizing patentees to use or license their inventions.\textsuperscript{188} For the information contained within patents to spread, the information has to be readily ascertainable by those interested in it.\textsuperscript{189} The reality of the modern system, however, fails to achieve this goal because of the overwhelming number of patents being issued, many of which are of questionable quality.

The mandatory licensing scheme proposed in this paper is designed to overcome the failure of the current patent system to achieve its underlying justification. Rather than using patents in ways that prevent technology from being transferred, it will ease the flow of technology from inventors to the public.


\textsuperscript{188} \textit{id.} at 470.

\textsuperscript{189} See Sean B. Seymore, \textit{The Presumption of Patentability}, 97 \textsc{Minn. L. Rev.} 990, 1018 (2013).
CLOSING THE TAX DEBT LOOPHOLE: WHY THE FTC SHOULD ENFORCE THE DEBT RELIEF RULE AGAINST TAX DEBT RELIEF COMPANIES

Cara Van Dorn†

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I. INTRODUCTION

“Do you owe back taxes? Are you tired of the IRS breathing down your neck? Call us today! We’ll help you settle your tax debt for pennies on the dollar! We’ve helped thousands of people just like you to cut tax debt in half in just six months!” Although some people know a scam when they see one, to those who find themselves in serious debt, an advertisement like this can sound like the answer to their prayers. While some debt relief companies do legitimately try to help their customers, many others prey on consumers’ misfortune, ignorance, and monetary mismanagement by promising incredible results and taking payment upfront, but failing to actually help reduce the customer’s debt.

By 2009, so many people had complained of deceptive advertising, lack of results, and outright fraud in the debt relief industry that the Federal Trade Commission (“FTC”) promulgated a rule regulating what companies could promise in their sales pitches and prohibiting companies from accepting fees prior to rendering a service. Surprisingly, the FTC excluded one category of debt relief companies from the ambit of these protective provisions—tax debt relief companies, thus allowing these entities to continue engaging in the same fraudulent and deceptive practices that the FTC found so injurious to consumers.

This article aims to explain why the FTC should reverse its decision

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1 See Reduce IRS Tax Debt Up to 85% by IRS Tax Relief Programs, YOUTUBE (Feb. 10, 2013), https://www.youtube.com/watch?v=nGBW9jmEoAk; TV Commercial, YOUTUBE (Oct. 28, 2010), https://www.youtube.com/watch?v=PJNNOEBOUs; TV Commercial, YOUTUBE (Dec. 15, 2011). https://www.youtube.com/watch?v=0F-JGBoJE4E.

2 Donna Fuscaldo, Don’t Become a Victim of a Tax-Relief Scam, FOX BUS. (July 30, 2013), http://www.foxbusiness.com/features/2013/07/30/dont-become-victim-tax-relief-scam.html (“Tax scams are alive and kicking,’ says Mitchell Friedman, a certified public accountant in Westlake Village, Calif. ‘More and more people are being caught up in them.’ Looking to prey on the desperate, scam artists peruse tax lien notices to identify taxpayers that have Uncle Sam breathing down their necks and then offer them bogus tax resolution services.”).

3 Id. (“In most cases, they ask the customer to pay a fee in advance; unfortunately, all too frequently, they do nothing,’ says Friedman, noting that one company was able to fraudulently collect tens of millions of dollars on behalf of tax payers without bringing any resolution in just a few years.”).


to exclude tax debt relief companies from the regulations it deemed necessary to protect consumers from abuses prevalent in the industry. Section I describes the historical context leading to the birth of the debt relief industry, the rise of abusive practices therein, and the largely failed attempts to reduce those practices. Section II explains the FTC’s decision to craft and impose new regulation, the “debt relief rule,” despite opposition from the industry. The Section goes on to describe the FTC’s unexpected decision to defer enforcement of the rule against tax debt relief companies. Section III proposes that the FTC close the current tax debt loophole in order to grant injured parties a more effective litigation path towards remedy. This Section also explains that enforcing the debt relief rule against tax debt relief companies comports with the FTC’s policy goals in creating the rule, as tax debt relief companies pose the same threat to consumers as the rest of the industry.

II. BACKGROUND

A. Birth of the Debt Relief Industry

In the late 1990s and early 2000s, Americans found themselves in increasing amounts of debt, and the inability to make required payments became more common.6 The first generation of debt relief companies emerged at the behest of creditors hoping to recoup the unpaid debt of overextended consumers on the verge of default.7 These companies, which operated as nonprofits, offered three types of assistance to indebted consumers.8

“Debt management” providers, acting as intermediaries to the creditor, helped debtors to map out a practical installment plan intended to facilitate full payment of the customer’s debts, usually within a three to five year period.9 Other entities offering “debt settlement” guided a customer nearing default in making a settlement offer of a lump sum to each creditor, typically in an amount substantially less than the full debt.10 A third strain of providers, calling themselves “debt

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7 Id. at 41,990, 41,994 (“For decades, debt relief services were almost exclusively the province of nonprofit credit counseling agencies (‘CCAs’). Beginning in the mid-1960s, creditor banks initiated this model, providing funding for CCAs with the intent of reducing personal bankruptcy filings.”).
8 Id.
9 Id. (“[C]ounselors work as a liaison between consumers and creditors to negotiate a ‘debt management plan’ (‘DMP’) — usually for the repayment of credit card and other unsecured debt.”).
10 Id. at 41,993.
negotiators,” communicated with creditors on their customer’s behalf to suspend penalty fees and obtain lower monthly payments and interest rates.11 While a majority of the industry focused on credit card debt, a handful of companies carved out a niche by specializing in assisting consumers with tax debt.12 Instead of negotiating with credit card companies and banks, these agents dealt with the Internal Revenue Service (“IRS”) and state tax entities.13

As consumer debt rose, the largely unregulated debt relief industry grew to meet the increasing demand and shifted to a for-profit model.14 Unfortunately, increasing opportunity, competition, and specialization in the industry did not result in increased efficiency, efficacy, and customer service, but instead, in a proliferation of abusive and deceptive practices against a vulnerable and largely defenseless customer base.15 Opportunists began to capitalize on the desperation and ignorance of indebted consumers by exaggerating their abilities to solve debt problems, but becoming less vigilant about fulfilling their promises.16

B. Rise of Abusive Practices in the Debt Relief Industry

The debt relief industry became infamous for defrauding customers and engaging in other abusive practices.17 In addition to making unauthorized withdrawals from customer accounts, the most common abusive practices involved deceptive advertising and fee structures that required customers to pay upfront, before the rendering of services and regardless of whether the customers ever received those services.18

11 Id. at 41,997.
13 Id. (Although many of these agents are tax attorneys, certified public accountants or “enrolled agents” (tax professionals authorized to practice before the IRS), some hold no qualifications and call themselves “tax consultants,” but are nothing more than specialized salespersons.).
14 Proposed Rule, supra note 6, at 41990–93 (“As consumer debt has grown in recent years, so have the number and type of entities that provide, or purport to provide, services to consumers struggling with debt . . . These developments have created an opportunity for a new debt relief business model offered by for-profit debt settlement companies.”).
15 Id. at 41,993.
16 Id. at 42,002.
17 Id. at 41,995.
18 Id. at 41,994.
1. Deceptive Advertising and Fraud

Increased competition and opportunity rewarded debt relief companies willing to say whatever was necessary to convince consumers to purchase their services. 19 Companies grossly misrepresented the success rates of their programs and the satisfaction of past customers, 20 and failed to disclose the potential risks and pitfalls of participating in their programs. 21

Companies used tempting hooks to grab potential customers’ attention, saying they could settle debt “for pennies on the dollar” or “for a fraction of the debt owed.”22 They guaranteed a certain percent reduction in total debt 23 or promised relief in a specific amount of time. 24 They promised they could stop contacts from creditors and debt collectors, and that they could reduce monthly payments, interest rates, and late fees. 25 Companies touted special relationships with credit card companies that would facilitate favorable negotiations that consumers could not achieve on their own. 26

Predictably, many companies failed to deliver. 27 Oftentimes, these promises were outright lies or gross exaggerations meant only to mislead customers. 28 In some cases, relief took much longer than advertised while monthly fees accumulated or the company achieved much less favorable terms than they promised. 29 Sometimes,

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19 Id. at 41,995.
21 Proposed Rule, supra note 6, at 42,002. For example, some creditors simply refuse to accept a settlement offer, change their interest rates, or reduce penalty fees.
22 Id. at 41,993. See also FTC v. Am. Tax Relief LLC, No. CV 11-6397 DSF (PJWx), 2012 WL 8281722, at *3 (C.D. Cal. Aug. 8, 2012).
25 Proposed Rule, supra note 6, at 41,993.
27 Proposed Rule, supra note 6, at 41,994.
28 Id.
29 See, e.g., Growth of the Debt Settlement Industry, DEBT SETTLEMENT USA, at 10, available at https://www.ftc.gov/sites/default/files/documents/public_comments/debt-settlement-industry-public-workshop-536796-00006/536796-00006.pdf (“Fraudulent firms also regularly fail to provide the services promised to consumers by claiming that they can help them become debt free in an unrealistically short continued . . .
companies attempted to help their customers, but failed because some creditors simply refused to negotiate or accept a settlement offer, change interest rates, or reduce penalty fees.\textsuperscript{30} In these situations, hopeful customers often suffered increased penalties, mounting interest, and damaged credit scores; meanwhile, the debt relief companies refused to refund the fees already paid that they had not earned.\textsuperscript{31}

2. \textit{Upfront and Excessive Fees}

The practice of charging upfront fees caused the greatest harm to consumers.\textsuperscript{32} Some companies charged thousands in upfront fees and punishing monthly payments without providing any service to the customer, while others glossed over their fee structure during the sales pitch, locking customers into a program that they could not afford and refusing to provide a refund.\textsuperscript{33} Many customers complained that the debt relief company they hired for assistance disappeared after receiving the initial payment.\textsuperscript{34} Other customers received continued assurances of progress on their case, only to discover later that the company had done no more than complete preliminary paperwork.\textsuperscript{35}
Thousands of customers found themselves even further in debt than before they enlisted these companies for help.\textsuperscript{36}

Tax debt relief companies actively participated in these abusive behaviors.\textsuperscript{37} TaxMasters, a now defunct Texas company, committed 110,000 violations of the state’s Deceptive Trade Practices Act and was ordered to pay $113 million of a $195 million judgment to defrauded customers.\textsuperscript{38} A woman who famously called herself “The Tax Lady” on late-night television commercials settled a $34 million lawsuit for fraudulent business practices with the California Attorney General.\textsuperscript{39} The FTC successfully sued a nation-wide provider of tax debt relief services, American Tax Relief, in a case discussed in detail later in this paper.\textsuperscript{40}

C. Attempts to Reduce Abusive Practices

Many of the abusive practices that consumers accused the debt relief industry of perpetrating were already prohibited under the Federal Trade Commission Act\textsuperscript{41} ("FTC Act"), which proscribed deceptive advertising.\textsuperscript{42} Additionally, the Telemarketing and Consumer Fraud and Abuse Prevention Act\textsuperscript{43} ("Telemarketing Act") already protected consumers from unwanted solicitous phone calls and the use of that the defendants failed to take any action on clients’ cases until months of payments had accrued); FTC v. Connelly, No. SA CV 06-701 DOC (RNBx) (C.D. Cal. 2006) (alleging that defendant failed to inform consumers that 45% of their total program fees had to accrue before he would begin work on their account); James O’Toole, \textit{TaxMasters Slapped with $195M Fraud Judgment}, CNN MONEY (Mar. 30, 2012, 7:24 PM), http://money.cnn.com/2012/03/30/news/companies/taxmasters-fraud/ (explaining that the state alleged that TaxMasters misled clients by claiming its employees would immediately begin work on a case, sometimes causing customers to miss IRS deadlines).

\textsuperscript{36} \textit{The Debt Settlement Industry}, CTR. FOR RESPONSIBLE LENDING (June 29, 2010), http://www.responsiblelending.org/research-publication/debt-settlement-industry ("Often, enrolling in a debt settlement service puts consumers in a worse position, i.e. facing increased debt, higher risk of (or actual) bankruptcy, ruined creditworthiness, heightened collections efforts and even lawsuits.").

\textsuperscript{37} O’Toole, \textit{supra} note 35.

\textsuperscript{38} Id.


\textsuperscript{40} See \textit{infra} note 113; \textit{infra} Section III(a)(i).


\textsuperscript{42} Id.

deceptive or coercive sales practices in such calls. But the FTC, state attorneys general, and injured consumers struggled to enforce these laws against debt relief companies because of difficulty in discovery, complicated proof structures, and loopholes that allowed some companies to escape regulation. Additionally, oftentimes the consumers injured by the abusive acts of debt relief companies simply lacked the resources necessary to pursue legal action.

III. THE NEED FOR SPECIFIC REGULATION

As the problems continued, the FTC determined that further, more specific regulation was necessary to protect the public. The Telemarketing Act authorized the FTC to promulgate rules to further the goal of consumer protection and empowered the FTC, private persons, attorneys general, and other state officials to bring civil action

45 See Proposed Rule, supra note 6, at 41,997–42,000. See also FTC Testifies About Ongoing Efforts to Protect Consumers from Deceptive Debt Relief Scams, FED. TRADE COMMISSION (Aug. 12, 2010). The FTC Act’s prohibition of the use of certain kinds of advertising (using deceptive or misleading statements or failing to disclose material terms of an agreement) can be difficult to enforce for several reasons. Finding sufficient proof can be a challenge when the offending statements were made verbally and without any record. Plaintiffs face difficulty in showing that the customer reasonably relied on any particular statement, even if one can show that the statement was made and that it was improper. Companies can often escape regulation by asserting that any illegal advertising practices were employed by a single rogue employee. The TSA only applies to telemarketing practices in which a company places unsolicited calls to the potential customer. Prior to the 2009 amendments to the TSR, a company could escape enforcement of the TSR’s provisions if prospective customers call the company in response to advertisements seen on television or heard on the radio. The proliferation of advertisements and activities on the internet also demonstrated the insufficiency of the scope of the TSR. Proposed Rule, supra note 6, at 41,999. Additionally, the industry has a long history of companies masquerading as nonprofits while operating for profit. The IRS discovered scores of companies abusing nonprofit status by reaping the benefits without adhering to the restrictions.
46 The Debt Settlement Industry, CENTER FOR RESPONSIBLE LENDING, http://www.responsiblelending.org/other-consumer-loans/debt-settlement/research-analysis/Debt-Settlement-The-Basics.pdf (last visited Apr. 4, 2016) (“The debt settlement model is an inherently flawed one, in that it requires consumers who are deep in debt (typically $20,000–30,000 worth, if not more) to save significant sums of money to settle each individual debt, but requires them to pay hefty up-front fees and monthly fees that leave the consumer with little savings left for settlement.”).
47 Proposed Rule, supra note 6, at 41,996–98 (“Based on its enforcement and outreach experience, including information from the Workshop, the Commission tentatively has concluded that additional legal restrictions are needed to address pervasive illegal conduct occurring in the sale of debt relief services.”).
for violations of the Act. The FTC crafted a rule requiring certain disclosures to help potential customers to make better informed decisions in purchasing debt relief services and prohibiting the practice of collecting payment prior to the performance of services. However, the FTC excluded tax debt relief companies from the scope of its rule, leaving this sector of the debt relief industry unregulated.

A. Low Rate of Success of Providing Promised Services

The Association of Settlement Companies (“TASC”), a trade association in the debt settlement industry, admits that rogue companies exist, operating fraudulent and abusive businesses at odds with interests of the legitimate industry. TASC submitted to the FTC the results of a self-reported survey of its members to show the effectiveness of legitimate debt relief companies. However, the survey’s unimpressive results accomplished just the opposite—notably, fewer than twenty-five percent of customers completed debt relief programs when “completion” was defined as settling at least seventy percent of enrolled debt. When the TASC allowed the term to go undefined, the “completion” rates ranged from thirty-five to sixty percent.

50 FTC Policy Statement, supra note 5.
52 Id.
53 See CENTER FOR RESPONSIBLE LENDING, supra note 46 (While this figure is not quoted outright in the TASC’s letter, the Center for Responsible Lending arrived at this figure by calculating the difference between the percent reported either completed or remaining in the program [35.4%] and the percent reported still remaining in the program [9.8%] to conclude that 24.4% had completed the program). See also Letter from the Association of Settlement Companies (TASC) to the Federal Trade Commission, commenting on the FTC’s proposed amendments to the Telemarketing Sales Rule on the marketing of debt relief services at 10 (Oct. 26, 2009), available at https://www.ftc.gov/sites/default/files/documents/public_comments/2009/10/543670-00202.pdf.
54 See Proposed Rule, supra note 6, at 41,995. By not defining “completion,” the TASC allows companies to report “completion” when a customer settled 80% of his or her debt, or 50% of his or her debt, or simply was no longer enrolled as a customer, regardless of whether any debt was settled at all.
55 See TASC Position Paper, supra note 51. See also Proposed Rule, supra note 6, at 41995. Some companies considered “completion” to mean settlement of 50%, 75%, or even 85% of debts. Some companies recorded a “completion” for a customer who was once enrolled in a program, but is no longer enrolled, without regard for whether any debts were settled at all.
Enforcement actions against debt settlement companies reveal an even bleaker picture of the industry.\textsuperscript{56} In an action against a California company, the FTC presented evidence showing that only 1.4% of customers who entered the company’s program obtained the promised result.\textsuperscript{57} In another case, evidence revealed that 12–14% of customers had debts settled to the extent the company promised.\textsuperscript{58} In requesting a restraining order against a Washington company, the FTC alleged that the company failed to achieve promised results in 99.5% of cases and failed to obtain any reduction in interest rates in 80.4% of cases.\textsuperscript{59} A state action in New York alleged that two debt settlement companies provided promised results to 0.33% and one percent of their customers, respectively.\textsuperscript{60}

\textbf{B. Effect and Prevalence of Upfront and Excessive Fees}

Even when companies succeeded in reducing debt, customers often lost these savings through payment of fees to the debt relief company.\textsuperscript{61} Most companies charged an upfront fee equal to a certain percentage of the debt enrolled in the program, instead of retaining a portion of the savings that the company obtained for the customer.\textsuperscript{62} TASC reports that companies commonly charge upfront fees equal to fourteen to eighteen percent of the customer’s debt, which often represents a large percentage of the savings achieved.\textsuperscript{63} The FTC reported companies charging advance fees as high as thirty to sixty percent of the consumer’s debt.\textsuperscript{64}

The advance fee model interferes with customers’ ability to make

\textsuperscript{56} Proposed Rule, supra note 6, at 41,995.
\textsuperscript{57} Id. (citing FTC v. Nat’l Consumer Council, Inc., No. SACV04-0474 CJC (JWX) (C.D. Cal. 2004)).
\textsuperscript{58} Id. (citing FTC v. Connelly, No. SA CV 06-701 DOC (RNBx) (C.D. Cal. 2006)).
\textsuperscript{59} Id. (citing FTC v. Debt Solutions, Inc., No. 06-0298 JLR (W.D. Wash. Mar. 6, 2006)).
\textsuperscript{61} Proposed Rule, supra note 6, at 42,000.
\textsuperscript{63} Proposed Rule, supra note 6, at 42,000. Recall that this is the self-reported average from companies who are members of the trade organization. Anecdotal customer reports and other research show substantially higher fees.
\textsuperscript{64} FTC v. Credit Restoration Brokers, No. 2:10CV00030, 2010 WL 1230609 (M.D. Fla. Jan. 9, 2010).
payments on their current debt or save enough to offer a lump-sum settlement to creditors, effectively making customers more likely to fail.\textsuperscript{65} Even assuming that the company succeeds in reducing the consumer’s debt, the company must save the person more than the amount charged for the consumer to have reaped any benefit.\textsuperscript{66} The FTC also noted several instances in which companies claimed to charge no upfront fee, yet waited until the customer’s monthly fees had accumulated to a certain percentage of the debt before they began work on that case.\textsuperscript{67} Coupled with the low success rates of the industry, the fee structure highlights the abusive nature of the industry that allows companies to ensure that they receive payment regardless of whether the customer enjoys a benefit.\textsuperscript{68}

The picture of the industry’s effectiveness is deliberately blurry at best and shrouded in deceit and fraud at worst, and even the most disciplined and credible members of the industry often fail to provide the advertised service.\textsuperscript{69} These shortcomings of the industry justify the FTC’s decisions to increase regulation despite opposition.\textsuperscript{70}

\section*{C. Industry Opposition to Regulation}

\textsuperscript{65}Proposed Rule, \textit{supra} note 6, at 42,007 ("The practice of charging substantial up-front fees, as is the case with many debt relief services, is inherently inconsistent with the purported goal of the services.").

\textsuperscript{66}See \textit{FTC Policy Statement on Unfairness}, \textit{FED. TRADE COMMISSION} (Dec. 17, 1980), https://www.ftc.gov/public-statements/1980/12/ftc-policy-statement-unfairness. \textit{See also id.} For example, if a person enrolls $20,000 of debt, assuming a 15\% fee, he or she must pay $3,000 upfront. The debt relief company must then save the customer more than $3,000 in the debt relief process for the customer to enjoy any benefit from the service at all.

\textsuperscript{67}See, e.g., FTC v. Debt-Set, Inc., No. 1:07-cv-00558-RPM (D. Colo. 2007) (alleging that defendants misrepresented the fee structure, telling customers that they did not charge an upfront fee, but waiting until their monthly payments reached a certain amount before beginning work on that); FTC v. Connelly, No. SA CV 06-701 DOC (RNBx) (C.D. Cal. 2006) (alleging that defendant failed to inform consumers that 45\% of their total program fees had to accrue before he would begin work on their account).

\textsuperscript{68}Proposed Rule, \textit{supra} note 6, at 42,008 ("However, the record lacks empirical data on whether debt relief companies actually provide the debt relief as represented to consumers. In fact, the federal and state law enforcement record demonstrates that few, if any consumers who pay upfront fees, receive any benefits from the advance fee practice. Thus, any increase in costs resulting from the advance fee ban would be unlikely to outweigh the consumer injury resulting from the current fee practice.").

\textsuperscript{69}Id.

\textsuperscript{70}Id. ("Moreover, while the Commission acknowledges that debt relief services may have labor and operating costs, it notes that the actual benefit of allowing entities to recover these costs largely rests on their ability to deliver represented results—an ability that still remains largely unsupported by the record.").
The FTC received input from interested parties and industry members when it held a public workshop called “Customer Protection and the Debt Settlement Industry” in 2008 and again during the notice and comment period of the rulemaking process. Unsurprisingly, many debt relief companies opposed the regulation of their industry, while others recognized the need for reform with respect to outright fraud, but advocated for regulation that would minimally burden the supposedly legitimate companies.

The FTC rejected this approach for two reasons. First, even legitimate debt relief companies have a poor track record of providing any benefit for their customers. Secondly, the FTC perceived such overarching abuse of customers in the industry that it determined protecting consumers required more restrictive means than the industry members found palatable. Therefore, the FTC, in crafting regulation, did not prioritize the continued operation of every company. Instead, the FTC justifiably considered the potential shrinking of the industry to be part of the solution rather than a problem to be avoided.

Many members of TASC agreed with the FTC’s assessment that regulation prohibiting misleading and deceptive statements would improve the industry standard. On the other hand, they opposed the advanced fee ban, arguing the necessity of upfront fees to pay for initial personnel and operating costs. The FTC dismissed this argument, arguing that consumers should not pay until they know whether or not the company will perform those services, pointing to the low success rates in the industry and the many lawsuits in which consumers complained that they paid an upfront fee and received nothing in

72 See Proposed Rule, supra note 6, at 41,998 (illustrating the Commission’s invitation for written comments on the proposed rule).
73 Final Rule, supra note 4, at 48,465.
74 See Proposed Rule, supra note 6, at 42,008.
75 See id. at 42,005–06; CTR. FOR RESPONSIBLE LENDING, supra note 36.
76 See CTR. FOR RESPONSIBLE LENDING, supra note 36 (“The data shows that few consumers benefit while many are harmed . . . success rates are low, while fees are high and often, at least some debt (and commonly substantial debt) remains.”).
77 Proposed Rule, supra note 6, at 42,006.
78 Id.
79 Id. at 42,008.
81 TASC Position Paper, supra note 51, at 6.
82 Proposed Rule, supra note 6, at 42,008.
The debt relief business contains many inherent uncertainties, and the debtors’ vulnerability and desperation make them more susceptible to believing misleading advertising or taking a potentially high-payoff risk. Therefore, allowing payment of fees only after the company provides the service gives consumers the best chance to succeed in paying off their debt and ensures that companies cannot cut-and-run.

D. The FTC’s Debt Relief Rule

In August 2009, the FTC proposed amendments to the Telemarketing Sales Rule (“TSR”) to reduce abuse in the debt relief industry. The final rule, published in 2010, requires entities selling debt relief services for profit to make specific disclosures to potential customers in order to improve consumers’ understanding of the potential benefits and risks, and the likelihood of success of the programs before they decide to buy. Most significantly, the final rule forbade debt relief companies from requesting or accepting any fee prior to providing the promised service. The rule also required companies to keep certain records to facilitate oversight and enhance compliance.

The required disclosures increase the likelihood that consumers will

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83 Id.
84 Proposed Rule, supra note 6, at 41,195–96. Is the creditor willing to make concessions or accept an offer of settlement? Will the customer be capable of adhering to the terms of the offer? Will the use of a debt relief program merely make the consumer’s problems worse by triggering more late fees and worsening his or her credit score?
85 Id. at 41,993.
86 Id. at 42,002.
87 See generally id.
88 Final Rule, supra note 4.
89 Id. at 48,465. The final rule required the following four disclosures: (1) the amount of time necessary to receive the represented results; (2) the amount of savings needed before the settlement of a debt; (3) if the debt relief program includes advice or instruction to consumers not to make timely payments to creditors, that the program may affect the consumer’s creditworthiness, result in collection efforts, and increase the amount the consumer owes due to late fees and interest; and (4) if the debt relief provider requests or requires that the customer place funds in a dedicated bank account at an insured financial institution, that the customer owns the funds held in the account and may withdraw from the debt relief services at any time without penalty, and receive all funds in the account. Id. The FTC decided not to include three additional disclosures that it had originally proposed: (5) that creditors may pursue collection efforts pending the completion of the debt relief service; (6) that any savings from the debt relief program may be taxable income; and (7) that not all creditors will accept a reduction in the amount owed. See id.
90 Id.
91 Id.
make prudent choices, but the ban on advance fees protects even the desperate and uninformed consumer. Many of the deceptive advertising techniques lose their effectiveness if the company must perform the promised service before the consumer pays the fee. Therefore, the advance fee ban reduces the company’s incentive to inflate consumer expectations with misrepresentations.

Enforcement of the advance fee ban is also substantially simpler than suing for fraudulent and deceptive advertising. In a suit for deceptive advertising, a plaintiff may fail because of the subjectivity of several malleable elements (such as a specific statement’s capacity to mislead a reasonable consumer) or because solid evidence of these elements may not exist (a common problem when attempting to prove a particular plaintiff reasonably relied on the defendant company’s claims). To prove a violation of the advance fee ban, the enforcing entity must establish only that (1) the company sold debt relief services (and was therefore subject to the rule) and (2) the company accepted fees prior to rendering the service. The clarity and simplicity of the advance fee ban reduces a company’s chance of wriggling out of enforcement because of a lack of sufficient evidence to show reliance or by claiming a rogue employee acted on his own. Examples of these differences are discussed in Section III.

Taken together, these provisions represent a well-calculated effort to reduce the ability of debt relief companies to injure people already experiencing financial distress. Therefore, it is puzzling that the FTC decided to defer enforcement of this rule against companies dealing in tax debt relief.

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92 See id. at 48,469–70.
93 Id.
94 Id.
95 Id.
96 See infra Section III(i)(a)-(b) and accompanying notes.
97 See infra Section III(i)(a) and accompanying notes.
98 See infra Section III(i)(a) and accompanying notes. To succeed on a claim for deceptive advertising, the injured party must show: (1) that a certain statement was made, (2) that the statement was inaccurate or lacked a reasonable basis in fact, (3) that the statement was likely to deceive or mislead the consumer, (4) that the consumer reasonably relied on the statement, and (5) that the customer’s reliance on the statement proximately caused the injury. See infra Section III(i)(a) and accompanying notes.
100 See infra Section III(i)(a)-(b) and accompanying notes.
101 Final Rule, supra note 4, at 48,467.
102 FTC Policy Statement, supra note 5.
E. The FTC Defers Enforcement of the Rule Against Tax Debt Relief Companies

The proposed rule did not distinguish tax debt relief companies from the rest of the industry.¹⁰³ When promulgated in August 2010, the FTC’s final rule specifically provided coverage of “all types of unsecured debts, including credit card, medical, and tax debts.”¹⁰⁴ Before the provisions took effect in October, the FTC issued a policy statement announcing it would defer enforcement of the new provisions against entities providing tax debt relief services because some providers of these services had questioned whether tax debt qualified as “unsecured” debt since the IRS can potentially obtain a lien on one’s assets.¹⁰⁵

Although the statement assures that the FTC “is considering other options, including additional rulemaking, to address deception and abuse within the tax debt relief industry,” this supposedly temporary deferment remains in effect without any further comment or explanation.¹⁰⁶ The original provisions of the TSR do apply to tax debt relief companies,¹⁰⁷ but these companies can still charge upfront fees and need not make the required disclosures, even though the FTC found such restrictions appropriate for the rest of the industry.¹⁰⁸

Without the benefit of these consumer protections, tax debt relief companies continue to engage in the actions that the FTC set out to eliminate in 2009.¹⁰⁹ The persistence of the problem is evidenced by the many complaints of fraud,¹¹⁰ attempted judicial action,¹¹¹ and the

¹⁰³ Proposed Rule, supra note 6, at 41,999 (“The Commission intends that the definition of ‘debt relief service’ encompass a broad swath of debt relief activities, including offers of debt settlement or negotiation services and debt management plans. The definition of ‘debt relief service’ is, however, limited with regard to the underlying nature of the debt involved and would not reach offers regarding consumers’ secured debt, such as mortgage loans.”).
¹⁰⁴ Final Rule, supra note 4, at 48,467.
¹⁰⁵ FTC Policy Statement, supra note 5.
¹⁰⁶ Id. See also Telemarketing Sales Rule, OFF. INFO. AND REG. AFF., RIN3084-AB19 (Spring 2011), available at http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201510&RIN=3084-AB19 (“The Commission is considering possible amendments to the TSR to address tax debt relief services.”).
¹⁰⁷ FTC Policy Statement, supra note 5.
¹⁰⁸ Id.
¹¹⁰ See infra notes 223–26 and accompanying text.
FTC’s own Consumer Information page, posted in April 2013, which continues to warn consumers about the “fraudsters” contaminating the tax debt relief industry.\textsuperscript{112}

**IV. PROPOSAL: CLOSE THE TAX DEBT LOOPHOLE**

The FTC should reverse its current position of non-enforcement of the debt relief rule against tax debt relief companies. The FTC originally deferred enforcement as a stopgap to allow time to conduct research and analysis.\textsuperscript{113} The FTC took this position without notice,\textsuperscript{114} and therefore the decision reflects only the interests of the regulated entities, leaving the regulatory beneficiaries without a voice.\textsuperscript{115} The propriety of the abrupt decision to defer enforcement remains questionable since none of the comments prompting the FTC to take this stance appear on the rulemaking record.\textsuperscript{116} Although the FTC’s 2012 Regulatory Agenda promised that it would “[consider] possible amendments to the TSR to address tax debt relief services,”\textsuperscript{117} the FTC did not include an invitation for public comment on the matter.\textsuperscript{118}

The FTC’s decision to defer enforcement against tax debt relief companies directly conflicts with the FTC’s express goal to “encompass a broad swath of debt relief activities, including offers of debt settlement or negotiation services and debt management plans.”\textsuperscript{119} Tax debt relief companies create the same danger of injury as any other debt relief company and should therefore receive the same regulation.\textsuperscript{120} The evidence of the strained attempts by injured consumers and regulators to rein in the practices of tax debt relief companies indicates the necessity of bringing these entities under the ambit of the rule as originally promulgated.\textsuperscript{121}

\textsuperscript{112} *Tax Relief Companies*, supra note 109.
\textsuperscript{113} See FTC Policy Statement, *supra* note 5.
\textsuperscript{114} See *id*.
\textsuperscript{115} See *supra* notes 103–112 and accompanying text.
\textsuperscript{116} See 5 U.S.C. §§ 552–553 (2012). The APA requires agencies to provide notice of the issues at stake in a rulemaking proceeding, as well as a chance to comment on them. Because this is only a policy statement and not a rule, it would be difficult to challenge its propriety. Also, although the APA allows that at some point agency inaction can constitute an improper delay, even these five years that have passed since the FTC stated that it was considering the issue, this delay may not be sufficient to trigger judicial remedy. *Id*.
\textsuperscript{118} See *id*.
\textsuperscript{119} Proposed Rule, *supra* note 6, at 41,999.
\textsuperscript{120} See generally *infra* notes 211–226 and accompanying text.
\textsuperscript{121} See *id*. See also *infra* notes 122–188 and accompanying text.
A. Advance Fee Ban Simplified Litigation

1. *FTC v. American Tax Relief*—An Uncharacteristic Success

The FTC successfully stopped an abusive tax debt relief company in a case against American Tax Relief (‘‘ATR’’), a national company now infamous for defrauding American taxpayers out of nearly $100 million.\(^\text{122}\) The national scope of this case, abundance of incontrovertible evidence, and egregious nature of the conduct alleged facilitated the FTC’s success.\(^\text{123}\) However, this case illustrates the disadvantages of pursuing a tax debt relief company under the FTC Act instead of alleging a violation of the advance fee ban.\(^\text{124}\) Although it succeeded against ATR,\(^\text{125}\) the FTC may have failed in a similar case with slightly different facts. Enforcing the advance fee ban against tax debt relief companies would reduce these disadvantages, bringing faster and more reliable outcomes.\(^\text{126}\)

On November 4, 2010, the Northern District of Illinois granted the FTC’s request for a preliminary injunction against ATR for violation of the FTC Act.\(^\text{127}\) On August 8, 2012, the Central District of California granted summary judgment for the FTC on the central issues, facilitating settlement.\(^\text{128}\) To succeed under the FTC Act, the plaintiff


\(^{124}\) See id.

\(^{125}\) Id. at *22.

\(^{126}\) FTC v. E.M.A. Nationwide, Inc., No. 1:12-CV-2394, 2013 WL 4545143, at *5 (N.D. Ohio Aug. 27, 2013) (granting the FTC’s motion for summary judgment for violation of the debt relief advance fee prohibition solely on the evidence that a single customer paid $1,078.25 without receiving the advertised debt relief service, ordering monetary damages as well as permanently enjoining the defendant from working in the debt relief industry). This demonstrates that proving violation of the advance fee ban requires only two elements: (1) that the company sold debt relief services and (2) that the customer paid a fee before the company provided the service.

\(^{127}\) FTC v. Am. Tax Relief, LLC, 751 F. Supp. 2d 972, 976 (N.D. Ill. 2010). ATR later agreed to a settlement order imposing a $103.3 million judgment against the defendants, which the FTC agreed to suspend the judgment once defendants had surrendered approximately $16 million in cash and assets. When printed in a headline, this certainly sounds like a victory for the FTC; however, the final settlement amount will reimburse the FTC, and subsequently the injured consumers, only approximately 15% of the harm endured. See FTC Policy Statement, *supra* note 5.

must prove the defendant made misleading or deceptive representations about its ability to reduce potential customers’ tax debt, using one of two tests. The FTC could show that express or implied advertising claims made by defendants were false, or that the defendants had no reasonable basis for asserting the claims. After showing either falsity or lack of reasonable basis, the FTC must then prove that (1) the representations were material; (2) the representations would likely mislead a reasonable consumer; (3) the consumer reasonably relied on these representations in deciding to purchase the services; and (4) reliance on these representations resulted in injury to the consumer.

Proving these elements can present difficulties due to the detailed factual requirements and the subjective nature of the reasonableness standard. The FTC succeeded in this case because of the abundance of undeniable evidence, the strength of ATR’s deceptive claims, and the egregiousness of the company’s conduct.

a. Evidence that Defendant Made Certain Claims

The FTC submitted into evidence transcripts of radio and television commercials as well as hardcopies of widely disseminated flyers and mailings, which stated that ATR had “helped thousands of people reduce their tax debt.” The FTC offered copies of the scripts the company provided to the sales representatives encouraging use of misleading assurances that the potential customer qualified for IRS programs. The FTC also had recordings of calls in which ATR sales staff made such representations to undercover FTC agents. In this

129 FTC v. Pantron I Corp., 33 F.3d 1088, 1096 (9th Cir. 1994).
130 Id.
131 Id.
134 Am. Tax Relief, 751 F. Supp. 2d at 978–79. (“To support its claim that ATR made material misrepresentations in its advertisements and in its dealings with consumers, the FTC has submitted declarations from consumers who were—for all intents and purposes—scammed by ATR; each paid significant fees to ATR, yet received little or nothing in return, and each said they were induced to do so by ATR’s promises and guarantees that it could settle tax liabilities for a small percentage of the debt claimed by the IRS . . . Beyond that, the record contains an abundance of evidence showing that consumers were harmed, not helped, by ATR.”)
135 Id. at 977–78.
136 Id. at 977.
137 Id. at 980.
case, the FTC enjoyed the benefit of concrete evidence that ATR made certain representations\textsuperscript{139} and to whom ATR made them.\textsuperscript{140} In many other cases,\textsuperscript{141} the only evidence of the deceptive or misleading statements lives in the memories of the victims of the scams, which a court could justifiably call into question.\textsuperscript{142}

\textit{b. Falsity of Claims or Lack of Reasonable Basis}

The two relevant representations in the ATR case were specific enough that the FTC could prove they were either false or that the company lacked a reasonable basis to make them.\textsuperscript{143}

The FTC could disprove the first statement (that the company had reduced the debt of “thousands” of people) because of the word “thousands.”\textsuperscript{144} ATR’s own records showed that it had successfully reduced the debt of fewer than 1,000 people, clearly contradicting the statements made to consumers.\textsuperscript{145} If the company had advertised more generally, perhaps that it had helped “many” people, then the FTC would have had difficulty establishing the statement as false or lacking reasonable basis.

The second category of representations included the guarantees made to specific potential customers that they would qualify for an IRS tax relief program.\textsuperscript{146} The FTC had no trouble disproving these statements due to their strength and directness.\textsuperscript{147} First, the staff made the statements without possessing any information about the customer that could justify such a statement.\textsuperscript{148} Secondly, sales representatives with no tax expertise made the statements rather than tax professionals.\textsuperscript{149} If the employees had said “I will not know for sure until I look at your records, but I am sure you will qualify for one of the programs,” the FTC would have struggled to show that they lacked a reasonable basis.\textsuperscript{150} The FTC succeeded here only because the sales

\textsuperscript{139} \textit{Am. Tax Relief}, 751 F. Supp. 2d at 977–78.
\textsuperscript{140} \textit{Id.} at 984–85.
\textsuperscript{142} \textit{See Brown v. Am. Tax Relief, 2007 WL 2174876, No. 0016771 at *1 (N.Y.Supp.) (Trial Order).}
\textsuperscript{143} \textit{Am. Tax Relief, 2012 WL 8281722 at *4–6.}
\textsuperscript{144} \textit{Id.} at *3 (“There is no question that these statements were false.”).
\textsuperscript{145} \textit{Am. Tax Relief, 751 F. Supp. 2d at 982.}
\textsuperscript{146} \textit{Am. Tax Relief, 2012 WL 8281722 at *5.}
\textsuperscript{147} \textit{Id.} at *5.
\textsuperscript{148} \textit{Id.}
\textsuperscript{149} \textit{Id.}
\textsuperscript{150} Indeed, in 2007, injured consumers brought a case in New York against the

\textit{continued . . .}
staff made bald assurances that each customer qualified for specific government programs.\textsuperscript{151}

c. \textit{Materiality of Defendant’s Claims}

The court held that ATR made the claims \textit{because} they would be material to anyone considering purchasing tax debt relief services.\textsuperscript{152} Hearing that a company had helped thousands of people would certainly influence someone who needed relief.\textsuperscript{153} Similarly, a guarantee of qualification for a certain available program would also impact a reasonable person’s decision to purchase the services.\textsuperscript{154}

d. \textit{Customers Relied on Defendant’s Claims and Reasonableness of Reliance}

The FTC offered substantial evidence that the complaining witnesses relied on the advertisements and promises made by sales representatives in deciding to purchase ATR’s services.\textsuperscript{155} The evidence included affidavits from many injured customers who stated that they purchased ATR’s services because the sales representatives promised to reduce their tax debt by a specific amount, in a specific amount of time, or at a specific cost.\textsuperscript{156} The evidence also included the statement of an attorney previously employed by ATR describing phone calls that she fielded daily from customers who were upset after being

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\textsuperscript{152} Am. Tax Relief, 2012 WL 8281722 at *4–6.

\textsuperscript{153} Id. at *4 (“The above statements . . . were unquestionably material.”).

\textsuperscript{154} Id. at *5 (“There is also no question that these representations about the callers’ qualifications for relief were material.”).

\textsuperscript{155} Am. Tax Relief, 751 F. Supp. 2d at 978–79.

\textsuperscript{156} Id.
misled by the company’s sales representatives regarding their ability to qualify for IRS programs.\textsuperscript{157} The standard for reasonable reliance is subjective, but the strength of the statements ATR made allowed the court to find that relying upon them was reasonable.\textsuperscript{158}

\textit{e. Reliance on Claims Proximately Caused Consumers Harm}

ATR’s customers paid substantial fees upfront and received absolutely nothing in return.\textsuperscript{159} The Better Business Bureau also received 375 complaints about ATR, and even at the preliminary injunction stage, the FTC had compiled and submitted specific statements from forty-three individuals.\textsuperscript{160}

The judge that granted the FTC’s motion for preliminary injunction expressed his initial hesitation to rely solely on testimony from the complaining witnesses, yet at every turn, the court found that it did not need to.\textsuperscript{161} The court made clear that it would have reached a different result without such solid, incontrovertible evidence.\textsuperscript{162} Statements from prior employees prevented the ATR from arguing that a rogue sales representative made the statements and did not represent the company’s practices as a whole.\textsuperscript{163} A case on a smaller scale or with less abundant,

\textsuperscript{157} Id. at 980 (See, specifically Ms. Garcia’s declaration: “‘[t]here was a distinct pattern to customers’ calls and complaints. Most of them said that they had been told they’d qualified for an OIC and some of them said that they had been told that ATR would be able to get interest and penalty abatements for them. They also said that the sales people had promised them that ATR could settle their debts so that they wouldn’t have to pay the IRS anywhere close to what they owed.”).

\textsuperscript{158} Id.

\textsuperscript{159} Id. at 975.

\textsuperscript{160} Id. at 979.

\textsuperscript{161} Id. at 984–85. “Frankly, given the nature of these transactions, the Court initially viewed the consumers' statements with some skepticism.” Id. The injured customers complained that they paid large sums upfront and received nothing in return; and when they confronted the company about the lack of results, the representatives became “unprofessional and even abusive” and blamed the customers. Id. One of the ATR representatives memorialized his own unprofessional and abusive treatment of a dissatisfied customer in a signed letter, printed on company letterhead. Id.

\textsuperscript{162} Id.

\textsuperscript{163} FTC v. Am. Tax Relief LLC, No. CV 11-6397 DSF (PJWx), 2012 WL 8281722, at *2 (C.D. Cal. Aug. 8, 2012) (“[T]he Court has relied on the statements of former ATR sales representatives regarding the practices of the ATR sales department. This includes things that the ATR representatives knew, what they personally told consumers, what they overheard . . . ATR management telling other employees. The Court has generally not relied on testimony of tax resolution department employees as to the practices of the sales representatives . . . the Court has relied on documentary evidence observed in and seized from ATR’s offices by continued . . .
advantageous evidence could certainly have a different result.

2. Brown v. American Tax Relief—An Example of the Challenges Posed by Suing for False Advertising Rather Than Violation of Advance Fee Ban

Brown v. American Tax Relief, 164 a 2007 class action brought in New York, provides a potent example of the difficulties faced when customers injured by tax debt relief companies must seek relief under false advertising statutes instead of using the ban on advance fees. 165 The named plaintiff in this case paid a $5,000 fee upfront to ATR after receiving some postcards containing arguably misleading or deceptive claims; she received no service in return and suffered as a result. 166

Although the court found that the plaintiff adequately stated a claim for relief, 167 the court denied the plaintiff’s motion to certify a class of similarly situated New York residents who also received the postcards and paid advance fees ranging from $1,000 to $5,000. 168 The court reached this conclusion because it found that (1) the class was over-inclusive; and (2) the “questions of fact affecting individual class members [would] predominate over fact questions common to the class.” 169

a. Class was Over-Inclusive

While noting the New York rule that “the criteria . . . considered in granting class action certification is to be liberally construed,” 170 the

government agents.”).

165 Id. at *2.
166 Id. at *3.
167 Plaintiff adequately alleged breach of contract (because ATR promised to obtain tax debt relief for her in exchange for $5,000) as well as claims under General Business Law § 349 (requiring a showing of an act or practice that is deceptive or misleading in a material way and that plaintiff was injured by reason thereof) and § 350 (requiring the same showing in addition to a showing that the plaintiff relied upon the underlying deceptive misrepresentations). Id. at *12–13.
168 Id. at *13.
169 Id. at *9.
170 Id. at *7 (citing Kidd v. Delta Funding Corp., 289 A.D.2d 203 (N.Y. App. Div. 2001). “[I]n New York, a class action may be maintained only if: (1) the proposed class is so numerous that joinder of all members is impracticable; (2) common questions of law or fact predominate over any questions affecting only individual members; (3) the claims of the representative parties are typical of the class as a whole; (4) the representatives parties will fairly and adequately protect the interests of the class; and (5) the class action is superior to other methods for the fair
continued . . .
court held that the class was over-inclusive. A class is over-inclusive “when the proposed class is defined so broadly that it encompasses individuals who have little connection with the underlying claim or who have not been harmed by the defendants’ allegedly wrongful conduct.” The class members all received postcards containing ATR’s claim that it could settle tax obligations for “pennies-on-the-dollar,” and the court agreed that these were likely misleading or fraudulent. However, the court held that the class would likely include individuals who did not rely on these claims, but decided to purchase services for a different reason (for example, to obtain one of the other advertised tax services) and therefore was over-inclusive.

b. Individual Questions Predominate over Common Questions

The court further denied the motion for class certification because the individual questions of fact would outweigh the common questions of fact. The fatal individual questions of fact included “issues of causation and reliance as to each member of the putative class” as well as which tax service each plaintiff purchased and what representations ATR made to each plaintiff. This court’s decision demonstrates the factual and procedural challenges faced by plaintiffs who attempt to remedy a harm by alleging deceptive advertising, as opposed to a violation of the advance fee ban. Both proving causation and demonstrating reasonable reliance for each particular plaintiff requires individualized factual showings that can stand in the way of successfully certifying a class. A suit for violation of the advance fee ban does not require the problematic demonstration of an individual plaintiff’s reliance on any particular misrepresentation or any showing of why each plaintiff decided to purchase services.

Instead, plaintiffs could easily satisfy the simple factual questions


172 Id.
173 Id. at *8.
174 Id. at *9.
175 Id.
176 Id. at *10.
177 Id.
178 Id. at *7–10.
179 Id. at *10.
necessary to prove an alleged violation of the advance fee ban—did the plaintiffs pay the company a fee prior to receiving services and did the plaintiffs suffer injury as a result? In such a case, the common questions of law and fact would have predominated over the individualized questions and the class would not have been over-inclusive, as all members suffered injury due to paying the advance fee. The court would likely have certified the class, allowing all plaintiffs convenient and efficient access to the justice system that the class action tool provides.

Class actions create an efficient vehicle for similarly situated plaintiffs, who have been injured at the hands of a common defendant, to aggregate their resources in order to reach a remedy. This procedural tool particularly benefits economically distressed plaintiffs, such as those defrauded by a tax debt relief company. Enforcing the

181 See supra text accompanying note 99 (identifying the threshold question of whether the company was in the business of selling debt relief services in order to establishing that it is subject to the TSR’s debt relief amendments).


183 Brown v. Consumer Law Assoc., 283 F.R.D. 602, 611–16 (E.D. Wash. 2012) (explaining the certification process for a class under Fed. R. Civ. P. 23(a) and (b) for plaintiffs alleging a per se violation of Washington’s Consumer Protection Act which prohibits charging an upfront fee in excess of $25.00). See also Gregory v. Preferred Fin. Sol., No. 5:11-CV-422 (MTT), 2013 WL 6632322 at *12 (M.D. Ga. Dec. 17, 2013) (certifying a class of plaintiffs accusing a debt relief company of charging fees in excess of the maximum imposed by Georgia’s Debt Adjustment Act. The court stated that the only individual factual questions that must be answered would be (1) the enrollment fee, calculated as a percentage of the customer’s total debt; (2) the monthly fee; (3) the number of months each member participated in the program; (4) the settlement fee, calculated as a percentage of total debt settled; and (5) whether the customer received a refund. This case involved more individual factual questions than the advance fee ban would require, but the court held that “[a] brief examination of each class member’s billing history would establish both the Defendants’ liability and the amount of damages to be awarded to that member. Accordingly, the Court [found] the questions common to all class members predominate over individualized questions”.

184 Laura J. Hines, The Dangerous Allure of The Issue Class Action, 79 IND. L.J. 567, 567 (2004) (“The class device holds out the promise of resolving issues ‘common’ to all plaintiffs in a single trial, preventing wasteful and repetitive litigation of similar issues, and the possibility of inconsistent results. And collective adjudication allows plaintiffs to pool resources against better-financed defendants”).

185 Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997) (“The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone’s (usually an attorney’s) labor”).

186 Deborah R. Hensler & Thomas D. Rowe, Jr., Beyond “It Just Ain’t Worth It”: Alternative Strategies for Damage Class Action Reform, 64 LAW & CONTEMP. continued . . .
advance fee ban against tax debt relief companies would make class actions more accessible to injured plaintiffs, and, as stated above, increase the likelihood of success on the merits.

The FTC provided only one explanation for deferring enforcement against tax debt relief entities: tax debt may not be considered unsecured debt. The “secured” versus “unsecured” delineation is, in this context, arbitrary and serves only to create a loophole for tax debt relief companies to charge upfront fees without serving consumers. Determining whether tax debt qualifies as secured or unsecured debt involves examining the intricacies of bankruptcy and tax law, and goes beyond the scope of this paper.

In short, the IRS has some power to place liens on debtor’s assets with a court order, but in some bankruptcy actions, courts treat tax debts as unsecured debts. Typically, tax debts that are more than three years old become general unsecured non-priority claims in bankruptcy. Although a debtor usually cannot avoid a tax lien in bankruptcy, the IRS has only limited power to attach an individual’s property. Fortunately, in the context of the debt relief industry, the distinction does not impact the analysis. Tax debt relief is a subcategory of general debt relief—the two industries pose the same problems that can be solved through identical regulations.

PROBS. 137, 145–46 (2001) (“[O]ne of the key purposes of class action [is] facilitating litigation precisely when many persons have suffered, as a result of another’s wrongdoing, losses that are too modest to allow them to obtain individual counsel”).

See Hines, supra note 184.

See supra notes 118–150 and accompanying text.

FTC Policy Statement, supra note 5. See also BLACK’S LAW DICTIONARY 488–89 (10th ed. 2014) (provides several definitions for debt and defines unsecured debt as “debt not supported by collateral or other security”).

See supra notes 104–108 and accompanying text. See also infra notes 197–199.


MCQUEEN & WILLIAMS, supra note 192, § 8:13.

See 26 C.F.R. §1.163-10T(o)(1)(iii) (2015) (“A debt will not be considered to be secured by a qualified residence if it is secured solely by virtue of a lien upon the general assets of the taxpayer or by a security interest, such as a mechanic’s lien or judgment lien, that attaches to the property without the consent of the debtor.”). See also Heinkel, supra note 193, at 56.

See supra notes 182–192 and accompanying text.
Enforcing the debt relief rule against tax debt relief companies fits neatly within the FTC’s own policy goals.\(^{197}\) In its Final Rule, the FTC excluded “secured debt, such as mortgage loans,” not because mortgage and secured debt companies did not pose a problem, but because the FTC “anticipate[d] comprehensively regulating such conduct under its new mortgage loan rulemaking authority.”\(^{198}\) While the secured loan and mortgage industry operates in a unique way, requiring particularized regulation, tax debt relief companies operate in much the same way as general debt relief companies\(^{199}\) and should be subject to the same rules.

**B. Same Business Model, Different Creditor**

By acting on their own behalf, debt-owing consumers can achieve the same or substantially similar results as debt relief companies supposedly provide, regardless of whether the debtor owes money to a credit card company or the IRS.\(^{200}\) Consumers seem to fear both public and private creditors as equally intimidating and ruthless.\(^{201}\) Hoping to encourage taxpayers to make direct contact and avoid risky tax debt relief companies, the IRS and state tax entities have attempted to make themselves more accessible.\(^{202}\) The IRS expressly invites taxpayers to contact them directly to negotiate any of the available adjustment

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\(^{197}\) Proposed Rule, *supra* note 6, at 41,999 (“The Commission intends that the definition of ‘debt relief service’ encompass a broad swath of debt relief activities, including offers of debt settlement or negotiation services and debt management plans.”).

\(^{198}\) *Id.*


\(^{200}\) Tax Relief Companies, *supra* note 109.


\(^{202}\) Tax Relief Companies, *supra* note 109 (“If you owe back taxes and don’t know how you’re going to pay the debt, the FTC, the nation’s consumer protection agency, says don’t panic, take a deep breath, and consider your options. If you are having trouble paying bills, it’s often better to try to work out a payment plan with the creditor yourself than to pay someone else to negotiate a plan for you.”).
plans. The IRS also created the Taxpayer Advocate Service, an independent organization within the IRS, to help taxpayers deal with debt.

Tax attorneys, accountants, and enrolled agents can provide helpful insight in filing tax returns, handling audits, or reviewing a taxpayer’s file to discover errors or anomalies. Tax debt relief companies, on the other hand, typically do no more than attempt to enroll the taxpayer in one of a few standard programs offered by the IRS. Tax debt relief agents arguably provide a less valuable service compared to their private debt relief counterparts because IRS agents exercise little discretion in accepting or rejecting offers. Instead, formulas and straightforward criteria determine whether or not a taxpayer qualifies for a particular program.

While tax debt relief companies often advertise a skill or connection that allows them to strike special deals with the IRS, taxpayers can accomplish everything these agents can accomplish by applying for relief programs online or by simply calling the IRS directly. The lack of utility of the tax debt relief industry, coupled with the prevalence of abusive practices, provides the FTC with a strong incentive to protect consumers from these companies, specifically by imposing the advance fee ban.

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203 Id. ("According to the IRS, you can apply for an Installment Agreement, OIC, or penalty or interest abatement without the help of a third party").

204 Id. (explaining that state tax entities vary in policy, but most of them offer similar programs and options to help taxpayers deal with their debt.).

205 Id. (explaining that an “installment agreement” arranges for a taxpayer who cannot afford to pay the amount owed in full to make smaller monthly payments with interest to avoid penalties like a tax lien or levy. A taxpayer can make an “offer in compromise” to settle their debt for less than the amount owed, but the IRS typically only accepts such an offer if the taxpayer has exhausted other avenues. A tax debtor can occasionally obtain a penalty abatement if he or she cannot pay the taxes owed because of some special hardship . . . Interest abatement relieves the taxpayer of fees and interest while still requiring payment of the taxes, but is also rare).

207 Id.

208 Id. (explaining that an installment agreement is the most common, and in certain situations, the IRS cannot deny a request for an installment agreement if the amount owed is less than $10,000. Under the Fresh Start Initiative, most people with less than $50,000 in tax debt can obtain a streamlined installment agreement that allows repayment over a six-year period by simply applying online).

209 Id. (nothing that although only a narrow group of people will qualify for the other programs, the taxpayer can find out if he or she qualifies without enlisting costly assistance).

210 Debbie Edwards, NATDRC Conference to Address Ways to Eliminate Fraudulent Lead Aggregators From the Tax Debt Resolution Industry, TAX RESOLUTION SERVICES, CO. (May 2012), continued . . .
C. Tax Debt Relief Companies Remain a Threat

In April 2013, nearly three years after promulgation of the debt relief rule, the FTC posted an informational page on its website warning consumers against tax debt relief companies, referring to them as “fraudsters.”\footnote{Tax Relief Companies, supra note 109.} The page, which remains active as of this writing, recounts the nightmares of tax debtors injured by tax debt relief companies, demonstrating that the problem of abuse in the industry persists.\footnote{Id. (noting that some paid thousands in upfront fees, only to find that the tax debt relief companies made unauthorized charges to their credit cards or withdrawals from their bank accounts; some were misled by promises of quickly eliminating debt; other eventually discovered the company had fraudulently omitted asset information on financial statements submitted to the IRS, which seemed to achieve a favorable result for the taxpayer in the short-term, but created enormous financial and legal problems in the long-run).}

A website called bestdebtcompanies.com\footnote{Tax Debt Relief Made Simple, BESTDEBTCOMPANYS.COM, https://bestdebtcompanies.com/tax-relief-companies/ (last visited Feb. 25, 2016).} uses an objective
standard to evaluate debt relief companies on a scale of one to ten, and creates a forum where customers post reviews of companies they hired to assist them with tax debt. Both the scores given by the website operators and the comments from customers illustrate that abuse in the tax debt industry remains a problem. Twenty-three out of the forty-six companies reviewed received a score of less than 5.0 out of 10.0 from the website staff, and only fifteen companies received consumer ratings of more than 5.0.

The website’s “#1 Staff Pick,” Tax Defense Network, received two-hundred reviews from satisfied customers and only nine reviews from dissatisfied customers, demonstrating that, assuming this website can be believed, legitimate tax debt relief companies do exist and provide a valuable service. However, the customer reviews of the nine companies with the worst consumer rating paint a worrisome picture. These nine companies received exclusively negative

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214 How We Rank—Understanding our ranking criteria, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/how-we-rank/ (last visited Mar. 31, 2016) (explaining how the company uses specific criteria to give each company a score: price, time in business, Better Business Bureau rating, specialization in tax services, staff accreditations, professional association members, refund policy, consumer reviews, and expert review, which includes financial standing of organization, the number of industry experts and professionals, the company’s ability to scale, historical revenue and growth, past and current lawsuits, customer service, and transparency).

215 Tax Debt Relief Made Simple, supra note 213.

216 Id.

217 Id.

218 Id.


220 Id. (four customers gave a score of seven, and 204 customers gave a score of eight to ten).

221 Id. (five scores of zero, and four scores of four).

222 See, e.g., id.

223 See Signature Tax Group, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/signature-tax-review/ (indicating one review from 2015 wherein a customer lost $2,200); Freedom Tax Relief, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/freedom-tax-relief-review/ (received one review in 2015 wherein a customer paid $3,600 upfront and received nothing); Consumer Tax Relief received three reviews from customers in 2014 and 2015 who paid $200, $4,000, and $4,000 respectively in upfront fees and received no service in return. Tax Debt Relief, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/consumer-tax-relief/; US Tax Shield, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/us-tax-shield-review/ (received two negative reviews in 2015, with one dissatisfied customer paying $3,500); Tax Defense Partners, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/tax-defense-partners-review/ (received six negative reviews from 2014 to 2016, with customers reporting lost fees of $10,000, continued . . .
customer reviews, all of which were posted from 2014 to 2016. Each customer reported that they had paid advance fees (ranging from $200 to more than $20,000) but received nothing in return. Many customers reported an inability to contact the company after payment and others reported that the company simply bounced them between staff members until they gave up. While customer reviews should sometimes be taken with a grain of salt, this information shows that abusive practices by tax debt relief companies have continued during the past two years.

D. A Simple Solution

The FTC should reverse its current policy of deferring enforcement against tax debt relief companies because these companies remain a threat to consumers. In 2009, the substantial hazard that debt relief companies posed to vulnerable consumers compelled the FTC to take action and promulgate a comprehensive rule to reduce abusive practices. What should have been a temporary policy has quietly become five years of allowing tax debt relief companies to continue to defraud the public. Requiring these companies to adhere to the ban on advance fees would provide a useful tool for injured consumers seeking judicial remedy and aligns with the FTC’s policy of consumer protection.

$6,800, $6,800, and $5,000); Tax Group Center, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/tax-group-center-review/ (received five negative reviews from 2014 to 2016, with customers reporting paying upfront fees of $20,000 and $1,500); Clear Creek Consulting BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/clear-creek-consulting-review/ (received one review from a dissatisfied customer in 2015); Top Tax Defenders, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/top-tax-defenders-review/ (received a score of zero in 2016); 911TaxRelief.com, BESTDEBTCOMPANYS.COM, https://bestdebtcompanys.com/taxrelief/911taxrelief-review/ (received a negative review in 2015 wherein the customer lost a $1,500 fee).
HAS GPS MADE THE ADEQUATE ENFORCEMENT OF PRIVACY LAWS IN THE UNITED STATES A LUXURY OF THE PAST?

Jennifer Ann Urban†

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†Mississippi Licensed Attorney and L.L.M. Candidate in Air and Space Law at the University of Mississippi School of Law. She earned her J.D., M.B.A., and B.A. at the University of Mississippi. She would like to thank Professor Michael Dodge for his helpful insights and support.
ABSTRACT

In today’s society, nearly everyone uses a piece of technology that allows them to be tracked by a Global Navigation Satellite System and rarely do we even consider the ramifications of using these devices. When a person uses an iPhone to get directions via Google Maps they may not realize that while they are gaining information from the website, they are also allowing their movements to be tracked. It may seem like only a paranoid person would worry about being tracked when they are going from their house to work, but the fact that there has not been a line drawn between what tracking information the government may or may not use against you creates a serious problem. This paper argues that due to the increasing use and development of the Global Positioning System’s (“GPS”) tracking abilities, the government must make it a priority to develop new privacy laws and clarifications. Because most of the privacy laws and amendments were created decades before GPS technologies existed, there is a clash between tracking and privacy that is difficult for the courts to decide without updated laws.

This paper begins with an introduction of Global Navigation Satellite Systems and the Global Positioning System. The historical section of the paper gives an overview of the Soviet Union’s attack on Korean Air 007 and its importance on the future use of GPS by civilians. Next, this paper thoroughly explains the complex technologies involved in GPS tracking. The fourth section summarizes the three main parts of the United States Code that apply to GPS and the U.S. Space-Based Positioning, Navigation, and Timing Policy. Fifth, the paper discusses where privacy laws conflict with certain uses of GPS tracking, which leads into the in depth review of the leading case in this area, United States v. Jones. Finally, this paper concludes with a summary of current, proposed legislation on this topic and suggestions for future legislation.
"Historically, privacy was almost implicit, because it was hard to find and gather information. But in the digital world, whether it's digital cameras or satellites or just what you click on, we need to have more explicit rules." – Bill Gates, Founder of Microsoft

I. INTRODUCTION

Global Navigation Satellite Systems ("GNSS") have changed the world as we know it. Forget the days where you could easily go unnoticed; now nearly every piece of technological equipment that we use has a way of tracking you embedded in it. Many people easily forget that the phone in their pockets or the Apple watches on their wrists, are not only providing the main services customers expected them to provide, but are also tracking the users. Recently, a woman in Pennsylvania went to police and claimed she had been raped. What she likely did not realize when she made this claim was that her Fitbit’s GPS tracking data would be used to substantiate or disprove her claim. In her story to police, the woman claimed she had been sleeping; however, her Fitbit showed she was active and awake the whole night. This data was then used when the government charged the woman with knowingly filing a false report. This is only one of the many cases yet to come where GPS tracking evidence can be used to help or hurt a legal case.

The Global Positioning System ("GPS") has positively impacted the economic sector by allowing increased productivity in areas such as mail delivery and farming. The GPS has been vital in enhancing the United States’ military operations and therefore improves national security as a whole, while keeping the country competitive with other nations using GNSS. The transportation sector has also been greatly
changed by GPS. One example of transportation improvement is the Next Generation Air Transportation System (“NextGen”) that improves the safety of air travel. While there is no doubt as to the technological strides that have been made because of GPS, there are also negative consequences to consider. The question must be asked of how far GPS will be allowed to go before the government puts limitations in place to protect areas of life that naturally do not need to be tracked.

There are many positive effects of GPS tracking; however, privacy concerns regarding the use of this technology have become a cause for concern. In 2013, New York Senator Charles Schumer suggested that the government should develop a program to track developmentally challenged children. He mentioned the program would be voluntary, but it was never specified as to whom it would be voluntary for. If parents could make the decision to track the children, would it violate the children’s privacy rights for their every move to be recorded? Many people would say no and that the parents had the right to subject their children to this, but whether or not it is ethical is another question.

Senator Schumer stated, “DOJ already funds these devices for individuals with Alzheimer’s and they should do the same for children with Autism Spectrum Disorder.” While the Department of Justice has made funds available for this type of voluntary tracking, it has not specified where the line will be drawn. One could argue that all children under the age of eighteen should be tracked because they are not mentally fully developed or that children with Attention Deficit Hyperactivity Disorder should be tracked because they are easily distracted and are more likely to get lost or wander off. There are arguments that can be made for requiring nearly every person to be tracked, causing one to ask, first, if that is a world people would want to live in, and second, how does that violate citizens’ constitutional rights?

One positive example of a device that parents are already using to track their children is the Amber Alert GPS. AT&T’s Amber Alert GPS is a device that children can carry around and stay connected with their parents through GPS location awareness.

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11 Id.
13 Id.
14 Id.
17 *Amber Alert GPS*, AT&T, https://www.att.com/devices/amberalertgps/amber-continued...
tracking capabilities, parents have the “ability to set and receive email alerts when [their] child enters or leaves a safe zone, exceeds a preset vehicle speed, or comes within 500 feet of a registered sex offender’s home.”\(^{18}\) This device gives parents piece of mind knowing that their children are in safe areas and that they can find their child’s exact location at any time.

II. HISTORY

The Soviet Union’s attack on Korean Air flight 007 was the event that triggered civilian use of GPS in the United States.\(^\text{19}\) The flight took off on September 1, 1983 from New York’s John F. Kennedy International Airport destined for Seoul, South Korea.\(^\text{20}\) The crew had set the Boeing 747’s autopilot, but when the airliner was approximately three hours from Seoul, the system failed, causing the flight to drift off course.\(^\text{21}\) Due to these malfunctions, the aircraft unintentionally headed towards Soviet airspace.\(^\text{22}\) Two Sukhoi Su-15 fighter jets were sent from a Soviet airbase to intercept the Korean Air Flight.\(^\text{23}\) One of the Soviet pilots claimed that he tried to signal the Korean flight’s pilot using international code but that the pilot did not respond.\(^\text{24}\) The Soviet pilots then fired warning shots and again claimed that they never got a response from the Korean Air pilot.\(^\text{25}\) Rather than using any sort of humane means of intercepting the flight, the Soviets chose to destroy it by shooting it down, killing 269 people.\(^\text{26}\) The Soviet Union’s claim that they attempted to signal the pilot is weak because not once did its pilots try to contact the aircraft by radio.\(^\text{27}\) According to the International Civil Aviation Organization’s (“ICAO”) report on this attack, “[t]he Soviet pilots failed to follow ICAO standards and

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\(^{18}\) Id.


\(^{21}\) Id.

\(^{22}\) Id.

\(^{23}\) Id.

\(^{24}\) Id.

\(^{25}\) Id.


\(^{27}\) Patterson, supra note 20.
recommended practices related to the interception of civil aircraft."

In the aftermath of the crash, then Soviet leader, Yuri Andropov, made the senseless claim that the flight was really a United States military operation trying to disguise itself by using a South Korean aircraft. The Soviet Union was not only unhelpful in the crash investigation, but hampered it by not releasing any information about whether or not it had found any bodies or pieces of the plane. This all changed once the Cold War ended, and in 1992 Russia released the cockpit voice recorder transcript to the United States Ambassador.

After ICAO was able to do a full investigation, it was determined that the pilot of the Korean Air flight had made an error and that the autopilot system was not in the proper mode. The autopilot was likely in “heading” mode, meaning that in this setting the system directs the plane along a route verified by the magnetic compass. The problem with this setting for autopilot is that depending on the altitude, the accuracy of the magnetic compass can significantly decrease. This autopilot mode is considered the cause of the aircraft going into Soviet airspace. According to Asaf Degani, a former cockpit information systems expert for the National Aeronautics and Space Administration (“NASA”),

if the autopilot had been flying under the plane’s highly accurate computerized ‘INS’ (inertial navigation system) setting, the 747 would have flown a different path, keeping it very close to—but still out of—Soviet airspace. The pilots . . . may have mistakenly thought they were flying in INS mode.

These mistakes are very unlikely to occur now because most commercial aircrafts have specific displays in them that clearly identify the mode that autopilot is in.

The attack on Korean Air 007 changed the use of the GPS around the world. On September 16, 1983, President Reagan published a press release in part stating,

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28 Id.
29 Id.
30 Id.
31 Id.
32 Id.
33 Id.
34 Id.
35 Id.
36 Id.
37 Id.
[i]n their recent statement on the Korean Air Lines tragedy, senior Soviet officials have shocked the world by their assertion of the right to shoot down innocent civilian airliners which accidently intrude into Soviet airspace. Despite the murder of 269 innocent victims, the Soviet Union is not prepared to recognize its obligations under international law to refrain from the use of force against civilian airliners. World opinion is united in its determination that this awful tragedy must not be repeated. As a contribution to the achievement of this objective, the President has determined that the United States is prepared to make available to civilian aircraft the facilities of its Global Positioning System when it becomes operational in 1988. This system will provide civilian airliners three-dimensional positional information.38

By making GPS available to civilian aircraft, President Reagan opened the doors for overall civilian use of the GPS system in all areas of life.39 Korean Air 007 was a horrific event, but the significant impact that it has had in modernizing the technological world is one positive aspect, amongst all the tragedy, that must be recognized.

III. TECHNOLOGICAL EXPLANATIONS

A. Global Navigation Satellite Systems

GNSS provide three main capabilities of positioning, navigation, and timing.40 Positioning is the idea of being able to know something’s or someone’s exact location on earth via the systems.41 Law enforcement has used these technological capabilities to determine someone’s location in many different situations, such as to track suspects, to find missing children, and to aid in emergency situations.42 Positioning is not only used by law enforcement; it has also been a

38 Statement by Deputy Press Secretary, supra note 19.
40 Dodge, supra note 26, at Slide 3.
41 Id. at Slide 4.
beneficial tool to the agricultural community and the military.43

The navigation capabilities from GNSS are extremely precise and are used for both navigation on earth and in outer space.44 The Department of Commerce and the modes of transportation within it use the navigational features of GNSS to improve efficiency and to anticipate where potential problems may occur.45 Many United States citizens as well as others around the world, use personal navigation tools that connect to GNSS.46 For example, a person that is using the directions feature within Google Maps is using both the positioning and navigation capabilities of GNSS to tell them where they currently are and how to get to their desired destination.47

Timing is the third key capability GNSS provides.48 There are atomic clocks on GNSS satellites that are incredibly precise, and this precise time data is used in many different industries.49 The ways the timing feature of GNSS can be used range from astronomical studies to NASDAQ using it as the way to determine the exact second the stock exchange closes,50 to students in space law classes using it to determine the precise time, down to the last minute, that they can turn in their papers without being late.

B. Global Positioning System

GNSS are used all over the world, not only in the United States. The Global Positioning System is the United States’ GNSS.51 Other countries also have their own GNSS, such as Russia’s Globalnaya Navigazionnaya Sputnikovaya Sistema52 (“GLONASS”)53 and the European Galileo.54

GPS has three critical sectors that allow it to work correctly and efficiently: the space sector, the control sector, and the user sector.55

43 Dodge, supra note 26, at Slide 4.
44 Id. at Slide 5.
45 Id.
46 Id. at Slide 6.
47 See id. at Slide 3.
48 Id. at Slide 7.
49 Id.
50 Id.
51 Id. at Slide 10.
52 Anurag Bisht, What is GLONASS and How it is Different from GPS, BEEBOM (May 5, 2015), http://beebom.com/2015/05/what-is-glonass-and-how-it-is-different-from-gps.
53 Id.
54 Dodge, supra note 26, at Slide 12.
The space sector is made up of a satellite constellation that relays radio signals to operators on earth. Currently, thirty-one operational satellites make up the GPS constellation and the United States made a commitment to have at a minimum twenty-four working satellites within the constellation 95 percent of the time. In the event that more than seven of the satellites in the constellation had a problem at the same time, the Air Force keeps decommissioned GPS satellites, also known as residuals, in orbit that can be reactivated to keep the minimum amount of satellites from dropping below twenty-four. Each of the satellites in this constellation orbit the earth twice a day, while flying at an altitude of about 12,550 miles above earth.

The control sector is made up of “a global network of ground facilities that track the GPS satellites, monitor their transmissions, perform analyses, and send commands and data to the constellation.” Members of the United States Air Force make up the 2nd Space Operations Squadron (“2SOPS”), which controls the constellation and is responsible for making sure GPS accessibility is never interrupted for either military or civilian uses.

The three main parts of the control sector are the Master Control Station, the Monitor Stations, and Ground Antennas. The Master Control Station is located in Colorado and is where 2SOPS manages the satellites. This station is responsible for performing the most important control functions, such as getting navigation information from the Monitor Stations to the satellites and checking to make sure the satellites are in proper condition.

There are sixteen monitoring stations across the globe, six stations belong to the United States Air Force and ten stations belong to the National Geospatial-Intelligence Agency (“NGA”). Monitor stations main responsibility is to track GPS satellites when they pass over the station and then send the collected data back to the Master Common Station.

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57 Id.
58 Id.
59 Id.
61 Id.
62 Id.
63 Id.
64 Id.
65 Id.
66 Id.
Ground antennas help 2SOPS “communicate with the GPS satellites for command and control purposes . . . [and] for normal command transmissions to the satellites.” 67 Not only are there four specific ground antenna locations in the same place as monitor stations, but the control segment is also linked to the eight Air Force Satellite Control Network remote tracking stations across the world.68

The user sector is the actual GPS receiver where the satellite signals are received.69 The receiver then uses the information from the satellite signals to decipher its receiver’s exact position and time.70 GPS receivers in this sector can be found in nearly every modern technology, ranging from cell phones to cars and even to watches.71

IV. LAWS AND POLICIES SURROUNDING GPS

The United States Code has three primary statutes that pertain to GPS.72 Title 10 of the U.S. Code § 2281 specifies that it must be sustained for both military and civilian purposes.73 This is important because it allows for the GPS to be maintained for civilian purposes without the government charging direct users a fee.74 The lack of a direct user fee vastly opens up the door for greater use in all areas of society, therefore again adding to the amount of tracking devices available.

This statute also requires that the Secretary of Defense and the Secretary of Transportation work together to create and update the Federal Radionavigation Plan.75 The Federal Radionavigation Plan is updated every two years and the last update was in 2014.76 It is a 217-page document that gives extremely detailed information on the United States’ policies on using, maintaining, and operating all sectors of the GPS.77 This plan is the main resource used regarding the positioning,

67 Id.
68 Id.
69 GPS Applications, supra note 9.
70 Id.
71 Id.
73 10 U.S.C. §§ 2281(a)–(b).
74 “The Secretary of Defense shall provide for the sustainment and operation of the GPS Standard Positioning Service for peaceful civil, commercial, and scientific uses on a continuous worldwide basis free of direct user fees.” Id. at § 2281(b).
75 Id. at § 2281(c).
77 Id. at iii.
navigation and timing of the GPS services and duties of the government. 78

In Title 51 of the United States Code § 50112, Congress encouraged the President to take three paramount actions to promote the United States GPS standards. 79 First, as mentioned previously, the President must make sure that the GPS is continually available worldwide and that direct users do not have to pay anything for it. 80 Second, the President should engage in agreements with foreign nations and organizations to promote the GPS as an international standard. 81 Third, the President shall provide efficient resources along with specific instructions to maintain and protect the GPS’ electromagnetic (radio) spectrum. 82 President Obama continued the support for this legislation in his National Space Policy of 2010, which specifically states “[t]he United States must maintain its leadership in the service, provision, and use of [GNSS].” 83

49 U.S.C. § 301 gives permission for the development of a Nationwide Differential Global Positioning System (“NDGPS”). 84 According to the National Coordination Office for Space-Based Positioning, Navigation, and Timing, “NDGPS is a ground-based augmentation 85 system that provides increased accuracy and integrity of GPS information to users on U.S. land and waterways.” 86 This is one of the key systems publicly available for citizen use in the United States. 87 Another critical part of this statute is that the Secretary of Transportation must work with state and local governments on the use of GPS, specifically NDGPS, in the transportation sector. 88 Although the law states that the different levels of government must work together, it fails to distinguish a point where state and local government

78 Id at iii, xiii.
80 Id. § 50112(1).
82 10 U.S.C. §§ 2281(a)–(b); 51 U.S.C. § 50112(3).
84 10 U.S.C. §§ 2281(a)–(b); 49 U.S.C. § 301.
85 Augmentation Systems, GPS.GOV, http://www.gps.gov/systems/augmentations/#ndgps (last modified Dec. 18, 2015) (“A GPS augmentation is any system that aids GPS by providing accuracy, integrity, availability, or any other improvement to positioning, navigation, and timing that is not inherently part of GPS itself.”).
86 Id.
87 Id.
88 49 U.S.C. § 301(8).
use of these systems comes into conflict with federal privacy laws. While it is clear in these laws that technological advances using GPS are a priority to the American government, nowhere in the legislation does it explain how courts should address privacy issues that arise due to GPS, the government’s operation of GPS, or the government’s use of GPS for criminal suspect surveillance. The lack of direction on how the law should be applied to GPS tracking shows another missed opportunity to easily fill the gaps between GPS technologies and the hundreds of years old laws.

A. U.S. Space-Based Positioning, Navigation, and Timing Policy

On December 8, 2004, President Bush approved the U.S. Space-Based Positioning, Navigation, and Timing Policy that superseded the U.S. Global Positioning System Policy of 1996. This new policy “established[d] guidance and implementation actions for space based position, navigation, and timing programs, augmentations, and activities for U.S. national and homeland security, civil, scientific, and commercial purposes.” The six primary goals included in the policy were to:

1) provide uninterrupted availability of positioning, navigation, and timing services;

2) meet growing national, homeland, economic security, and civil requirements, and scientific and commercial demands;

3) remain the pre-eminent military space-based positioning, navigation, and timing service;

4) continue to provide civil services that exceed or are competitive with foreign civil space-based positioning, navigation, and timing services and augmentation systems;

5) remain essential components of internationally accepted positioning, navigation, and timing services; and

6) promote U.S. technological leadership in applications involving space-based positioning.

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89 Id.
91 Id.
navigation, and timing services.\(^{92}\)

In order to achieve these goals, the United States wanted to make sure that GPS and the systems that go with it could function solely on their own, without being dependent on any foreign GNSS.\(^{93}\) However, it was still important that the GPS be compatible with foreign systems, without creating any security risks or unauthorized access, in order to benefit the world as a whole.\(^{94}\)

The policy also instructed to “[p]romote the use of U.S. space-based positioning, navigation, and timing services and capabilities for applications at the Federal, State, and local level, to the maximum practical extent.”\(^{95}\) By different levels of government using this technology, such as in criminal investigations, it creates a lack of legal oversight of what the “practical extent” is and where to draw the line. While the policy did authorize the Secretary of Homeland Security to work with the Secretary of Transportation and other agencies to encourage use of GPS for aiding in public safety and emergency responses,\(^{96}\) the policy failed to address how the governments or the Secretary were to handle any situations where GPS and the current laws may conflict. This policy also requires that continual improvements be made to GPS so that it meets the everyday needs of the American and global societies.\(^{97}\) This purpose, however, does not address the laws that need to have continual improvements, guidelines, or interpretations made in order to keep up with technological advances. The law has not caught up to technology, and without it catching up many critical issues will arise, creating a battleground between the traditional laws and the technological advances.

V. PRIVACY LAWS

Privacy Law is defined as “[r]egulation[s] or statute[s] that protect[] a person’s right to be left alone, and govern[] collection, storage, and release of his or her financial, medical, and other personal information.”\(^{98}\) Justice Brandeis defined the right to privacy as “the right to be [left] alone.”\(^{99}\)

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\(^{92}\) Id.

\(^{93}\) Id.

\(^{94}\) Id.

\(^{95}\) Id.

\(^{96}\) Id.

\(^{97}\) Id.


The Bill of Rights has four Amendments that specifically address privacy. The First Amendment protects each citizen’s privacy of personal beliefs. The Third Amendment does not allow soldiers to use private homes without the consent of the owner, which essentially protects the privacy of one’s home. The Fourth Amendment is the main privacy law that applies to GPS tracking, because it protects the privacy of a person from unreasonable searches and seizures. Finally, the Fifth Amendment protects a person’s right against self-incrimination, which means that the privacy of personal information is then also protected. While these privacy laws are critical parts of the United States Constitution, they fall short when applied to privacy concerns regarding new technologies. Courts address privacy concerns case-by-case; however, this causes a lack of uniformity of what the set standard should be. Journalist, Tim Sharpe, explained this uniformity complication regarding privacy laws, stating “[a]s public opinion changes regarding relationships and activities, and the boundaries of personal privacy change, largely due to social media and an atmosphere of ‘sharing,’ the definition of the right to privacy is ever-changing.”

There is no federal statute that explicitly protects the privacy of one’s geolocation information. Because GPS tracking information easily crosses state lines in many different forms, the privacy protection of a person’s personal location needs to instead be a federally enacted law. While some states have attempted to enact laws to aid in the direction on how to handle GPS tracking information, it is likely that the laws would vary state to state and cause more confusion. United States Senator, Ron Wyden, explained that “[j]udges in different jurisdictions have issued conflicting rulings about what procedures law enforcement must follow—and how much evidence is necessary—to obtain individuals’ geolocation data . . . [t]his lack of clarity creates problems for law enforcement agencies and private companies.” If a new federal law were enacted, it would need to clarify that it preempts...
any existing state law on this matter. Due to the lack of laws on this specific privacy matter, one must look to other areas of privacy law that may apply.

Section 652B of the Second Restatement of Torts states “[o]ne who intentionally intrudes, physically or otherwise, upon the solitude or seclusion of another or his private affairs or concerns, is subject to liability to the other for invasion of his privacy, if the intrusion would be highly offensive to a reasonable person.” Therefore, under tort law the government could be liable for using GPS tracking on a citizen, depending on the perception of how a reasonable person would view this type of intrusion. Because the reasonable person standard regarding new GPS tracking technology lacks clarity, tort law does not adequately protect privacy rights.

Most younger generations today cannot imagine what life would be like without all of the current technologies, especially information provided by GPS. Most high school students have never struggled to figure out directions with a written map; instead, they use one of the many apps available to help provide directions using GPS. It is possible with the rise of social media accounts and the amount of public information people put out, that future generations may be the ones who care less about privacy, but this does not mean privacy laws should be abandoned or left outdated. In her concurrence in United States v. Jones, Justice Sotomayor addressed this point when she discussed how people might be okay with the tradeoff of less privacy for the convenience of GPS data and other new information providing technologies. Justice Murphy addressed the conflict between advancing technologies and privacy when he stated, “the search of one’s home or office no longer requires physical entry, for science has brought forth far more effective devices for the invasion of a person’s privacy than the direct and obvious methods of oppression which were detested by our forebears and which inspired the Fourth Amendment.”

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113 Id. at 959 (Alito, J., concurring) (quoting Goldman v. United States, 316 U.S. 129, 139 (1942) (Murphy, J., dissenting)).
A. United States v. Jones

*United States v. Jones*\(^{114}\) is the leading case dealing with the issue of GPS and privacy rights. After Antoine Jones was suspected of trafficking drugs, the Federal Bureau of Investigation and the local police force began investigating him using visual surveillance.\(^{115}\) Through the information gained in the primary investigation, the Government was able to get a warrant to place a GPS tracking device on Jones’ wife’s car (Antoine was the main driver of the car).\(^{116}\) The stipulations that went along with this warrant were that the device had to be installed in Washington D.C. and the government had ten days from when the warrant was signed to install it.\(^{117}\) The agents violated the warrant when they did not adhere to the stipulations by installing the tracking device on the 11th day in Maryland.\(^{118}\) Even though the warrant was executed improperly, the agents tracked Jones for twenty-eight days, which provided them with 2,000 pages of information that eventually helped in the prosecution of him and his co-conspirators on the charges of drug trafficking conspiracy.\(^{119}\) Jones filed a Motion to Suppress the data acquired by the tracking device.\(^{120}\)

The District Court held that the data obtained from the GPS tracking device when the car was parked at Jones’ house needed to be suppressed, but that data from when the car was elsewhere was admissible.\(^{121}\) The reason this court believed that some of the data did not violate his Fourth Amendment right was because Jones did not have a reasonable expectation of privacy when the car was on public streets.\(^{122}\) The jury then found Jones guilty and the court gave him a life prison sentence.\(^{123}\) The Appeals Court for the D.C. District reversed this conviction, holding that none of the GPS data would be admissible because by failing to properly execute the warrant it constituted a warrantless search that violated the Fourth Amendment.\(^{124}\)

\(^{114}\) Id. at 945.
\(^{115}\) Id. at 948.
\(^{116}\) Id.
\(^{117}\) Id.
\(^{118}\) Id. at 948 n. 1.
\(^{119}\) Id. at 948.
\(^{120}\) Id.
\(^{121}\) Id. at 946.
\(^{122}\) Id.
\(^{123}\) Id. at 949.
\(^{124}\) Id. at 946.
1. Majority Opinion

The issue presented to the United States Supreme Court was “whether the attachment of a [GPS] tracking device to an individual’s vehicle, and subsequent use of that device to monitor the vehicle’s movements on public streets constitutes a search or seizure within the meaning of the Fourth Amendment.”\textsuperscript{125} The United States Supreme Court held that these actions did constitute a search because the government physically occupied Jones’ private property with the sole goal of gaining information on his movements.\textsuperscript{126} The court stated that a physical intrusion of this kind would have constituted a search under the Fourth Amendment when it was created.\textsuperscript{127} This court cites Justice Harlan’s concurrence in \textit{Katz v. United States},\textsuperscript{128} which stated that the Fourth Amendment is violated when the government breaches a person’s “reasonable expectation of privacy.”\textsuperscript{129}

The Government attempted to argue that Jones did not have a reasonable expectation of privacy on the underside of his vehicle or on public roads.\textsuperscript{130} The majority decided not to address this argument because they found that Jones’ Fourth Amendment rights did not fall under the \textit{Katz} test and instead stated that the Court must “assur[e] preservation of that degree of privacy against government that existed when the Fourth Amendment was adopted.”\textsuperscript{131} The historical interpretation of the Fourth Amendment used a trespass test to determine if a violation had occurred.\textsuperscript{132} The trespass test was whether the government committed trespass on a person, house, paper or their personal effects.\textsuperscript{133} Although the government cites to previous cases that used the \textit{Katz} test of reasonable expectation of privacy, the Court held that the \textit{Katz} test was meant to supplement the trespass test, not to replace it.\textsuperscript{134} The Court clarifies that neither the trespass test nor the \textit{Katz} test are the exclusive tests for the Fourth Amendment and, if there is only a transmission of electronic signals without a trespass occurring, that it would simply continue to follow the \textit{Katz} test.\textsuperscript{135} Therefore, due

\textsuperscript{125} Id. at 948.
\textsuperscript{126} Id. at 949.
\textsuperscript{127} Id.
\textsuperscript{128} 389 U.S. 347, 360 (1967).
\textsuperscript{129} See \textit{Jones}, 132 S. Ct. at 950 (quoting \textit{Katz}, 389 U.S. at 360 (Harlan, J., concurring)).
\textsuperscript{130} Id.
\textsuperscript{131} Id. (quoting \textit{Kyllo v. United States}, 533 U.S. 27, 34 (2001)).
\textsuperscript{132} See id. at 949–51.
\textsuperscript{133} Id. at 950.
\textsuperscript{134} Id.
\textsuperscript{135} Id. at 953.
to the fact that law enforcement officers did trespass on Jones’ property by installing and using the tracking device, there was a violation of the Fourth Amendment, and the U.S. Appeals Court decision was affirmed.\footnote{Id. at 954.}

Due to the majority’s focus on the physical trespass test, its analysis will not apply when the GPS tracking device has been preinstalled, such as those put in new cars.\footnote{Richard M. Thompson II, United States v. Jones: GPS Monitoring, Property & Privacy, 6 (Cong. Research Serv., CRS Report for Congress Order Code R42511, April 30, 2012), available at https://www.fas.org/sgp/crs/misc/R42511.pdf.} An example of this type of preinstalled device placed in many cars is OnStar.\footnote{Sarah Rahter, Privacy Implications of GPS Tracking Technology, 4:3 I/S, J. OF L. & POL’Y FOR THE INFO. SOC’Y 751, 752–53 (2008).} The OnStar program is used to provide directions to the driver, locate a stolen vehicle, and help manage features of the car remotely when an accident occurs.\footnote{Id.} The following two concurrences provide better clarification as to how the law should handle preinstalled GPS tracking devices as well as future technologies.\footnote{Thompson, supra note 137, at 6.} The majority opinion fails to give direction on how to deal with the new technologies and their potential to violate the Fourth Amendment.

2. Justice Sotomayor’s Concurrence

Justice Sotomayor joins the majority in its decision because she agrees that a search falls within the Fourth Amendment when the government gets information through a physical intrusion on an area that is constitutionally protected.\footnote{Jones, 132 S. Ct. at 954 (Sotomayor, J., concurring).} She states, “[t]he government usurped Jones’ property for the purpose of conducting surveillance on him, thereby invading privacy interests long afforded, and undoubtedly entitled to, Fourth Amendment protection.”\footnote{Id. at 955.}

Trespass does not have to occur for there to be a Fourth Amendment violation, as there is a violation if the government oversteps in their search of an area that is generally known as a place where a person would have a general expectation of privacy.\footnote{Id. at 954–55.} Justice Sotomayor clarifies a very important point on the changing technology when she addresses the issue that government surveillance methods no longer always require a “physical intrusion” to take place.\footnote{Id. at 955.} She explains that...
the majority decision failed to give direction as to how its “trespassory test” should properly be used when the new surveillance methods do not involve an actual physical invasion.\footnote{Id.} Obviously, the \textit{Katz} test will be used when there is no trespass and only the transmission of electronic signals are involved; however, this test will also be affected as the expectation of privacy changes because of technological advances.\footnote{Id.} Justice Sotomayor stated, “I agree with Justice Alito that, at the very least, ‘longer term GPS monitoring in investigations of most offenses impinges on expectations of privacy.’”\footnote{Id.}

The \textit{Katz} test for shorter periods of GPS surveillance will need to be further analyzed, because the information that can be obtained from this way provides a list\footnote{See Jones, 132 S. Ct. at 955 (Sotomayor, J., concurring).} of extensive details about one’s personal life.\footnote{Id. at 956.} While this information can be obtained by traditional surveillance methods, such as police following persons of interest, GPS surveillance methods are easier, cheaper, and more efficient.\footnote{Id.} The reason why GPS surveillance and traditional surveillance methods differ under the Fourth Amendment is because GPS surveillance gets around the main checks and constraints against excessive police practices.\footnote{Id. (quoting United States v. Cuevas-Perez, 640 F.3d 272, 285 (7th Cir.) (citing People v. Weaver, 909 N.E.2d 1195, 1199 (2009)).} Justice Sotomayor clarified the issue by stating,

\begin{quote}
[a]wareness that the Government may be watching chills associational and expressive freedoms. And the Government’s unrestrained power to assemble data that reveal private aspects of identity is susceptible to abuse. The net result is that GPS monitoring—by making available at a relatively low cost such a substantial quantum of intimate information about any person whom the Government, in its unfettered discretion, chooses to track—may\footnote{Id.} ‘alter the relationship between citizen and government in a way that is inimical to democratic society.’\footnote{Id.}
\end{quote}
This changes the way people perceive the meaning of “reasonable expectation of privacy” and how it should be judged. Many people would likely agree that their reasonable expectation of privacy is violated by the government tracking their every move and being able to get a much more in depth view into their personal lives. Justice Sotomayor makes sure to explain that while she does feel like GPS surveillance will change people’s view on privacy, this does not mean that the Government cannot obtain information from GPS surveillance when done lawfully, such as by a properly executed warrant.

3. Justice Alito’s Concurrence

Justice Alito’s concurrence also had Justice Ginsburg, Justice Breyer, and Justice Kagan join. The concurrence begins by stating one of the biggest flaws that the concurring justices see with the majority opinion: the fact that they believe the opinion is “based on eighteenth century tort law.” This claim is interesting because, in reading the majority opinion, one will see that the Court does not eliminate other types of Fourth Amendment protection of privacy rights, but states that they are unnecessary in this type of case. Justice Alito claims that the actions taken by the officers when installing the tracking system on Jones’ car would have constituted trespass to chattels in 1791 and that is the key reason he believes the majority said it constituted a search. Justice Alito strongly disagrees with this approach as he thinks that the way the Fourth Amendment has more recently been interpreted does not support the majority’s conclusion. Instead of answering the issue of whether the attachment of the GPS tracking device on a car using public roads is a search under the Fourth Amendment, Justice Alito contends that the issue that needs to be addressed is “whether respondent’s reasonable expectations of privacy were violated by the long-term monitoring of the movements of the vehicle he drove.”

While the majority does not believe the actions taken by the officers constituted a seizure, they do decide that a search in violation of the
Fourth Amendment occurred. Justice Alito finds a problem with this reasoning because in his opinion search and seizure should not be separated. If they are separated, then the majority fails to explain how either could constitute a search under the Fourth Amendment.

In this concurrence, it is argued that the mere placing of the GPS tracking device, without obtaining any information, was not a search, and the Court did not find that the use of the tracking device was a search either. Justice Alito argues that the Court’s understanding that any trespass where information and evidence was obtained amounted to a search is incorrect because information gained outside the home is not covered by the Fourth Amendment.

Justice Alito continues the concurrence, stating that the majority’s reasoning was similar to previous cases that held a technological device that obtained information was found to be a search under the Fourth Amendment. The majority opinion argues that the holdings in these cases find that a “technical trespass” is enough to constitute a search, but it fails to further adequately support this argument. In Soldal, the Court found that a seizure in violation of the Fourth Amendment occurred when a trailer home was taken without the owner’s consent, even though technically the privacy within this motor home was not violated. This is different from the case at hand because the majority does not hold that a seizure occurred. In Alderman, the Court held that there was a Fourth Amendment violation because homeowners have a reasonable expectation of privacy to conversations occurring within their residences. Because these two cases do not provide enough basis for the majority to base their trespass

162 Id.
163 Id. (“A seizure of property occurs when there is ‘some meaningful interference with an individual’s possessory interests in that property.’”) (quoting United States v. Jacobsen, 466 U.S. 109, 113 (1984)).
164 See id. at 958 (Sotomayor, J., concurring)
165 Id.
166 Id.
167 Id. at 958–59 (“At common law, any unauthorized intrusion on private property was actionable . . . but a trespass on open fields, as opposed to the ‘curtilage’ of a home, does not fall within the scope of the Fourth Amendment because private property outside the curtilage is not part of a ‘hous[e]’ within the meaning of the Fourth Amendment.”).
168 Id. at 958.
169 Id. at 960 (citing Soldal v. Cook County, 506 U.S. 56 (1992); Alderman v. United States, 394 U.S. 165 (1969)).
170 Id. at 959.
171 Id. at 952 n.8.
173 See Jones, 132 S. Ct. at 953.
theory on, Justice Alito finds the majority’s holding on this matter hard pressed.\footnote{See Jones, 132 S. Ct. at 960 (Alito, J., concurring).} He claims that there is “disharmony” between the holding in the present case and past case law, which is his major issue with the majority’s holding.\footnote{Id. at 961.}

Justice Alito also finds four other problems with the majority opinion.\footnote{Id.} First, the majority focuses too much on the actual attachment of a small device to the bottom of a car that does nothing to impair the car’s normal capabilities.\footnote{Id.} Instead, Justice Alito argues that the focus should be on the actual use of the device and the information it provides in regards to the long term tracking of a subject.\footnote{Id.} He explains that if the government could use GPS tracking through another technological means, such as all cars having to automatically have GPS systems, then the majority’s ruling would not protect this under the Fourth Amendment.\footnote{Id.} It is important to look at the actual information that is being obtained and how this could be done in the future, so that similar cases have better direction with technological advancements.

Second, Justice Alito finds additional disharmony in the majority’s decision when it finds two different outcomes for essentially the same action: tracking a car.\footnote{Id.} The majority states that a Fourth Amendment violation occurs when a GPS tracking device is put on a car and evidence is obtained that way, but a violation does not occur when undercover officers and aerial support tracking is used to gain the same evidence.\footnote{Id.} When the GPS tracking device was placed on the car after Jones’ wife had given him the keys, it allowed him to have a claim that a Fourth Amendment violation occurred.\footnote{Id.} The reason behind for is that the Court basis its opinion on the belief that Jones would have the same property rights of a bailee, if not more.\footnote{Id.} The problem then arises that if the GPS tracking device had been installed before the defendant obtained the keys from his wife, he would not have a claim that his property had been trespassed upon and a Fourth Amendment violation claim would fail.\footnote{Id.} It seems silly that the detail of simply placing the device on the car is more important to the majority than the information being obtained and how far one’s privacy should extend to.
Third, because of the same issues addressed in the second problem, Justice Alito argues that if the Court’s theory were to be used in regards to the Fourth Amendment, it could create variations of it applicability in different states. If Jones lived in a community property state or a state that had adopted the Uniform Marital Property Act, he would already be considered an owner of the car along with his wife and it would not matter that the device was installed before his wife gave him the keys. This would be different if he lived in a state that did not accept the community-property law, because his wife would always be understood to have been the sole owner of the car. Because of the different applications of state law, it would be difficult to determine when the tracking device may be allowed and whether or not Jones would have had an actual claim based on the property law of each state. It is important that the United States Supreme Court’s holdings have the same applicability across state lines, especially because this could also complicate interstate tracking.

Fourth, the trespass test that the majority uses creates friction between how the law should be applied in cases where electronic surveillance is used and how it should be applied differently when physical tracking devices are used. The example Justice Alito cites to is if a car had a tracking device previously installed in it, in case the car was stolen, would the radio signal activation be considered a trespass, even though there was no physical touching of the tracked car. Courts have been attempting to decipher how the trespass to chattels law should be applied when there has been uninvited electronic contact with computers, showing that this is not the only area where the “trespass” law is unclear. Justice Alito shows the failing logic of the trespass test in future cases when he asks, “[a]ssuming that what matters under the Court’s theory is the law of trespass as it existed at the time of the adoption of the Fourth Amendment, do these recent decisions represent a change in the law or simply the application of the old tort to new situations?”

Although Justice Alito thoroughly criticized the majority’s use of the trespass test, he does not find the Katz test to be without fault. The Katz test requires judges to use the reasonable person analysis,
which is difficult because some may rely on their own perceptions of privacy rather than that of a reasonable person.\textsuperscript{195} He also notes that the current reasonable person in the *Katz* test has thorough and established expectations of privacy, but these expectations can easily change with advances in technology.\textsuperscript{196} These new technologies can create large gaps in different people’s perceptions of the meaning of privacy. As also stated in Justice Sotomayor’s concurrence, people may be willing to trade more of their privacy rights for the convenience and security that technology brings.\textsuperscript{197} Justice Alito also theorizes that “even if the public does not welcome the diminution of privacy that new technology entails, they may eventually reconcile themselves to this development as inevitable.”\textsuperscript{198}

Hopefully, the opposite effect will happen and instead of accepting the lack of privacy due to technology, people will begin to push for new privacy legislation like they did when the wiretapping issue arose.\textsuperscript{199} Rather than allow the court system to attempt to deal with wiretapping under the Fourth Amendment after *Katz*, Congress enacted statutes to better handle the problem.\textsuperscript{200} This provided a better framework and much more clarity on how wiretapping needed to be regulated, which is exactly what needs to be done in the case of GPS tracking.

These regulations by Congress are necessary because of the increase of tracking devices in the United States. Justice Alito states, “cell phones and other wireless devices now permit wireless carriers to track and record the location of users—and as of June 2011, it has been reported, there were more than 322 million wireless devices in use in the United States.”\textsuperscript{201} Before computers, neither the courts nor the legislature had to really deal with the privacy issue, because the barriers were pretty obvious.\textsuperscript{202} Manpowered tracking was only done on rare occasions because of the constraint on resources and time, but technology has changed all of this making statutes the best way to handle these privacy concerns.\textsuperscript{203} The Court would be hard pressed to be able to try and interpret the majority’s ruling in future cases with the changing perceptions around technology. Personal GPS tracking, such as through maps and social media, is not viewed as a rare aspect by most people, but is seen a part of everyday life.\textsuperscript{204} It is difficult then to know

\textsuperscript{195} Id.
\textsuperscript{196} Id.
\textsuperscript{197} Id. at 957.
\textsuperscript{198} Id. at 962.
\textsuperscript{199} Id. at 962–63.
\textsuperscript{200} Id. at 963.
\textsuperscript{201} Id.
\textsuperscript{202} Id.
\textsuperscript{203} Id. at 964.
\textsuperscript{204} Id. at 963.
what the current, overall, public perception is regarding government tracking, when there are so many different ways that tracking is already occurring. Justice Alito exemplifies this, explaining,

> [t]he availability and use of these and other new devices will continue to shape the average person’s expectations about the privacy of his or her daily movements. . . . A legislative body is well situated to gauge changing public attitudes, to draw detailed lines, and to balance privacy and public safety in a comprehensive way.\(^{205}\)

By having the legislature in charge, it limits the amount of interpretation that must be done by the Courts.

At the time this concurrence was written, neither Congress nor most states had enacted any type of statute that would help solve this GPS tracking issue and that is why Justice Alito is forced to use the current Fourth Amendment reasonable person analysis for this case.\(^{206}\) Using this approach, Justice Alito finds that short-term tracking on public streets is acceptable to most people, but that long-term GPS tracking is not.\(^{207}\) The longer period of tracking with a GPS monitor infringes on privacy rights because it could not easily be done using manpower alone and no technology.\(^{208}\) He notes that when the time frame could be questionable as to whether or not it is too long of a time to track someone’s car, the police can get a warrant to make sure there are no Fourth Amendment violations.\(^{209}\) Overall, Justice Alito concurs with the majority because he did find the GPS tracking on Jones car to be long-term and a violation of his Fourth Amendment right.\(^{210}\)

Justice Alito’s concurrence is a thorough explanation of not only how the existing privacy laws fall short, but also how case law falls short and how court interpretations can easily be flawed. His suggestion of having the legislature enact laws would simplify and help limit the problems that are bound to occur with the increase in GPS tracking. The Alito concurrence better identifies the issues with the current tests used by the courts and problems that will continue to arise in the future if modern laws are not enacted that are more on point with this technology.

At the end of this case, one thing that all nine justices agreed upon was that a four-month tracking period constituted a search under the

\(^{205}\) *Id.* at 963–64.

\(^{206}\) *Id.* at 964.

\(^{207}\) *Id.*

\(^{208}\) *Id.*

\(^{209}\) *Id.*

\(^{210}\) *Id.*
Fourth Amendment. A key issue in this case that never got addressed was how much suspicion for probable cause is needed to be able to conduct GPS tracking on a suspect or whether a warrant is needed in all cases where GPS tracking may take place. Because the Court did not address this issue, future cases will have to be decided on the current Fourth Amendment standards until better clarification is given.

VI. FUTURE LEGISLATION

GPS information combined with other technological means of obtaining information provide the government with a vast array of private data, with very few clearly defined limits. Congress should enact new laws to provide stronger and definite barriers as to how potentially private information can be obtained and used. There are five congressional bills currently being deliberated regarding GPS tracking information: the FY 2016 Transportation Appropriations Bill, the Consolidated and Further Continuing Appropriations Act 2015, the GPS Act, the Online Communications and Geolocation Protection Act, and the Location Privacy Protection Act.

The FY 2016 Transportation Appropriations Bill establishes how the funds for the Departments of Transportation, and Housing and Urban Development are to be allocated from the treasury for the 2016 year. Section 144 of this Act proclaims, “[n]one of the funds made available by this Act may be used to mandate [GPS] tracking in private passenger motor vehicles without providing full and appropriate consideration of privacy concerns under 5 U.S.C. chapter 5, subchapter II.” This section is a step in the right direction to help to protect persons’ privacy rights in their vehicles from unconstitutional use of GPS tracking by the government.

Section 417 of Division K of the Consolidated and Further Continuing Appropriations Act 2015 contained the exact same wording as Section 144 of the FY 2016 Transportation Appropriations Bill. The legislative history of this act shows that in the version of the FY 2013 transportation funding bill that was passed by the House of

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211 Thompson, supra note 137, at 10.
212 Id.
213 Id. at 10–11.
215 Id.
216 Geolocation Privacy Legislation, supra note 42.
218 Id. at § 144.
219 Geolocation Privacy Legislation, supra note 42.
Representatives, a similar section regarding GPS tracking was included, but the final version that was enacted did not contain this section.\textsuperscript{220} This shows that some acts are getting better about including this type of privacy protection, likely because of the increased public awareness of these issues.

The Geolocation Privacy and Surveillance Act (\textquotedbl{}GPS Act\textquotedbl{}) is currently the most important bill on the docket regarding this topic.\textsuperscript{221} This act seeks to establish a legal framework that gives government agencies, commercial entities, and private citizens clear guidelines for when and how geolocation information can be accessed and used. The bill would create a process whereby government agencies can get a probable cause warrant to obtain geolocation information in the same way that they currently get warrants for wiretaps or others types of electronic surveillance. In addition, the GPS Act would prohibit businesses from disclosing geographical tracking data about its customers to others without the customers’ permission.\textsuperscript{222}

The GPS Act has bills in both the House of Representatives, introduced by Representative Jason Chaffetz, and the Senate, introduced by Senator Ron Wyden.\textsuperscript{223} The two congressional members that introduced this legislation are from separate political parties, showing that it is a bipartisan issue.\textsuperscript{224} Senator Wyden noted that the GPS Act is modeled after the federal wiretapping laws.\textsuperscript{225} The fact that the same legislation was given to both the 112th Congress and the 113th Congress and neither did anything substantial to move it further along in the process is disappointing.\textsuperscript{226} It is critical that the 114th Congress takes this issue more seriously and gives this legislation the adequate time and attention it deserves, due to the pressing nature of GPS tracking advancements and their use in society.

The Online Communications and Geolocation Protection Act has many similar specifications that the GPS Act has, but it also addresses

\textsuperscript{220} Id.
\textsuperscript{221} Id.
\textsuperscript{222} Id.
\textsuperscript{224} Geolocation Privacy Legislation, supra note 42.
\textsuperscript{225} Wyden, supra note 108.
\textsuperscript{226} Geolocation Privacy Legislation, supra note 42.
privacy for internet users. According to United States Representative Zoe Lofgren, this act “would require the government to obtain a warrant to intercept or force service providers to disclose geolocation data.” It also establishes a civil cause of action if GPS data was unlawfully disclosed or unlawfully obtained. This bill was only introduced to the 113th Congress and no further action has been taken on it.

The Location Privacy Protection Act of 2015 would make it unlawful for private companies to collect or pass on any geolocation data obtained from an electronic communications device. Exceptions to this act include user consent, parents or legal guardians tracking their children, emergencies and some uses by law enforcement. Senator Al Franken reintroduced this bill on November 10, 2015, and it was referred to the judiciary committee.

Another solution is to limit the way information is combined, such as limitations on GPS obtained data and other private database information. Attorney Martha Bridegam explained this option by stating:

[Technological innovation does not . . . seem likely to change the fact that democratic freedoms depend on maintaining democratically chosen separations—for example, the separation of powers among the executive branch, Congress, and the courts; separation between foreign spying and domestic policing; separation between public and private databases; separations among privately created databases whose combination would invade privacy; and separations between the use of data for its intended purpose (healthcare, credit card billing) and the use of data for other purposes (marketing, insurance policy decisions).]

While this may seem inefficient, it is one method that keeps privacy in

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227 Id.
229 Id.
231 Location Privacy Protection Act of 2015, S. 2270, 114th Cong. (2015); Geolocation Privacy Legislation, supra note 42.
232 Geolocation Privacy Legislation, supra note 42.
233 Id.
234 BRIDEGAM, supra note 214, at 86–88.
check, especially in regards to government use. These adjustments and new laws would help separate out information that may cross the line in a Fourth Amendment search and it would give government officials clear boundaries on what information they can combine from different databases and methods and which they cannot.

Justice Marshall’s dissent in the 1979 case, Smith v. Maryland, also addressed the issue of the need to separate information gaining methods. He explained that a person may be okay divulging some private information for a particular purpose, but this should not open up the door for that information to be used for any purpose. The Katz case further pointed out that “[w]hat [a person] seeks to preserve as private, even in an area accessible to the public, may be constitutionally protected.”

It can be concluded from the numerous bills and large amounts of commentary by lawmakers on the issue, that there are many people offering solutions. The problem is that there is a lack of further action being taken to get these solutions made into laws. In order to adequately be able to protect privacy rights, there must be new laws established that specifically address the use of GPS and the use of GPS tracking devices.

VII. CONCLUSION

The daily increase in technological devices that use GPS does not seem like it will be slowing down anytime soon, so it is imperative that the legal world catches up quickly in regards to limitations and privacy protections. Clear laws are needed not only to protect citizens’ privacy rights, but also so that law enforcement agencies know the correct procedures to legally use GPS tracking devices. In regards to the proposed legislation, the GPS Act is the best solution for modernizing privacy laws to address GPS tracking issues. This act provides clear direction to all potential parties (i.e., government agencies, private companies, and citizens) on how GPS tracking can legally be used and what are unlawful uses. While it may not be a solution to every GPS issue in the future, it begins the process of unifying privacy law and technology. If the GPS Act is enacted, the passage of more laws will likely follow, especially as technology continues to advance. It is

235 Id. at 88.
237 Id. (“Privacy is not a discrete commodity, possess absolutely or not at all. Those who disclose certain facts to a bank or phone company for a limited business purpose need not assume that this information will be released to other persons for other purposes”).
important that more lawmakers step up to the challenge of getting these new laws enacted, rather than pushing the proposed bills aside. Without new privacy laws and clarifications for GPS tracking, the existing law will continually become more out of date, providing no adequate regulations for this key aspect of today’s society.
ADDRESSING UNFAIRNESS TO NON-DEBTOR PATENT LICENSEES IN BANKRUPTCY FREE AND CLEAR OF SALES: ISSUES OF TIMING, NOTICE & CONSENT

Anne M. Culotta†

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† Anne Culotta is an IP attorney in private practice serving clients as a one stop shop for new product and service commercialization. Anne’s academic achievements include a Ph.D. in chemistry, an M.B.A., a J.D. and LL.M in IP. Her full bio is available at https://www.linkedin.com/in/culottalawfirm. Anne offers deepest thanks to Professor Greg. R. Vetter, Professor of Law, University of Houston Law Center; Co-Director, Institute for Intellectual Property and Information Law. Professor Vetter supervised this writing project, provided instructive feedback and a superb process for academic legal writing. Additionally, thanks go to Assoc. Professor Spencer Simons, Director of O’Quinn Law Library, and Assistant Clinical Professor Lauren Simpson.
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D. FIGURE 4. SUMMARY OF RULES EXTERNAL TO
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I. INTRODUCTION

Under United States bankruptcy law, Title 11 U.S.C. § 363(f) empowers a debtor licensor to sell property “free and clear” of any patent license under certain conditions. This writing considers the sale of any one or more of the following by a licensor in a Chapter 11 or Chapter 7 bankruptcy: (1) a non-exclusively licensed patent, (2) either a non-exclusive patent license or sub-license, and (3) an exclusive patent license. The debtor licensor may sell any one or more of these assets to the same buyer or to different buyers.

The central claim of this writing is that § 363(f) sales are unfair to licensees in three ways implicating issues of timing, notice and consent. The aim of this writing is to provide licensee with guidance useful in defending a valuable license against the possibility of extinguishment in a § 363(f) sale.

Part II of this writing begins with two test cases (“Test Cases”) and three questions in order to fully understand the potential unfairness to patent licensees in a § 363(f) sale. The purpose of the Test Cases is to delineate which assets the debtor licensor has to sell to extinguish the licensee’s patent license. The three questions structure this article as a guide for the reader.

Part III applies the plain language of § 363(f) to the Test Cases in order to gain a basic understanding of the statute. The first Test Case will be referred to as the “Patent Test Case” and the second Test Case as the “License Test Case.” The Patent Test Case involves the debtor’s sale of either or both of a non-exclusively licensed patent and a non-exclusive patent license agreement.

The License Test Case replaces the sale of the non-exclusively licensed patent in the Patent Test Case with the sale of an exclusive patent license agreement under which the exclusive licensee has granted a non-exclusive sub-license. Like the Patent Test Case, the debtor may sell either or both of the exclusive patent license agreement and the non-exclusive patent sub-license agreement.

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Part IV takes up and answers the first question, which considers what laws govern the facts of the Test Cases when the selling licensor is not bankrupt. For example, absent bankruptcy, what happens to a non-exclusive or exclusive patent license agreement when the licensed patent is sold to a new owner? Also, what happens when a licensor sells a patent license agreement?

Part V takes up the second of the three questions and asks how the law outside bankruptcy is applied inside a bankruptcy § 363(f) sale. As will be demonstrated in Part V, what happens external to bankruptcy does not happen inside bankruptcy. Section 363(f)(1) incorporates the law external to bankruptcy, discussed in Part IV. But bankruptcy courts do not follow that law in sales involving patent licenses and licensed patents.

Part VI takes up the third of the three questions. Using the facts of the Test Cases again, what is a licensee in a § 363(f) sale to do to protect its license from extinguishment? Part VI identifies three particular aspects of unfairness to patent licensees in § 363(f) sales: (1) timing issues, (2) notice issues, and (3) consent issues. The Part further discusses how licensees might address these issues.

Part VI.A addresses timing issues from a procedural point of view in the licensor’s bankruptcy. Bankruptcy law only requires the debtor licensor to give twenty-one days advance notice of a license-extinguishing sale, further reducible for cause. In some circumstances, notice by general publication in a newspaper may be adequate. The notice will advise of a hearing date and deadline for the filing of written objections. This leaves licensees little time to seek what protection bankruptcy law purports to offer.

For example, section 365(n) was designed to protect patent license agreements in bankruptcy but such license protections are ephemeral. Such protections are triggered only upon the licensor’s rejection of a patent license. However, debtor licensors do not have an obligation to reject a patent license agreement in bankruptcy. In fact, the licensor can sell a licensed patent and do nothing with the license agreement. Absent timely objection by the licensee, the sale will extinguish the license.

In another example, the debtor can delay a decision to assume or reject a license agreement until after the § 363(f) sale, an aspect desirable to bankruptcy buyers. The resulting question is, what should

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the threatened licensee do to protect itself when the sale that extinguishes a patent license occurs before the possibility of protection under § 365(n)?

Part VI.A. concludes with suggestions to licensees for dealing with unfair timing problems before and after the sale. After the sale, with the possible exception of adequacy of notice, a licensee’s appeal to vacate or modify a § 363(f) sale is not likely to succeed. The balance of this writing provides guidance for addressing the unfairness of notice and consent issues prior to closing of a § 363(f) sale.

Part VI.B. addresses the adequacy of notice due licensees before a license may be extinguished. Challenges to the adequacy of notice in a § 363(f) sale constitute one of the most frequent reasons bankruptcy courts vacate or modify a sale order. Other than such notice challenges, final sale orders can be extremely difficult to change.

Part VI.C addresses consent. In sales other than those involving licensed patents, some bankruptcy courts explicitly require the affirmative consent of interest holders. Others take the opposite view by deeming that the adequately noticed interest holder’s lack of objection constitutes consent. In the sale of licensed patents, many bankruptcy courts have followed this deemed consent approach.

Bankruptcy courts following such a deemed consent approach justify the approach on the basis that requiring affirmative consent would slow the pace of sales needed to generate cash for the debtor. Part VI.C takes the position that, in the context of the law external to bankruptcy that would not permit such a sale without the consent of the licensee, it is unfair to follow a contrary rule by deeming consent given inside of bankruptcy. Part VI.C closes with guidance for licensees in addressing the unfairness of deemed consent.


9 See infra notes 123–24 and accompanying text.
10 See infra note 139.
11 See infra note 168.
12 See infra notes 169–70 and accompanying text.
13 See, e.g., FutureSource L.L.C. v. Reuters Ltd., 312 F.3d 281, 286 (7th Cir. 2002) (construing licensee’s failure to timely object to properly noticed sale of copyrights in software and data as consent); In re Eastman Kodak Co., No. 12-10202 (ALG), 2013 WL 588965 (Bankr. S.D.N.Y. Feb. 13, 2013) (deeming, in sale order paragraph GG, that failure to timely object to the sale, including licensed patents, constitutes consent to the sale under the noticed sale terms); In re Nortel Networks, Inc., No. 09–10138 KG, 2011 WL 1661524, at *7 (Bankr. D. Del. May 2, 2011) (deeming, in a bankruptcy sale order, consent given to assumption and assignment of executory license agreements in the absence of timely objection).
II. TWO TEST CASES AND THREE QUESTIONS

A. The Patent Test Case

Your client, Distributor, is a party to a non-exclusive patent license agreement with KnifeCo. Distributor is the licensee. Distributor makes and sells specialty cooking knives covered by KnifeCo’s patents.

KnifeCo, licensor to Distributor, fell on hard times and filed for Chapter 11 bankruptcy, hoping to reorganize its business and return to profitability. KnifeCo needs cash to continue operating in bankruptcy. To generate cash, KnifeCo has decided to sell some of its property in a “free and clear” bankruptcy sale, possibly including the patents and license agreement with Distributor. The free and clear sale can extinguish “interests in property,” including Distributor’s non-exclusive patent license rights.

Competitor and Distributor are archrivals, having tussled more than once in previous litigation. Competitor makes and sells knives different from, but competitive with, Distributor’s knives. Competitor is negotiating behind the scenes with KnifeCo hoping to buy some of KnifeCo’s property in the sale, which could include the patents, non-exclusive license, or both.

You return to your office and re-read Distributor’s patent license agreement with KnifeCo. The patent license is non-exclusive and each party owes the other ongoing performance. There is no mention of either party’s authority to assign its rights or delegate its duties under the agreement. A “no oral modifications” clause was included in the

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14 This writing examines a free and clear sale from two perspectives. First, under Test Case One, KnifeCo is a debtor and patent licensor. Second, under Test Case Two, KnifeCo is both a debtor licensee (through the exclusive patent license with the third party) and debtor licensor (through the non-exclusive sub-license agreement with Distributor).

15 Competitor is playing the role of stalking horse bidder in a free and clear sale. The stalking horse bidder establishes the minimum price of the property to be sold in an asset purchase agreement for the § 363(f) sale. The sale bidding procedures will establish the requirements for higher, better offers. In the absence of any such offers in the sale, and on approval the sale by the bankruptcy court, the stalking horse can proceed to close the sale with the trustee. See infra Figure 1.

16 See AM. BANKR. INST., COMMISSION TO STUDY THE REFORM OF CHAPTER 11 (2012–2014), FINAL REPORT AND RECOMMENDATIONS 112 (2015) (recommending codification of the Countryman definition because of, among several reasons, the body of case law developed around the Countryman definition); Vern Countryman, Executory Contracts in Bankruptcy: Part I, 57 MINN. L. REV. 439, 460 (1973) (proposing that an executory contract should be defined as a “contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.”).
agreement. You also know that neither KnifeCo nor your client has breached the license agreement. Distributor has always timely paid the running royalties due under the license agreement.

Neither you nor your client, Distributor, has received any communications from KnifeCo. You are not certain of what KnifeCo might actually plan to sell. For example, KnifeCo could sell (1) the patent, (2) the non-exclusive license agreement, or (3) both.\textsuperscript{17} Each asset could potentially be sold to the same buyer or to different buyers.

\textbf{B. The License Test Case}

In this test case, assume that KnifeCo does not own the patent licensed to your client, Distributor. Instead, a third party owns the patent and KnifeCo has an exclusive license to the patent with the right to sub-license. The exclusive license is something less than what would be construed to be a complete assignment of title to the patent.\textsuperscript{18} The exclusive patent license agreement explicitly prohibits assignment of the exclusive license agreement by either of the third party licensor or KnifeCo without the prior written consent of the non-assigning party.

Your client, Distributor, obtained a non-exclusive sub-license to the third party’s patent by sub-licensing from KnifeCo. Like the non-exclusive patent license agreement in Patent Test Case, the non-exclusive sub-license agreement between KnifeCo and Distributor is silent as to assignment. Each party owes the other ongoing performance.\textsuperscript{19}

Here, KnifeCo can potentially sell (1) the exclusive patent license agreement between the third party and KnifeCo (as licensee), (2) the non-exclusive sub-license agreement between itself and Distributor (KnifeCo as licensor), or (3) both. Each asset could potentially be sold to the same buyer or to different buyers.

\textsuperscript{17} The Test Cases are oversimplified in providing that the non-exclusive patent license agreements are silent as to assignment.

\textsuperscript{18} Elaine D. Ziff, \textit{The Effect of Corporate Acquisitions on the Target Company's License Rights}, 57 \textit{Bus. Law.} 771–75 (2002) (noting that the question of whether an exclusive patent license is tantamount to an outright assignment of the licensed patent turns, in part, on the extent of the rights granted to the exclusive licensee and other terms of the license agreement).

\textsuperscript{19} See Countryman, supra note 16.
C. Three Questions

The questions raised by the Test Cases include:

1. External to bankruptcy, what laws govern the transfer of (a) the Patent Test Case non-exclusively licensed patent, (b) in both Test Cases, the non-exclusive patent license agreements, and (c) the License Test Case exclusive patent license?20

2. Considering a bankruptcy free and clear sale under § 363(f), how is the law external to bankruptcy applied in bankruptcy?

3. What actions should Distributor take to protect itself as a non-exclusive patent licensee, and when?

Part IV takes up the first question. Part V takes up the second and Part VI the third. Figure 1 provides an example of a § 363(f) sale timeline. Figure 2 provides a generalized example timeline of bankruptcy to set the § 363(f) timeline in context of the entire case. Figure 3 summarizes all possible asset sales considered by the Test Cases and summarizes the general findings of this writing. What follows next is a brief introduction to § 363(f) using the Test Cases.

III. THE PLAIN LANGUAGE OF § 363(f)

A. Introduction to § 363(f)

This Part III introduces the plain language of 11 U.S.C. § 363(f), which governs free and clear sales in bankruptcy.21 Part III.B introduces terminology used in the Code and Rules; interests susceptible to extinguishment in the sale, and also a few concepts for understanding free and clear sales. Part III.C applies § 363(f)(1)-(2) to the Test Cases.

Section 363(f) provides as follows:

20 The License Test Case is intentionally oversimplified. The exclusive patent license agreement expressly prohibits assignment by either of KnifeCo or the third party.

The trustee may sell property under section (b) or (c) of this section [363] free and clear of any interest in such property of an entity other than the estate, only if—

(1) applicable non-bankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.22

The five conditions stated in §§ 363(f)(1)-(5) are listed in the alternative. Only one of the five conditions need be applicable for a bankruptcy court to approve the sale.23 This writing addresses the first two of the five conditions.

B. Requirements and Terminology Pertinent to § 363(f)

There exist a few other requirements not specifically mentioned in § 363(f), and a few terms in the Code, used repeatedly, yet undefined. Figure 1 provides an example timeline of a § 363(f) sale. To begin, the sale must not be of the kind conducted in the ordinary course of the debtor’s business.24 The trustee must request, by motion to the bankruptcy court, approval to conduct the sale.25 In its motion, the

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23 Sections 363(f)(3)–(f)(5) are beyond the scope of this writing. Section 363(f)(3) is pertinent when there is a security interest in the property to be sold. The security interest attaches to the sale proceeds, leaving the previously secured property unencumbered by the security interest. Under § 363(f)(4) the bankruptcy court will allow the sale to proceed when the interest is in bona fide dispute but protect the interest holder so that the issue can be later resolved. Section 363(f)(5) permits the sale in the case that the interest holder could be compelled in a legal or equitable proceeding to accept money in exchange for the interest.
24 11 U.S.C. § 363(b)(1) (2012) (“other than in the ordinary course of the debtor’s business”). Compare FED. R. BANKR. P. 6004(g) (requiring the trustee to seek permission for a sale outside of the ordinary course of the debtor’s business), with § 363(c)(1) (not requiring the trustee to seek permission when the sale is in the ordinary course of the debtor’s business).
25 Section 363(f) incorporates § 363(b)(1) by stating, “The trustee may sell property under subsection [363](b)[.]” 11 U.S.C. § 363(f) (2012). Section 363(b)(1) states, “The trustee, after notice and a hearing, may . . . sell . . . property of the bankrupt estate that is not of the kind held by the debtor in the ordinary course of the debtor’s business.”
trustee must articulate a sound business justification for the sale.\textsuperscript{26} The trustee must provide all interested parties with at least twenty-one days notice of the sale, including the deadline for receipt of objections to the sale, and of the sale hearing date.\textsuperscript{27}

The Code and Rules leave a number of terms undefined. “Interest” is one such term.\textsuperscript{28} “Interest,” of the type at risk of extinguishment in a § 363(f) sale, has been construed to include the right to be included in a waiting list to buy full golfing privileges at an exclusive club.\textsuperscript{29} An

\begin{quote}
(1) the proportionate value of the asset to the estate as a whole,
(2) the amount of elapsed time since the filing of the bankruptcy petition,
(3) the likelihood that a plan of reorganization will be proposed and confirmed in the near future,
(4) the effect of the proposed disposition on future plans of reorganization,
(5) the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property,
(6) alternative of use, sale or lease of the property to be sold, and
(7) whether the asset is increasing or decreasing in value.” \textit{Id.} at 1071.
\end{quote}

\textsuperscript{29} See, e.g., \textit{In re Magness}, 972 F.2d 689, 692 (6th Cir. 1992) (finding the interest to be extinguished in this a § 363(f) sale was not club membership, but rather the “rights of other club members to apply for golf membership as set out in the continued . . .
easement in real property has also been considered.\textsuperscript{30} In \textit{Precision v. Qualitech} ("\textit{Precision}")\textsuperscript{,} a lease of real property was also found to be an interest which can be extinguished by the sale of the property.\textsuperscript{31} 11 U.S.C. § 365(h) (2012) provides lessees the option to retain rights in a lease if rejected by the lessor.\textsuperscript{32} The lessee in \textit{Precision} failed to exercise its option to retain rights in the lease.\textsuperscript{33} This failure is partly attributable to the bankruptcy court’s sale order authorizing a delay of the decision to assume or reject the property lease until after the § 363(f) sale of the property.\textsuperscript{34} This exposes a timing issue explored throughout this writing.\textsuperscript{35} Code § 365(n) is analogous to § 365(h) and applies to intellectual property ("IP") licenses.\textsuperscript{36}

In view of \textit{Precision}, IP commentators predicted that if property

\textsuperscript{30} See Gregory G. Hesse & Cameron W. Kinvig, \textit{How Problem Easements Can Limit Sale Rights}, AM. BANKR. INST. JOURNAL 32–33 (May 2014) (discussing cases involving a § 363(f) sale of land burdened by an easement or other covenant running with the land).

\textsuperscript{31} See, e.g., Precision Indus. v. Qualitech Steel SBQ, L.L.C., 327 F.3d 537, 540–541 (7th Cir. 2003) (A debtor lessor intended to sell its leased real property in a § 363(f) free and clear sale. The debtor properly noticed the lessee providing sale terms, a hearing date and objection due date. The sale terms provided for the buyer to choose whether to assume or reject the lease after the close of the sale.).

\textsuperscript{32} See \textit{Precision}, 327 F.3d at 542. Under § 365(h)(1)(A)(ii), upon rejection of a property lease, the lessee is entitled to elect to retain possession of the lease property “for the balance of the term [of the lease] and for any enforceable extensions of the term.” \textit{Id.}

\textsuperscript{33} \textit{Id.} at 541.

\textsuperscript{34} \textit{Id.} at 541–42. The bankruptcy court’s sale order reserved the debtor’s right to assume and assign the lease after the sale. \textit{Id.} at 541. Presumably, the lease was not extinguished in the sale based upon the sale order. \textit{Id.} at 542. However, after the sale and the lapse of time provided to the buyer to decide whether to assume or reject the lease, the lease was rejected by operation of law. \textit{Id.} at 541. Upon such rejection, the lessee still had the right to elect to retain rights under the lease under § 365(h)(1)(A)(ii). \textit{Id.} The case never mentions an election by the licensee to retain rights in the lease following rejection by operation of law.

\textsuperscript{35} The timing issue in \textit{Precision}, can also arise in the context of IP licenses as taken up in Part V. \textit{Id.} The reader may care to refer to Figure 1 providing a generalized timeline in a § 363(f) sale. To preview the timing issue, in \textit{Precision}, the § 363(f) sale of the property purports to extinguish the lease in the property. \textit{Id.} at 541. The buyer obtained the right to assume or reject the lease after the close of the sale. \textit{Id.} The protections of § 365(h) are only available to the lessee after rejection. \textit{Id.} at 542. In \textit{Precision}, the sale of the leased property purported to extinguish the lease before rejection, in effect circumventing the lessee’s option to retain rights under the lease unless otherwise protected by the bankruptcy court’s sale order. \textit{Id.}

\textsuperscript{36} See S. REP. NO. 100-505, at 4 (1988), \textit{as reprinted in} 1988 U.S.C.C.A.N. 3200, 3203 (acknowledging a licensee’s lack of alternatives upon license rejection and intending for § 365(n) to provide protection of intellectual property licenses in a “manner that parallels generally the treatment of real estate leases” in § 365(h)).
leases are extinguishable by the sale of real property, an IP license is extinguishable by the sale of the underlying IP rights. The IP community’s predictions of license extinguishment were borne out in a case involving a license to data and software copyrights. Patent licenses have also been considered an interest that can be extinguished in a § 363(f) sale. Part IV provides guidance to licensees in pursuing the ephemeral protections provided under § 365(n) addressing timing problems, including that encountered in Precision but applied to patent licenses.

It appears that interests in IP at risk of extinguishment in a § 363(f) sale may be quite broad. For example, a bankruptcy court has considered patent-related obligations to or from standards setting organizations as an interest. At least one bankruptcy court excluded from a § 363(f) sale data created by a company under a federal research grant. This exclusion suggests that the bankruptcy court considered the possibility that an interest of the federal government in data or intellectual property rights created through federal research funding may be extinguished in a § 363(f) sale.

Yet another bankruptcy court recently issued an interim sale order purporting to sell patents free and clear of requests for injunctive relief and copyright infringement claims. The requests for injunctive relief

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37 See, e.g., John C. “Kit” Weitnauer & Jay E. Sloman, The Potential Impact of Precision Inds. v. Qualitech Steel, SBQ, LLC on Licensees, 9 No. 7 Cyberspace Law 3 (2004) (predicting that if § 363(f) could trump the § 365(h) protections to threatened lessees, § 365(n) protections for licensees would suffer a similar fate).

38 FutureSource, L.L.C. v. Reuters, Ltd., 312 F.3d 281, 283–84 (7th Cir. 2002) (The facts of this case are similar to the Patent Test Case except that the licensed subject matter included copyrights in software, and perhaps databases).

39 See In re Particle Drilling, Nos. 09-33744, 09-33830, 2009 WL 2382030, at *4 (Bankr. S.D. Tex. July 29, 2009) (considering an exclusive patent licensee’s objection to a trustee’s proposed 363(f) sale of the licensed patents as an interest in property that could be extinguished); Compak Cos, LLC v. Johnson, 415 B.R. 334, 342 (N.D. Ill. 2009) (holding a patent license is an interest in a patent that can be extinguished in a § 363(f) sale).

40 Precision, 327 F.3d at 541.

41 See, e.g., In re Nortel Networks Inc., No. 09-10138, 2011 WL 4831218, at *10 (Bankr. D. Del. July 11, 2011) (excluding patent holder’s obligations to standards setting organizations in order authorizing a § 363(f) sale thereby preserving obligee’s interest). See also In re Eastman Kodak Co., No. 12-10202 (ALG), 2012 WL 2255719, at *10 (June 15, 2012) (ensuring that any interest or obligation to a standards setting organization would not be extinguished in a free and clear sale).

42 See, e.g., Documents 81, 1, 4, In re Atmospheric Glow Techs, Inc., No. 08-31320 (Bankr. N.D. Tenn. 2008) (the documents from the Atmospheric Glow bankruptcy litigation will be identified by their assigned document number rather than their description).

and copyright infringement claims arose out of the debtor’s operating within the scope of its own patent claims found to infringe copyrights of television broadcast networks.44

Like the term “interest” discussed above, “party in interest” is also undefined in the Code and the Rules.45 “Party in interest” is generally understood to include all persons whose pecuniary interests are directly affected by the bankruptcy proceedings.46

Unlike the terms “interest” and “party in interest,” “creditor” is defined in the Code. A creditor is always a party in interest; however, a party in interest is not always a creditor. A creditor is defined in the Code, in pertinent part, as an “entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.”47 Therefore, in the Test Cases, Distributor cannot be a creditor of KnifeCo (assuming no other obligations exist). Prior to filing for bankruptcy, KnifeCo had not breached any patent license agreement. Therefore, Distributor has no possible claim against KnifeCo.48

Below, this writing will use the term “party in interest” to refer to both creditors


46 See FutureSource, L.L.C. v. Reuters, Ltd., 312 F.3d 281, 283–84 (7th Cir. 2002) (characterizing the licensee as a “party in interest in the context of a § 363(f) sale and neither party breached the license agreement pre-bankruptcy); In re Alpex Computer Corp., 71 F.3d 353, 356 (10th Cir. 1995) (observing that the term party in interest “is generally understood to include all persons whose pecuniary interests are, directly affected by the bankruptcy proceedings”).

47 The term “creditor” means . . . “entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.” 11 U.S.C. § 101(10)(A) (2012). Portions B and C of the definition of “creditor” are not pertinent to this writing and are omitted.

48 The term “claim” means:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured. 11 U.S.C. § 101(5) (2012).
and party in interest.

Although each of the terms “consent” and “objection” appear in the Code and the Rules, neither term is defined. As will be demonstrated in Part VI.C, each term contributes to the unfairness to patent licensees in § 363(f) sales.

Finally, an important concept to keep in mind for the discussion that follows is the distinction between a license and a license agreement.\(^\text{49}\) A license is a permission to do something that would otherwise be prohibited.\(^\text{50}\) A license agreement embodies the conditions and covenants under which the license is granted.\(^\text{51}\)

C. Section 363(f)(1)-(2) Applied to the Test Cases: Distinguishing Which Sales Extinguish a License

This writing addresses only the first two of the five conditions for the sale in § 363(f). In the Test Cases, consider how § 363(f)(1) “applicable non-bankruptcy law” or § 363(f)(2) “consent” of the interest holder would apply to each possible asset sale.

In theory, in the Patent Test Case, KnifeCo can sell any, or both of: (1) the non-exclusively licensed patent and (2) the non-exclusive patent license with Distributor. In theory, in the License Test Case, KnifeCo, can sell any, or both of: (1) the exclusive patent license with the third party, and (2) the non-exclusive patent sub-license with Distributor (Figure 3). The Test Cases demonstrate the dual nature of executory agreements in bankruptcy as potentially an interest burdening property on the one hand and yet on the other hand, property that the debtor can sell.

KnifeCo cannot extinguish its own interest as a party to a license agreement by selling any license agreement as property.\(^\text{52}\) It is


\(^{50}\) See David M. Epstein, *Introduction to Licensing Issues*, 1 ECKSTROM'S LICENSING IN FOREIGN AND DOMESTIC OPERATIONS § 1.1 (database updated November 2015) (stating that the historical definition of a license is a “right or rights by some competent authority to do an act which, without such license, would be illegal”).

\(^{51}\) Eric E. Bensen, *Preface: License Versus License Agreement*, 1-1 INTELLECTUAL PROPERTY IN BANKRUPTCY: A COLLIER MONOGRAPH § 4:1 (database updated 2012) (“[A] license is a right to do something while a license agreement is a contract that conveys a license, typically, along with other rights and obligations”).

\(^{52}\) See 11 U.S.C. § 363(f) (2012). “Free and clear” only applies to interests “other than the estate.”
important to think through what law, external to bankruptcy, governs the transfers contemplated above. Section 363(f)(1) incorporates the law external to bankruptcy as “applicable non-bankruptcy law.” Absent a finding that applicable non-bankruptcy law permits a sale, § 363(f)(2) requires consent of the interest holder. Part VI.C takes up aspects of consent. Next, in Part IV, this writing takes up “applicable non-bankruptcy law” under § 363(f)(1).

IV. SALES EXTERNAL TO BANKRUPTCY

External to bankruptcy, two general rules govern the transfer of patent licenses and licensed patents, respectively. This Part IV will demonstrate that, under these two rules, non-exclusive patent license rights persist despite transfers of licensed patents. The licensee is not required to take any affirmative action for its non-exclusive license to persist. The non-exclusive licensee may need to litigate to enforce its rights in a license in the case of a transfer of ownership in the licensed patent. However, the point remains that, external to bankruptcy, the non-exclusive licensee will show up to the litigation with its license rights still in existence. Part V will demonstrate that this is not necessarily so inside a bankruptcy § 363(f) sale. If the license does nothing, the transfer will extinguish the license with finality.

A. General Rules Characterized as Applicable Non-Bankruptcy Law Under § 363(f)(1)

Consider the Test Cases (but external to bankruptcy) with the following two rules in mind. The first rule deals with the assignment of a non-exclusive patent license agreement, and the second with the transfer of a non-exclusively licensed patent. Part IV.B will address separately the assignment of an exclusive patent license agreement.

The first rule provides that a non-exclusive patent license agreement is not assignable absent an express intention to the contrary by the non-assigning party. This general rule of non-assignability is the opposite of state contract law favoring free assignability of both property and contracts.

53 Id.
54 See ROBERT A. MATTHEWS, JR., 5 ANNOTATED PATENT DIGEST § 35:36 (2016) (summarizing cases that follow the general rule of non-assignment of patent and copyright licenses). See also Unarco Indus. v. Kelley Co., 465 F.2d 1303, 1303–06 (7th Cir. 1972) (applying federal, not state, law under an exception in Erie R. Co. v. Tompkins, 304 U.S. 64, 78 (1938) and holding a non-exclusive patent license is not assignable).
Generally, patent license agreements use one of three approaches to assignment: (1) silence, (2) express prohibition of assignment, or (3) conditional language authorizing assignment. Under the last approach, a bankruptcy court may be required to interpret the conditional language and determine whether the conditions authorizing assignment materialized. This writing intentionally oversimplifies the Test Cases in order to avoid the complexities that arise with conditional assignment language.

The second rule provides that, “the transferee of the patent takes title ‘subject to’ the license.” Generally, this rule also applies to exclusively licensed patents.

The reader may ask why the first rule prohibits assignment of a non-exclusive patent license agreement absent consent of the non-assigning party, but the second rule requires that the transferee of the licensed patent be bound by the non-exclusive license whether or not the transferee is aware of the license. The license, not the license agreement, diminishes the patent by the right to sue one entity, the licensee. In selling such a non-exclusively licensed patent, the owner cannot transfer to the buyer what he does not own. The patent owner

proposition that state statutes favor a policy of free transferability of property, including contracts but not when the duties in a contract are personal to the parties as with non-exclusive patent licenses).

56 Bd. Of Regents of the Univ. of Neb. v. BASF Corp., No. 4:04CV3356, 2007 WL 3342406, at *12 (D. Neb. Nov. 6, 2007) (”The law treats a patent license as if it contained restrictions of non-assignability and non-transferability in the absence of express provisions to the contrary.”).

57 See Keystone Type Foundry v. Fastpress Co., 272 F. 242, 245 (2nd Cir. 1921) (citations omitted) (”It had long passed into the textbooks that such an assignee acquired title [to the patent] subject to prior licenses of which the assignee must inform himself as best he can, and at his own risk.”); Innovus Prime, L.L.C. v. Panasonic Corp., No. C-12-00660-RMW, 2013 WL 3354390, at *5 (N.D. Cal. July 2, 2013) (”It is a longstanding principle that an assignee of a patent takes the patent subject to prior licenses”); Jones v. Berger, 58 F. 1006, 1007 (D. Md. 1863) (holding oral patent license granted prior to transfer of the patent to plaintiff constitutes valid defense to infringement).

58 See Armstrong Pump, Inc. v. Hartman, 745 F. Supp. 2d 227, 233–34 (W.D.N.Y. 2010) (finding buyer of exclusively licensed patent would take the patent subject to the license). See also MATTHEWS, JR., supra note 54, § 35:4 (summarizing cases wherein the assignee of a licensed patent takes the patent subject to the license, including an exclusive patent license).

59 See V-Formation, Inc. v. Benetton Group SPA, No.02-CV-02259 PSF CBS, 2006 WL 650374, at *5 (D. Colo. Mar. 10, 2006) (holding the transferee of a patent licensed pre-transfer does not own the right to sue the licensee because the transferor parted with that right and could not convey to the transferee what it did not own).

60 See Innovus Prime, 2013 WL 3354390, at *7. The Court in the Northern District of California first equated a covenant not to sue with a patent license. Id. at *8. The court then held that the non-exclusive patent license was effective against continued . . .
B. Transfers of Patent Licenses

Consider each of the Test Cases, but external to bankruptcy. Each of the non-exclusive license agreements in the Test Cases is silent as to assignment. Under the general rule of non-assignment of patent license agreements, would an assignment from KnifeCo to Competitor be permissible? No. Silence under such circumstances is generally not construed as consent. Therefore, in each Test Case external to bankruptcy, the general rule of non-assignment of non-exclusive patent license agreements prevents the assignment by KnifeCo unless Distributor consents.

The License Test Case also includes the possibility that KnifeCo could sell the exclusive patent license agreement with the third party. The law governing assignment of exclusive patent license agreements is unsettled relative to the rules pertaining to non-exclusive patent license agreements discussed above. The unsettled nature of the law as to exclusive patent license agreements is explained, in part, by the confusion in determining when an exclusive patent license is tantamount to an assignment of the patent and when the exclusive patent license is something less than a complete assignment of a patent. The License Test Case is oversimplified in the following ways. The exclusive patent license agreement is less than a complete assignment of the patent. In addition, the exclusive license agreement expressly prohibits assignment by either party without advance written consent of the plaintiff patent holder in a patent infringement suit despite four intervening transfers of the patent. Id. at *7. The court simply noted that licensing a patent merely diminishes the patent by the right to sue one entity. Id. at *5.

61 V-Formation, 2006 WL 650374, at *5.


63 Ziff, supra note 18, at 771 (“Non-exclusive patent licenses which are silent (or deemed, by virtue of the Bankruptcy Code, to be silent) as to prohibitions on assignment have virtually unanimously been found not assignable.”).

64 See id. See generally Superbrace, Inc. v. Tidwell, 124 Cal. App. 4th 388 (2004). Superbrace provides a useful history of the general rule of non-assignment of patent licenses. Id. at 393–401. The court, construed an agreement for the sale of a patent under a payment installment plan as an exclusive patent license and not an outright assignment. Id. at 403. The buyer failed to make all installment payments and arranged to sell the agreement for sale to a third party over the objections of the licensor Id. The court construed the agreement for sale to permit assignment of the agreement to the third party, but prohibited further sales. Id. at 405.
the non-assigning party.

C. Transfers of Licensed Patents

Consider the Patent Test Case external to bankruptcy involving the sale of the non-exclusively licensed patent to Competitor. Such sale implicates the rule that the transferee of a licensed patent takes subject to the license. KnifeCo can transfer the non-exclusively licensed patent to Competitor.\textsuperscript{65} Distributor’s license will persist because Competitor takes the patent diminished by KnifeCo’s license with Distributor.\textsuperscript{66} Finally, in the Patent Test Case but external to bankruptcy, consider the possibility that KnifeCo could sell both the non-exclusively licensed patent and the non-exclusive patent license agreement with Distributor. The result should be no different than as discussed above.\textsuperscript{67}

This Part IV answers the first of the three test questions posed in Part II.C, which asked, external to bankruptcy, what laws govern the transfers posed in the Test Cases? To recap, this Part IV provided a synopsis of two general rules external to bankruptcy regarding the transfer of licensed patents and patent license agreements. Part IV.C demonstrated that external to bankruptcy, a non-exclusive patent licensee does not need to take any affirmative action to ensure that its rights exist through a transfer of the licensed patent. Inside bankruptcy, § 363(f)(1) refers to “applicable non-bankruptcy law.”\textsuperscript{68} The discussion in this Part is the “applicable non-bankruptcy law” of § 363(f)(1). Below, this writing takes up the next of the three questions and turns to patent licenses inside bankruptcy in a § 363(f) sale.

V. Patent License Agreements Inside Bankruptcy in View of A § 363(f) Free and Clear Sale

An understanding of this Part provides context necessary for exploring the actions Distributor can take to protect its license, taken up in Part VI. This Part V returns to the second of the three questions in

\textsuperscript{65} KnifeCo could still potentially be liable, for example, for a breach of contract or breach of warranty claim by Distributor. It is arguable that neither type of claim, without more, will prohibit or void the transfer of the patent from KnifeCo to Competitor. Distributor will be left to argue breach of contract or breach of warranty damages.


\textsuperscript{67} See, e.g., PPG Indus. v. Guardian Indus., 597 F.2d 1090 (1979) (holding non-exclusive patent license agreements not transferred by operation of law under state merger statute even when licensed patents also transferred).

Part II.C. Considering a bankruptcy free and clear sale under § 363(f), how is the law external to bankruptcy applied in bankruptcy?

Each of the Test Cases involves at least one executory patent license agreement whether exclusive or non-exclusive. The trustee for KnifeCo has four options at its disposal with respect to executory patent licenses. The trustee may (1) assume, (2) assume and assign, (3) reject, or (4) do nothing. Assumption alone is not pertinent to this writing.

As will be demonstrated in this Part, the trustee can use a § 363(f) sale of a licensed patent to circumvent § 365(n) licensee protections and an ongoing burden to the patent. To sell a patent license agreement, the trustee must first obtain bankruptcy court approval to assume and assign the license agreement (option two).

Consider the Patent Test Case. What if the trustee sells the patent and does nothing with the non-exclusive patent license agreement? Doing nothing (trustee’s option four) is not rejection (option three). Rejection triggers § 365(n) and the possibility of protecting Distributor’s license. Absent objection by the licensee, the license will be extinguished.

The License Test Case forces the issue of assumption and assignment. The trustee only has an exclusive patent license agreement

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69 Generally, courts find many patent license agreements to be executory, hence this writing does not explore what constitutes an executory agreement. See generally, THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE § 4:76, available at Westlaw (database updated Nov. 2015).

70 Assumption, the first option, is not pertinent to this writing. In the Test Cases, the trustee needs the second option which is to assume and then assign any license agreement the trustee intends to sell.

71 See, e.g., In re Lockwood, No. 05-31424-DM, 2008 WL 943025, at *4 (Bankr. N.D. Cal. Apr. 7, 2008) (approving the debtor licensor’s assumption of a patent license agreement and assignment to the licensee).

72 See, e.g., In re Ice Mgmt. Sys., Inc., No. CC-14-1046-KiBuDa, 2014 WL 6892739, at *2 (B.A.P. 9th Cir. Dec. 8, 2014). A patent license agreement was rejected by operation of law when the debtor neither assumed nor rejected the license within the period required under Chapter 7 of the Code. Id. The following day, the rejected licensee elected to retain its rights as provided under 11 U.S.C. § 365(n). Id.

73 See In re JZ L.L.C., 371 B.R. 412, 426 (B.A.P. 9th Cir. 2007) (holding that the parties did nothing with respect to an executory license agreement, therefore the agreement “rode through” bankruptcy).

74 11 U.S.C. § 365(a) (2012); FED. R. BANKR. P. 6004(c), (d).

75 In re Ice Mgmt., 2014 WL 6892739, at *2.

76 Jeffrey S. Berkowitz & Brett S. Theisen, Intellectual Property Licensees Should Pay Close Attention to Kodak’s Planned Auction Sale, 8 PRATT’S J. BANKR. L. 230, 234 (Apr. 2012) (warning licensees of Kodak patents of the consequences of a § 363(f) sale and advising licensees of the option to elect to retain licensed rights under § 365(n) upon licensor rejection).
to sell. Selling the exclusive license agreement purports to extinguish Distributor’s non-exclusive patent sub-license. This Part introduces bankruptcy law actual and hypothetical assignment tests applied to license agreements in bankruptcy.

Trustee delay is a truncated form of doing nothing under option four. Buyers in § 363(f) sales manage risk by asking the trustee to delay the decision to assume or reject an executory license agreement until after the sale.77 Bankruptcy courts generally approve such requests in order to attract buyers. This is the timing dilemma of Precision in the context of patent licenses.78 Unless Distributor provides a timely written objection before the sale, Distributor is likely to fall into the timing trap of Precision.79 Below, this Part explores the latter three of the trustee’s four options. In the context of a § 363(f) sale, this Part examines how the trustee’s exercise of its options impacts the licensee. Part VI addresses how Distributor, as the licensee, can counter the trustee’s exercise of its options.

A. Assumption and Assignment of Non-Exclusive Patent License Agreements

In the Test Cases, the trustee for KnifeCo must have the power to assume and assign any license agreement included in the sale.80 Generally, courts analyze whether the trustee has such power under one of two tests: (1) the actual assignment test (“actual test”), and (2) the hypothetical assignment test (“hypothetical test”).81 Others’ writings provide a more in-depth discussion of these assignment tests, considered one of the most complex areas of bankruptcy law.82

To simplify each test, consider in order the following two prongs of inquiry: (1) whether the trustee has the power to assume an executory

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77 See, e.g., In re Nortel Networks, Inc., No. 09-10138 (KG), 2011 WL 4831218, at *6 (Bankr. D. Del. July 11, 2011) (finding buyer would not have entered into § 363(f) sale agreement without the right to assume or reject executory patent license agreements after the sale).
78 Precision Indus. v. Qualitech Steel SBQ, L.L.C., 327 F.3d 537, 541 (7th Cir. 2003).
79 Id. at 548.
80 See Fed. R. Bankr. P. 6004 advisory committee’s note (requiring the bankruptcy court’s permission for the sale of the property).
license agreement, and (2) if yes to the first question, whether the trustee has the power to assign the executory license agreement to the buyer.

Under the actual test, the trustee has the power to assume a non-exclusive patent license agreement even without the licensee’s consent. This is so because bankruptcy law treats the pre-bankruptcy debtor and trustee in bankruptcy as identical even though the two are technically separate entities. Turning to the second prong of the inquiry under the actual test, the trustee has the power to assign only if an actual assignee exists and the assignment would be permitted by applicable non-bankruptcy law (as previously discussed in Part IV.B).

Turn now to the hypothetical test. The hypothetical test treats the pre-bankruptcy debtor and the trustee as separate entities (the opposite of the actual test). Considering the first prong of the inquiry under the hypothetical test, the trustee has the power to assume an executory agreement only if the agreement would permit assignment to the trustee. Under the second prong of the inquiry under the hypothetical test, the trustee has the power to assign an executory patent license agreement only if the agreement permits the assignment to a hypothetical third party whether or not such party actually exists (as previously discussed in Part IV.B).

The License Test Case forces the issue of assignability of patent license agreements. Part VI.C.2 will analyze whether the trustee for KnifeCo has the power to assume and assign the license agreements to Competitor. Doing so allows full development of Distributor’s possible arguments in objecting to the sale by demonstrating lack of consent. The analysis requires integration of the rules of non-assignment of patent license agreements (Part IV.B, discussing § 363(f)(1) “applicable non-bankruptcy law”). For now, realize that in the oversimplified Test Cases, each prong of the analysis is going to cause the trustee a problem. As will be demonstrated in Part VI.C.2, which prong of the analysis causes a problem depends upon which test is used.

B. Rejection of Non-Exclusive Patent License Agreements

This Part V.B addresses the third of the trustee’s four options. The third option is for the trustee to reject an executory agreement. In the

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83 AM. BANKR. INST., supra note 16, at 123. See also WARD, supra note 69, § 4:88 (asserting assumption not generally an issue under the actual test when the pre-bankruptcy debtor and debtor are identical but open to challenge when not identical).
84 City of Jamestown v. James Cable Partners, L.P., 27 F.3d 534, 537 (11th Cir. 1994).
85 AM. BANKR. INST., supra note 16, at 123.
86 Perlman v. Catapult Entertainment, 165 F.3d 747, 754–55 (9th Cir. 1999).
87 AM. BANKR. INST., supra note 16, at 114.
Test Cases, imagine that the trustee for KnifeCo believes that KnifeCo stands to lose more than it will gain in assuming the non-exclusive patent license agreement with Distributor. In that case, the trustee can reject the non-exclusive patent license agreement.

When the trustee rejects a non-exclusive patent license agreement, two options become available to the licensee. Consider these options from Distributor’s position in the Test Cases. Distributor may elect: (1) to retain rights under any of the rejected licenses in the Test Cases or (2) elect to treat the trustee’s rejection as a breach of the license agreement and file a claim for breach of contract damages in the bankruptcy proceeding. Distributor cannot exercise its two options until the trustee rejects the non-exclusive patent license agreement.

Code § 365(n) is complex and has been covered extensively by others. Generally speaking, a post-rejection election to retain rights under § 365(n) provides Distributor with fewer rights under the pre-rejection license. Nevertheless, an election under § 365(n) may be better than no license rights. For example, imagine that Distributor invested millions of dollars in specialized knife making equipment, the operation of which would be infringing absent its patent license agreement with KnifeCo. Imagine how Distributor would be harmed if Distributor were to have no rights under its license.

88 From the licensee’s perspective, electing to retain rights under the license as provided in § 365(n)(1)(B) is less preferred relative to having the original license agreement. See AM. BANKR. INST., supra note 16, at 124. For example, the licensee cannot compel the debtor’s performance of affirmative obligations. Id. Rather, the licensee only retains rights to the extent that the right existed as of the bankruptcy petition date, and for any applicable term of extension. Id. Of course, the licensee is required to continue payment of all royalties and other fees under the retained license agreement. Id.

89 See WARD, supra note 69, § 4:97. The licensee may treat the licensor’s rejection as a pre-bankruptcy breach of the license agreement. Id. Accordingly, the rejected licensee may file a claim against the bankruptcy estate for breach of contract damages under § 502(g)(1). Id. However, the licensee is likely to receive only pennies on the dollar for such claim (assuming the licensee’s claim is unsecured).

It is important to note that rejection by the debtor licensor and the licensee’s breach of contract claim does not, without more, terminate the license agreement. Id. However, if an independent ground for termination can be found to exist (for example, material breach by the debtor licensor which would excuse continued performance under applicable state law), then the licensee may have an independent ground for terminating the license agreement if it so chooses. Id.


91 See id. at 430–36.
C. Trustee Delay and Ride Through Doctrine

The trustee’s fourth option as to executory agreements is to do nothing.\(^{92}\) Delay is a truncated form of doing nothing. When both parties do nothing with respect to an executory agreement for the entire bankruptcy, a court may determine the agreement simply “rides through” the bankruptcy.\(^{93}\)

In Chapter 11 bankruptcies, the trustee may delay deciding whether to assume and assign or reject a license agreement as late as the reorganization plan confirmation (Figure 2).\(^{94}\) Plan confirmation occurs at the end of the bankruptcy proceeding; whereas a §363(f) sale typically occurs earlier in the bankruptcy process.\(^{95}\) The policy reason underlying this generous time allocation is to maximize the debtor’s opportunities to reorganize successfully.\(^{96}\)

The trustee may delay rather than do nothing. Doing so exploits the timing issue in *Precision v. Qualitech* by delaying assumption and assignment or rejection until after the sale.\(^{97}\) This option is attractive to buyers such as Competitor for the purposes of risk management. In either Test Case, Distributor’s licenses are in peril under the trustee’s do nothing option. Part VI addresses the actions Distributor may take in dealing with this possibility.

To summarize, this Part V introduced the trustee’s four options in

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\(^{93}\) See id. at 820–21 (Ride through may be appealing if neither party has breached the agreement and no more than the status quo is required at the conclusion of a bankruptcy. Sometimes ride through just arises out of sub-optimal license agreement management. For example, either party to a license agreement can lose track of the agreement. Additionally, a licensee may not be aware of a licensor’s bankruptcy.).

\(^{94}\) See 11 U.S.C. § 365(d)(2) (2013) (providing, in Chapter 11, for the trustee’s assumption or rejection of an executory agreement any time before plan confirmation and also providing the other party to the agreement an opportunity to ask the bankruptcy court to order the trustee to specify a time when the determination will be made). See also 11 U.S.C. § 365(d)(1) (2013) (rejecting by operation of law, executory agreements of the debtor in Chapter 7 if such agreements are not assumed or rejected “within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes”).

\(^{95}\) See infra Figure 2 (providing an example of a bankruptcy timeline and demonstrating that a § 363(f) sale can occur earlier than plan confirmation and discharge).

\(^{96}\) See, e.g., *In re Kmart Corp.*, 290 B.R. 614, 619–20 (Bankr. N.D. Ill. 2003) (justifying the debtor’s delay and the court’s refusal to compel an earlier decision on the goal of successful debtor reorganization).

\(^{97}\) See *Precision Indus. v. Qualitech Steel SBQ, L.L.C.*, 327 F.3d 537, 542 (7th Cir. 2003).
dealing with executory patent license agreements in bankruptcy. With respect to the sale of a patent license, the trustee needs to assume and assign the license agreement to a buyer (option two of four). This issue necessarily arises in the License Test Case. Distributor can challenge the trustee’s power by applying the hypothetical or actual assignment tests as applicable in the jurisdiction of the debtor’s bankruptcy.

However, as is the trustee’s right, the trustee may do nothing (option four). The trustee can sell the patent and extinguish Distributor’s patent license, circumventing § 365(n). As was the case in Precision, buyers such as Competitor may obtain the right to choose which license agreements to assume or reject after the sale. Absent action by Distributor, the sale will extinguish Distributor’s license. Part VI takes up Distributor’s options in view of the issues raised in this Part and returns to the last of the three questions.

VI. DEALING WITH UNFAIRNESS IN SECTION 363(f) SALES

This Part takes up the last of the three questions posed in Part II.C. What actions should Distributor take to protect itself as a non-exclusive patent licensee, and when? Continuing with the theme of trustee delay first introduced above in Part V.C, assume in the Test Cases that Competitor obtains the right to assume and assign or reject any license agreement up to thirty days after the closing in KnifeCo’s § 363(f) sale. This is similar to the timing issue in Precision.

The same issue involving cross-licensed patents arose in Kodak. In Kodak, the debtor in a Chapter 11 case sought the approval of the bankruptcy court in the Southern District of New York to sell licensed and cross-licensed patents as part of Kodak’s digital imaging business. Numerous licensees of the Kodak patents objected to the

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99 Precision, 327 F.3d at 541–42.
100 In re Nortel Networks, Inc., No. 09-10138 (KG), 2011 WL 4831218, at *7 (Bankr. D. Del. July 11, 2011). See infra number 7 in Figure 1.
101 This timing problem is analogous to that in Precision, 327 F.3d at 541–42, first introduced in Part III.B and further discussed in Part V.C. The buyer is allowed to choose which executory agreements may be assumed and assigned or rejected after the interest-extinguishing sale effectively circumventing protections available under the Code (e.g., § 365(h) for property leases). Precision, 327 F.3d at 548.
proposed sale of the licensed patents to Intellectual Ventures. The licensees expressed concern that Intellectual Ventures had the right to reject license agreements following the sale, which could extinguish a licensee’s rights prior to an opportunity to elect to retain rights under § 365(n), which is triggered by rejection.

What is Distributor supposed to do to protect its non-exclusive license if the sale of the licensed patent extinguishes its license without a rejection of the license agreement by the trustee? The balance of this writing addresses Distributor’s options, arranged in order of timing, notice and consent.

Part VI.A addresses timing issues before and after the sale. Before the sale, the licensee has two non-mutually exclusive options. After the sale, other than adequacy of notice, Distributor’s likelihood of success on appeal is low. Part VI.B addresses the notice due licensees in a § 363(f) sale, more frequently a basis for vacating or modifying a sale order.

Part VI.C addresses consent of the licensee under § 363(f)(2). That Part will demonstrate that it is unfair for a bankruptcy court to deem a properly noticed licensee’s silence as consent to the sale if applicable non-bankruptcy law would not do so. In the Test Cases, the wise course is for Distributor to timely raise all possible challenges to a proposed § 363(f) sale in writing by the due date for receiving objections (Number 3 in Figure 1). Part VI.C guides the reader through the arguments Distributor can present in objection, and in so doing will bring closure to the timing problem first identified in Precision.

A. Timing

Figure 1 provides a sample timeline in a § 363(f) sale. The trustee for KnifeCo is only required to give Distributor twenty-one days’ notice of the § 363(f) sale. A bankruptcy court may reduce this short period even further for cause. The notice of sale will provide a due date for

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104 Id. at *9.
105 Id.
106 Compak Cos. v. Johnson, 415 B.R. 334, 341 (N.D. Ill. 2009) (“By far the most frequent mistake or infirmity held to warrant vacating a confirmed sale is defective notice to interested parties of the judicial sale.”).
107 Precision Indus. v. Qualitech Steel SBQ, L.L.C., 327 F.3d 537, 541–42 (7th Cir. 2003).
109 Id. at 2002(a)(2). E.g., In re Borders Grp., Inc., 453 B.R. 477, 485 (Bankr. S.D.N.Y. 2011) (reducing sale notice period from twenty-one to five days because a streamlined sale would benefit the bankruptcy estate and still provide adequate time for objection).
receipt of objections and also a sale hearing date. At the latest, a hearing date will be the day of entry of the final sale order, generally one to three days after the conduct of the sale. These items are summarized in Figure 1 providing an exemplary timeline in a § 363(f) sale. This appears unfair, constituting precious little time for Distributor to address the possible extinguishment of a license.

As discussed in Part V.C, in the Test Cases, the trustee can do nothing with respect to the executory license agreements. Distributor need not allow this. In either Test Case, doing so puts the non-exclusive patent license in peril. Below, this Part takes up two options Distributor can take before the sale. After the sale closes, other than adequacy of notice, Distributor’s avenues for appeal are limited. This Part considers appeals and Part V1.B addresses adequacy of notice.

1. How Licensees Can Address Trustee Delay Before the Sale

This Part is limited to two non-mutually exclusive approaches available to the licensee in addressing timing problems: (1) compel the trustee to decide whether to assume or reject a license agreement before the sale, and (2) change the licensee’s role and bargaining power in the bankruptcy. That said, Distributor should not rely exclusively on these approaches (and duly consider the other Parts herein).

In the first approach, Distributor can request that the bankruptcy court fix a time for the trustee’s assumption or rejection of an executory agreement before the sale. Chapter 11 of the Code does not fix the time for the trustee to assume or reject executory agreements as it does in Chapter 7 (Figure 2). The requesting party must state a justifiable need. However, no clear standard for justifiable need exists.


111 11 U.S.C. § 365(d)(2). This Code section provides, in pertinent part, that any party to an executory contract with the debtor may ask the court to order the trustee “to determine within a specified period of time whether to assume or reject such contract . . . .”

112 11 U.S.C § 365(d)(1)–(2).

113 See, e.g., In re Kmart Corp., 290 B.R. 614, 619–20 (Bankr. N.D. Ill. 2003) (acknowledging that no clear standard exists to justify a court compelling a debtor to set a time for assumption or rejection but signaling that an agreement “is the cornerstone of . . . [a] reorganization” might fulfill the standard) (quoting In re Resource Tech., Corp., 254 B.R. 215, 227 (Bankr. N.D. Ill. 2000)). See also In re Dynamic Tooling Sys., Inc., 349 B.R. 847, 850 (Bankr. D. Kan. 2006) (admonishing the appellant licensee because the licensee could have sought the bankruptcy court’s help under 11 U.S.C. § 365(d)(2) but did not).
involving numerous assets and executory agreements. For example, the bankruptcy court in *Kmart* signaled a willingness to compel the debtor to decide earlier when an executory agreement “is the cornerstone of . . . [a] reorganization.”

Consider the second approach. Distributor can ask the bankruptcy court to estimate the dollar value of a claim against the debtor as if the trustee rejected the license agreement. This approach has the added potential benefit of changing Distributor’s role in the bankruptcy from party in interest to unsecured creditor. An unsecured creditor is entitled to be heard on all matters in a bankruptcy proceeding whereas a party in interest is limited to those matters that affect its interest in property. Additionally, an unsecured creditor is entitled to vote on the debtor’s proposed plan for reorganization (letter “D” in Figure 2). These aspects may raise the licensee’s bargaining power in the

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114 See *In re Kmart Corp.*, 290 B.R. at 620.
115 Id. (quoting Resource Tech., 254 B.R. at 227).
116 See 11 U.S.C. § 502(c)(1)–(2) (2012). That Code section provides a mechanism for estimating and allowing a claim in a bankruptcy proceeding in the case of an executory agreement that has not been breached, assumed or rejected. In such circumstance under § 502(c)(1)–(2), the bankruptcy court “shall” for the “purpose of allowance” of a claim under § 502 estimate:

“(1) any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case; or

(2) any right to payment arising from a right to an equitable remedy for breach of performance.” Id.

See, e.g., *Dynamic Tooling*, 349 B.R. at 857. The bankruptcy court noted that the non-exclusive licensee could, at any time, have become a creditor of the debtor in the bankruptcy proceeding by invoking § 502(c)(1)–(2). *Dynamic Tooling*, 349 B.R. at 857. The court pointed out that attaining the status of an unsecured creditor with an allowed claim in the proceeding would have entitled the licensee to vote on the reorganization plan confirmation, potentially to the licensee’s advantage. Id. at 857.

118 See, e.g., Philip A. Schovance, *Bankruptcy: The Sale of Property Under Section 363: The Validity of Sales Conducted Without Proper Notice*, 46 OKLA. L. REV. 489, 498–99 (1993) (“Because of the importance placed on each party’s stake in the property to be sold, even a single creditor has a sufficient interest to have a proposed sale reviewed, and if appropriate denied.”). See also 1 *BANKRUPTCY LITIGATION* § 6:33, *available at* Westlaw (database updated August 2015). In the case of a creditor, the creditor may or may not have an interest in the property up for sale, yet still has the opportunity to review the sale terms and object. Id. By contrast, a party in interest only has standing to object if that party’s interest is affected by the sale. Id.

119 LEE MORRIS, *Reorganization in Chapter 11, in Bankruptcy Roadmap* at 262, n. 38 (State Bar of Texas 2010) (citations omitted) (“[T]he holders of at least two-thirds in amount and more than half in number of the allowed claims of such class must vote in favor [of a plan for reorganization].”).
bankruptcy, depending upon the dollar value of the claim.\textsuperscript{120}

2. \textit{Appeals After the Sale Closes}

There is a third timing issue to consider. Rule 6004(h) provides for the automatic issuance of a fourteen-day stay after entry of a final sale order “unless the court orders otherwise (number 6 in Figure 1).”\textsuperscript{121} Absent objection, the bankruptcy court may shorten or waive the stay on the request of the trustee.\textsuperscript{122} Absent the stay, a timely filed appeal to vacate or modify a final sale order is likely to be dismissed as equitably moot.\textsuperscript{123} This may be so even if the underlying facts and arguments are favorable to the appellant.\textsuperscript{124}

The stay is even more important if the sale order includes a § 363(m) good faith purchaser finding.\textsuperscript{125} In that case and without a stay, that finding generally insulates the sale order from an appeal. To obtain a new stay, the appellant must post a supersedeas bond,\textsuperscript{126} and present successful arguments in support of the stay.\textsuperscript{127}

\textsuperscript{120} Id. at 270–71.

\textsuperscript{121} FED. R. BANKR. P. 6004(h). \textit{See also} Hower v. Molding Sys. Eng’g Corp., 445 F.3d 935, 937–38. (7th Cir. 2006) (holding no abuse of discretion in the bankruptcy court’s authorization of the sale order with no stay because the debtor required cash immediately and dismissing losing bidder’s appeal of the sale order as moot).

\textsuperscript{122} FED. R. BANKR. P. 2002(a), Notes of Advisory Committee on Rules, \textit{supra} note 27.

\textsuperscript{123} \textit{See, e.g.}, \textit{In re Dynamic Tooling Sys., Inc.}, Nos. KS-06-105, KS-06-111, 04-15900-11, 2007 WL 1747045, at *3 (B.A.P. 10th Cir. June 18, 2007). The Tenth Circuit employed the five-factor test applied in \textit{In re Continental Airlines} to determine whether an appeal from a bankruptcy court’s order should be dismissed on the grounds of equitable mootness. \textit{In re Continental Airlines}, 91 F.3d 553 (3d Cir.1996). One of the factors was whether or not a stay of the order pending appeal had been obtained. \textit{In re Dynamic Tooling Sys.}, 2007 WL 1747045, at *3.

\textsuperscript{124} \textit{See, e.g.}, \textit{In re Dynamic Tooling Systems, Inc.}, 2007 WL 1747045, at *2–3 (refusing to consider an appeal of the sale order on the grounds of both equitable mootness and constitutional mootness because the appellant failed to obtain a stay of the sale, and the completed sale could not be easily unwound).


\textsuperscript{126} FED. R. BANKR. P. 8007(a)(1)(B).

\textsuperscript{127} Id. at 8007. \textit{See, e.g.}, \textit{In re Virgin Offshore USA, Inc.}, No. 11-13028, 2012 WL 6059359, at *3 (Bankr. E.D. La. Dec. 6, 2012) (denying appellant’s request for a stay pending appeal under the four-factor test used in requests for injunctive relief). The four factors favoring grant of the stay are: (1) the appellant’s likelihood of success on the merits, (2) the appellant will be irreparably harmed, (3) other parties continued
Even with the existence of a stay and a timely filed appeal, bankruptcy courts are extremely reluctant to overturn prior sale orders in a § 363(f) sale. After the close of a bankruptcy sale, bankruptcy courts favor a policy of finality of sales not likely to favor the licensee. Further, in the event of an appeal, bankruptcy courts have jurisdiction to interpret their own sale orders. Yet, the sale order is likely to incorporate language suggested by the trustee favoring the debtor and buyer and not the licensee.

In further appeals after entry of a final sale order, a reviewing higher level court will not set aside the bankruptcy court’s findings of fact unless clearly erroneous, again favoring the debtor and buyer over the licensee. Conclusions of law in the sale order are subject to a de novo standard of review and may be more susceptible to modification relative in interest would be substantially harmed absent the stay, and (4) grant of the stay is not contrary to the public interest. In re Virgin Offshore, 2012 WL 6059359, at *3.

See also LAWRENCE R. AHERN, III AND NANCY FRAAS MACLEAN, BANKR. PROC. MANUAL § 6004:1 (2016 Ed.), available at Westlaw (database updated Jan. 2016). The authors highlight the reluctance of courts to invalidate a sale because of concern for public confidence in the finality of judicial sales. Id. at § 6004:1. The authors also note the added protection from the possibility of a court reversing a sale under 11 U.S.C. § 363(m). AHERN & MACLEAN supra, at § 6004:1. Under § 363(m), a sale order finding that the buyer was acting in good faith cannot reversed on appeal. AHERN & MACLEAN supra, § 6004:1.

In re Edwards, 962 F.2d 641, 643 (7th Cir. 1992) (“If purchasers at judicially approved sales of property of a bankrupt estate, and their lenders, cannot rely on the deed that they receive at the sale, it will be difficult to liquidate bankrupt estates at positive prices.”).


See Document 34 at 6, In re Atmospheric Glow Techs., Inc., Case No. 08-31320 (Bankr. E.D. Tenn. June 17, 2008) (proposing certain provisions presented by the trustee be included in a sale order).

to fact finding. Other than adequate notice, taken up in the next Part, the licensee should temper its expectations of success in appealing a sale order.

To summarize, this Part suggested two approaches Distributor can use to address trustee delay. The first approach involved attempting to compel the trustee to decide between assuming and assigning or rejecting a license agreement before the sale. The second approach involved changing Distributor’s role from party in interest to unsecured creditor. This Part concluded with a warning about appeals. With the possible exception of adequate notice discussed below, appeals favor debtors like KnifeCo and buyers like Competitor. Appeals do not favor licensees like Distributor. The wiser course for Distributor is to raise all possible challenges to the sale by the objection due date, or in any event before entry of a final sale order (number 7 in Figure 1). What follows next is a discussion of adequacy of notice.

B. Adequate Notice Requirements

A § 363(f) sale that purports to extinguish a non-exclusive patent license with the sale of the licensed patent constitutes depriving a person of property. The Fifth Amendment of the United States Constitution prohibits depriving a person of property, or an interest in property, without due process. Therefore, in the context of a § 363(f) free and clear sale, bankruptcy law requires constitutionally mandated due process including adequate notice.

If a party in interest receives adequate notice of a § 363(f) sale and fails to object, the party’s interest will usually be extinguished by the sale. A party in interest can appeal a sale order on the basis of

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133 W. Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus.) 43 F.3d 714, 719 n.8 (1st Cir. 1994) (requiring de novo standard of review under same appellate standards as district court review).

134 See sources cited infra note 136.

135 U.S. CONST. amend. V (“No person shall be . . . deprived of life, liberty, or property, without due process of law. . . .”).

136 See generally 11 U.S.C. § 324 (2012); FED. R. BANKR. P. 2002(a), 6004(c) (addressing aspects of notice pertinent to this writing further developed in case law). See, e.g., Unaatuq, L.L.C. v. Green (In re Catholic Bishop of N. Alaska), 509 B.R. 229, 241–42 (Bankr. D. Alaska 2014) (stating “[u]ndoubtedly, parties holding known liens or asserting known interests in property to be sold are entitled to actual notice of a debtor's intent to sell such property free and clear of those interests. This is required by the Bankruptcy Code, the bankruptcy rules, and the due process clause of the Fifth Amendment.” (internal footnotes omitted)).

137 See, e.g., FutureSource L.L.C. v. Reuters Ltd., 312 F.3d 281, 285–86 (7th Cir. 2002) (finding a licensee’s rights in licensed software and data extinguished in a § 363(f) sale because the licensee had adequate notice and did not object).
inadequate notice,\textsuperscript{138} which has become a common procedure.\textsuperscript{139} The party claiming inadequate notice must make a prima facie showing that the notice was indeed inadequate.\textsuperscript{140} In an order approving the trustee’s motion to sell assets under § 363(f), a finding of adequate notice reduces the buyer’s risk and, depending upon the sale terms, also the seller’s.\textsuperscript{141} What constitutes adequate notice depends upon whether a party in interest is known or unknown.\textsuperscript{142}

1. Known Parties in Interest

The debtor in bankruptcy is required to provide the court a list of its

\textsuperscript{138} See, e.g., Compak Cos. v. Johnson, 415 B.R. 334 (N.D. Ill. 2009). Known parties in interest had general knowledge of a § 363(f) sale of licensed patents but never received actual notice including hearing and bar dates. \textit{Id.} at 339–40. In an appeal of the sale challenging the adequacy of notice, the district court considered the circumstances of the sale and held “terminating the DuoTech License pursuant to the Sale Order would violate Holdings' [the licensee’s] right to due process of law under the Fifth Amendment to the Constitution of the United States.” \textit{Id.} at 340. Emphasizing the “strong policy of finality in bankruptcy sales,” the district court voided only that portion of the sale order necessary to protect the non-debtor licensee’s rights. \textit{Id.} at 341–43.

\textsuperscript{139} \textit{Id.} at 341 (“By far the most frequent mistake or infirmity held to warrant vacating a confirmed sale is defective notice to interested parties of the judicial sale.”). \textit{But see In re Edwards,} 962 F.2d 641, 645 (7th Cir. 1992) (denying property owner’s defective notice challenge, in part, because of the appellant’s delay even though notice was defective).

\textsuperscript{140} \textit{In re Catholic Bishop,} 509 B.R. at 249 (“The claimants have the burden ‘of proving a prima facie error [of notice] in service.’”).

\textsuperscript{141} See, e.g., \textit{In re Nortel Networks Inc.,} No. 09–10138 KG, 2011 WL 1661524 at *5 (Bankr. D. Del. May 2, 2011) (approving, in the sale order, notice to unknown patent licensees by national publication as reasonably calculated to put unknown patent licensees on notice).

\textsuperscript{142} As to the difference in level of notice required, “The level of notice required by the Due Process Clause depends on whether a creditor is ‘known’ or ‘unknown.’ A debtor must provide actual notice to all ‘known creditors’ in order to discharge their claims. Known creditors include both claimants actually known to the debtor and those whose identities are ‘reasonably ascertainable.’ A claimant is ‘reasonably ascertainable’ if he can be discovered through ‘reasonably diligent efforts.’ [I]n order for a claim to be reasonably ascertainable, the debtor must have in his possession, at the very least, some specific information that reasonably suggests both the claim for which the debtor may be liable and the entity to whom he would be liable. By contrast, the debtor need only provide ‘unknown creditors’ with constructive notice by publication. Publication in a national newspaper such as \textit{The Wall Street Journal} is sufficient.” \textit{Williams v. Placid Oil Co. (In re Placid Oil Co.),} 753 F.3d 151, 154–55 (5th Cir. 2014) (internal citations omitted). \textit{See In re Argonaut Fin. Serv., Inc.,} 164 B.R. 107, 112 (N.D. Cal. 1994) (“Generally, however, in bankruptcy cases, courts have found that known creditors are deserving of actual notice while unknown creditors are owed only publication notice.”).
creditors. The debtor is also required to provide a list of executory agreements to the court along with the address of the other party (or parties) to the executory agreement. At times, debtors fail to include all executory agreements in the schedules it is required to submit. Presumably, any party on the debtor’s schedules is “known” to the debtor for the purposes of notice.

A known party in interest is entitled to written notice by mail, to a specifically named person, at the address provided in a license agreement at issue whether it is the licensed patent or the patent license that is the subject of the sale. The known party may request that notice be provided at a different address or by a different method.

2. Unknown Parties in Interest

The notice standard for unknown parties in interest is different from the standard for known parties in interest. The standard for unknown parties in interest requires “notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.” Mere general knowledge of a bankruptcy is insufficient for the purposes of providing adequate notice.

The bankruptcy court may specify the conditions under which notice by publication satisfies the reasonably calculated standard. The Nortel Networks bankruptcy provides an example of proper notice to unknown licensees. Nortel Networks conducted a § 363(f) sale of

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143 FED. R. BANKR. P. 1007(a).
144 Id. at 1007(b)(1)(C).
145 For example, the debtor did not disclose an executory patent license agreement as either an asset or an executory agreement. In re IZ L.L.C., 357 B.R. 816, 819 (Bankr. D. Idaho 2006).
146 FED. R. BANKR. P. 2002(g)(1). See Compak Cos. v. Johnson, 415 B.R. 334, 338–39 (N.D. Ill. 2009) (“Unless a creditor specifies a different mailing address, notices must be mailed to the address shown on the list of creditors or schedule of liabilities, whichever is filed later.”).
147 FED. R. BANKR. P. 2002(g).
148 See, e.g., In re Gencor Indus., 298 B.R. 902, 914–915 (Bankr. M.D. Fla. 2002) (stating that general knowledge is insufficient and requiring that adequate notice includes dates relevant to the party receiving notice).
149 Id.
approximately six thousand patents covering wireless communications technologies. Patents in such technology areas are usually the subjects of multiple non-exclusive license agreements ensuring freedom to operate by multiple industry participants.

In the Nortel sale, the stalking horse bidder was concerned with its potential risk related to the possibility of unknown licensees of the Nortel patents. In the order approving the sale and bidding procedures, the bankruptcy court found that the notice to unknown licensees was sufficient.

3. How Licensees Can Address Notice

From the discussion so far and in the context of the Test Cases, the reader may ask how the threatened licensee can challenge notice in a § 363(f) sale, ensure timely receipt of notice, and also how to ensure an early warning that licensor bankruptcy is on the horizon. This Part addresses each of these questions.

As discussed previously in Part VI.A.2, bankruptcy courts are extremely reluctant to overturn previous orders relating to a § 363(f) sale. The policy justification for this position is that bankruptcy courts do not want to create the appearance of uncertainty for buyers in such sales as doing so would discourage future buyer participation in bankruptcies. However, notice is the cornerstone of due process in bankruptcy and susceptible to challenge at the bankruptcy court level and on appeal.

152 Id. at *5.
153 See generally Michael Kerman, Delaware Bankruptcy Court Approves Sale of $4.5 Billion of Nortel Networks, Inc. Assets, BANKRUPTCY LAW REPORTER (BNA July 14, 2011) (describing the potential for the purchased wireless communications patents to cover a variety of third party products).
154 See In re Nortel Networks, 2011 WL 1661524, at *3. The bankruptcy court order included a finding that the stalking horse bidder would not have entered into the purchase agreement had the order approving the sale not authorized the buyer to assume or reject executory license agreements. Id.
155 Id. at *5.
157 See, e.g., In re Fulks, 343 B.R. at 706–07; see also AHERN & MACLEAN, supra note 128, § 6004:1. See generally In re Edwards, 962 F.2d 641, 643 (7th Cir. 1992) (predicting that “positive prices” would be difficult to obtain absent reliance on judicially approved bankruptcy sales).
158 In re Savage Indus., 43 F.3d 714, 720 (1st Cir. 1994).
Consider in the Test Cases what Distributor can do to ensure timely receipt of notice. Distributor can at least check to ensure that KnifeCo listed the non-exclusive license agreement with Distributor on the schedule of KnifeCo’s executory agreements. Distributor would be entitled to notice of a § 363(f) sale as a party in interest. Distributor may care to elect to receive notices as a party in interest in the bankruptcy proceeding electronically to minimize regular mail time lags.\textsuperscript{160}

In the future, and to get an earlier warning of impending or actual bankruptcy of a licensor such as KnifeCo, Distributor may consider using internet-based information systems. For example, systems such as Pacer can be used to follow a bankruptcy case.\textsuperscript{161} However, the knowledge of the jurisdiction of the bankruptcy and party name are required.\textsuperscript{162} Pacer does not push notices to users.\textsuperscript{163} Other no or low fee-based information services do push information to users, but still require some advance knowledge of jurisdiction and party name.\textsuperscript{164} Higher cost fee-based services require no prior knowledge.\textsuperscript{165} The parties to a license agreement can also include notice provisions related to events such as bankruptcy in the agreement.\textsuperscript{166}

\textsuperscript{160} See MORRIS, supra note 119, at 5–6 (describing general practices relating to notice in bankruptcy motions and highlighting the necessity of checking local rules of a bankruptcy court, which may even vary from judge to judge in a given court).


\textsuperscript{162} Id.

\textsuperscript{163} See id.

\textsuperscript{164} See, e.g., How Email Noticing Works, ELEC. BANKR. NOTICING, http://www.ebnuscourts.com/register/link_works.adp (last visited Feb. 10, 2016). This Electronic Bankruptcy Noticing website pushes information to registered users based upon the party name in the case title. There is no charge for the first instance of document retrieval, however, fees will apply upon any subsequent access to the same document. To minimize costs, download documents on the first instance of access.

\textsuperscript{165} For example, Westlaw, Lexis Nexis and Bloomberg information services allow a user to create an alert based upon the filing of a document in a bankruptcy court in any jurisdiction in the United States based upon a search of the licensor’s name in the case title. The alert user will be notified when a new filing occurs meeting the alert criteria. See MICHAEL L. BERNSTEIN & GEORGE W. KUNEY, BANKRUPTCY IN PRACTICE § 2.33 (5th ed. 2015), available at Westlaw (providing a short list of very useful websites including, for example, www.bankruptcydata.com).

\textsuperscript{166} See Cross License Agreement between Intuitive Surgical, Inc. and Hansen continued . . .
To summarize, a licensee may use any aspect of notice discussed in this Part in an objection to a § 363(f) sale, and even in challenging an order for sale. Appeals of final sale orders require a stay. Licensees should take care to prevent waiver of the automatic stay period after the close of the sale (Numbers 6 and 7 in Figure 1).

C. Consent

Courts are divided as to what constitutes consent of the non-exclusive licensee under § 363(f)(2). As will be demonstrated below, deeming consent given absent the licensee’s objection to a sale is unfair when applicable non-bankruptcy law already prohibits the sale. Bankruptcy courts seem not to follow applicable bankruptcy law applied to patent licenses. This leaves only one safe choice when dealing with the consent requirement in § 363(f)(2) in the context of the Test Cases. That choice is to timely object to the sale in writing by the due date. What follows below is a brief discussion of the jurisdictional split over the consent requirement under § 363(f)(2). Thereafter, Part VI.E.2 turns to how the threatened licensee, like Distributor, can address consent.

1. Consent May be Express or Implied but Construing Silence as Consent is Unfair

Outside of the patent licensing context and assuming proper notice, some courts require the trustee to approach the interest holder and obtain express consent prior to an interest-extinguishing sale. In the patent context and assuming proper notice, some courts require the trustee to approach the interest holder and obtain express consent prior to an interest-extinguishing sale. In the patent

Medical, Inc. (Sept. 1, 2005), available at http://www.sec.gov/Archives/edgar/data/1276591/000095013406021209/f22304a3exv10w15.htm (last visited Feb. 10, 2016). Paragraph 5.4 of the agreement provides for immediate notice to the other party in the event of an insolvency event or filing of a bankruptcy petition.


168 See, e.g., Lichtenstein, supra note 167, at 2. In In re DeCelis, the debtor co-owned a house subject to four liens. In re DeCelis, 349 B.R. 465, 466–67 (Bankr. E.D. Va. 2006). The co-owner never responded to any bankruptcy notices and never participated in the bankruptcy proceeding. Id. In a well-reasoned denial of the trustee’s motion, bankruptcy court Judge Robert G. Mayer held that the co-owner’s continued...
licensing realm, this author is unaware of a bankruptcy court requiring a trustee to affirmatively seek a licensee’s consent in a § 363(f) sale. This author is aware of one case that stands for the proposition that a failure to object to the sale of copyrights in software and data constitutes consent of a properly noticed licensee. A number of bankruptcy court orders in the realm of patent licensing deem lack of objection to be consent of a properly noticed licensee.

To deem lack of objection on the part of a patent licensee as consent is a departure from applicable non-bankruptcy law applied to patent licenses and licensed patents. This is unfair to licensees. The licensee may fail to affirmatively object inside bankruptcy in reliance on applicable non-bankruptcy law and lose an important license.

Conflicting word use between the Code and the Rules may also be to silence does not constitute consent. Id. at 474 n.10. The trustee relied upon the cases in 3 COLLIER ON BANKRUPTCY ¶ 363.06[3] n. 27 (15th ed. 2006) and also the case of In re Gabel, 61 B.R. 661 (Bankr. W.D. La. 1985). In re Decelis, 349 B.R. at 469. Judge Mayer distinguished each case pointing out that the trustee may provide evidence of express or implied consent but that silence of the interest holder alone cannot be construed as consent. Id. at 469–74. See also In re Roberts, 249 B.R. 152, 158 (Bankr. W.D. Mich. 2000) (holding that lack of objection does not constitute consent and identifying the procedural posture of In re Gabel as cause for the misguided view that silence in a § 363(f) sale can constitute an interest holder’s consent to the sale.).

169 FutureSource, 312 F.3d at 285–86 (construing licensee’s failure to timely object to properly noticed sale of copyrights in software and data as consent).

170 See In re Eastman Kodak Co., No. 12-10202 (ALG), 2013 WL 588965 (Bankr. S.D.N.Y. Feb. 13, 2013) (deeming in sale order paragraph GG that failure to timely object to the sale, including licensed patents, constitutes consent to the sale under the noticed sale terms); In re Nortel Networks, Inc., No. 09-10138 KG, 2011 WL 1661524, at *7 (Bankr. D. Del. May 2, 2011) (deeming, in a bankruptcy sale order, consent given to assumption and assignment of executory license agreements in the absence of timely objection). But see Digital Domain Media Grp., Inc., No. 12-12568(BLS), 2012 WL 6571072, at *43–44 (Bankr. D. Del. Dec. 11, 2012) (objecting to the proposed § 363(b) sale of licensed patents in licensee’s written motion); In re Digital Domain Media Grp., Inc., No. 12-12568 (BLS), 2012 WL 5427546, at *20–21 (Bankr. D. Del. Sept. 12, 2012) (deeming in paragraph 17 of a § 363(b) sale order that the assumption and assignment of executory licenses in the sale of licensed patents consented to over ongoing vigorous objection by Disney); In re Aviza Tech., Inc., No. 09-54511-RLE-11, 2009 WL 4720035, at *6 (Bankr. N.D. Cal. Sept. 29, 2009) (finding in a sale order that proper notice and requirements of § 363(f)(1)–(5) were satisfied, but silent on deemed consent in the absence of timely objection); In re DDMG Estate, 594 F. App’x 92, 92 (3d Cir. 2015) (preserving Disney’s license under § 363(b) but construing the license narrowly). See also Pusser’s (2001) Ltd. v. HMX, L.L.C., No. 11 C 4659, 2012 WL 1068756, at *8 (N.D. Ill. Mar. 28, 2012) (cause dismissed Sept. 28, 2012) (deeming consent given in a sale order in the absence of objection and rendering § 363(f) sale of a trademark free of a trademark cancellation claim).

171 See supra Part IV.
blame, at least in part. 172

The policy justification for construing a failure to object as consent is predicated upon the transaction costs of obtaining consent. 173 Whatever the policy justification, the safe course of action is for the threatened licensee to timely object in writing to the sale of a licensed patent or sub-licensed exclusive patent license even if applicable non-bankruptcy law already prohibits the sale.

2. Ensuring Non-Consent: Arguments Used in Objection

What follows below is a discussion of the arguments a licensee can raise in timely written objection to a § 363(f) sale. The specific content of the objection will depend upon which of the following, whether alone or in combination, is for sale: (1) the non-exclusively licensed patent (Patent Test Case), (2) the non-exclusive patent licenses (both Test Cases), and (3) the exclusive patent license (License Test Case). These arguments use other sections of § 363 and implement the legal concepts introduced in Part V.

a. Sale of The Non-Exclusively Licensed Patent of Test Case One

Consider the Patent Test Case and the sale of the non-exclusively licensed patent therein. This Part introduces a new sub-section of § 363 helpful to Distributor, namely § 363(e). Section 363(e) provides:

The bankruptcy court on the request of an interest holder in property to be sold shall prohibit or condition a sale or proposed sale of property as is necessary to provide adequate protection of such interest. 174

Under § 363(e), Distributor may ask the bankruptcy court to protect its rights in the license through the sale. 175 For example, § 363(e) was

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172 Section 363(f)(2) uses the word “consent” if applicable non-bankruptcy law does not permit the sale. However, Rule 6004 pertaining to § 363(f), uses the phrase “opportunity to object.”

173 FutureSource, 312 F.3d at 285–86 (“[T]ransaction costs would be prohibitive if everyone who might have an interest in the bankrupt's assets had to execute a formal consent before they could be sold.”).


175 See, e.g., Patrick A. Jackson & Ian J. Bambrick, Debunking the Perceived Conflict Between §§ 365(h) and 363(f), 33 AM. BANKR. INST. J. (Oct. 2014) (“[Section] 363(e) is one of the Bankruptcy Code’s ‘you snooze, you lose’ provisions. Thus, if the non-debtor does not request adequate protection, the court is under no obligation to provide it, but if the non-debtor is not caught snoozing and is able to prove the validity of its leasehold interest, adequate protection must be continued . . .”)
available to a threatened licensee in the case of *In re Dynamic Tooling Systems, Inc.* 176 That case involved a free and clear sale of licensed patents as part of a Chapter 11 plan confirmation, similar to a § 363(f) sale. 177 The trustee neither assumed nor rejected the patent license agreement before the sale. The § 363(f) asset purchase agreement provided the buyer with the option to assume or reject the license agreement up to thirty days after the sale. 178

The bankruptcy court overruled the non-exclusive patent licensee’s objection to the reorganization plan, which included the sale of the licensed patents. 179 The bankruptcy court recognized that the licensee’s option to retain under § 365(n) would only be triggered upon the buyer’s rejection of the license agreement following the license extinguishing sale. 180 The bankruptcy court pointed out that § 363(e) protection of the license agreement through the sale by express order of the bankruptcy court would have been available. 181 The bankruptcy court’s opinion did not expressly find that the licensee did not ask for § 363(e) protection of its license agreement. However, one is left to conclude that *In re Dynamic Tooling* stands for the proposition that the licensee who does not ask for § 363(e) protection of its license agreement does not get it. 182

Distributor, however, need not rest solely on § 363(e) for protection. At least one commentator questioned whether § 365 and § 363(e) are mutually exclusive. 183 Fortunately, § 363(e) is not the only source of protection for licensees in the sale of a non-exclusively licensed patent. For example, in at least one case the licensee invoked § 365(n)(4)(B) for protection and not § 363(e). 184

Section 363(n)(4)(B) provides, in pertinent part,

Unless and until the trustee rejects such contract, on the written request of the licensee the trustee shall . . . not

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177 *Id.*

178 *Id.*

179 *Id.* at 858.

180 *Id.* at 856.

181 *Id.* See also *Compak Cos. v. Johnson*, 415 B.R. 334, 343 (N.D. Ill. 2009) (“Compak was authorized to sell its intellectual property free and clear under another subsection of § 363(f), the defendants could have requested adequate protection under § 363(e).”).

182 *In re Dynamic Tooling*, 349 B.R. at 855.


interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment), including any right to obtain such intellectual property (or such embodiment) from another entity.\(^{185}\)

In the case of *In re Particle Drilling*, a patent licensee objected to a proposed free and clear sale of the debtor’s non-exclusively licensed patents.\(^{186}\) The licensee asked the bankruptcy court to protect its rights to a non-exclusive license, directly invoking § 365(n)(4)(B) but not § 363(e).\(^{187}\)

There is an argument that the licensee in *In re Particle Drilling* did not go far enough in its request for protection under § 365(n)(4)(B). The debtor did not contest the licensee’s objection and request for protection from the bankruptcy court.\(^{188}\) As will be demonstrated further below, other threatened licensees have gone further by invoking §§ 365(n)(1)(B) and 365(n)(2).\(^{189}\) There is a sound reason for doing so. Section 365(n)(4) protections end at the trustee’s rejection.\(^{190}\) In theory, such protections would not be sufficient in the case that a buyer is allowed to assume or reject a license agreement days after the close of the bankruptcy sale. Because of this possibility, threatened licensees object to such sales by asking the bankruptcy court to preserve the right to elect under § 365(n)(2) through the § 363(f) sale.\(^{191}\)

The case of *In re Ice Management*\(^ {192}\) is unique because the threatened licensee asked the bankruptcy court for protection of its

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\(^{186}\) *Particle Drilling*, 2009 WL 2382030, at *1.

\(^{187}\) *Id.* at *3.

\(^{188}\) *Id.*

\(^{189}\) 11 U.S.C. § 365(n)(1)(B) provides for the licensee’s option to elect to retain at least some of its licensed rights upon a debtor licensor’s rejection of an executory patent license agreement. Section 365(n)(2) provides that the trustee shall allow the licensee to exercise its right to retain the license. The licensee must pay royalties owed and agree to waive the right allowable claims and set-off (if any). 11 U.S.C. § 365(n)(2) (2012).


\(^{191}\) See *In re DNL Indus.*, No. 13-22079 (RDD), 2013 WL 3778348, at *10 (Bankr. S.D.N.Y. July 12, 2013) (preserving objecting licensee’s rights under § 365(n) in the event of license rejection). *See also In re GameTech Intl.,* Inc., No. 12-11964 (PJW), 2012 WL 5464489, at *16 (Bankr. D. Del. Nov. 7, 2012) (preserving objecting software licensee’s rights under § 365(n)).

elected 365(n) rights prior to the sale.\textsuperscript{193} \textit{In re Ice Management} involved the sale of licensed patents.\textsuperscript{194} The license agreement was deemed rejected prior to the § 363(f) sale.\textsuperscript{195} The licensee elected to retain its rights in the license agreement to the extent provided in § 365(n).\textsuperscript{196} The trustee sought the bankruptcy court’s approval to sell the licensed patents free and clear.\textsuperscript{197} The threatened licensee argued that under § 363(e), the bankruptcy court could not sufficiently protect the licensee’s elected rights under § 365(n).\textsuperscript{198} The bankruptcy court upheld the licensee’s objection and asked the trustee to modify the terms of the sale.\textsuperscript{199} The trustee modified the asset purchase agreement to provide that the sale of the licensed patents would be subject to the licenses and other liens against the licensed patents under 11 U.S.C. § 363(b).\textsuperscript{200} The bankruptcy court approved the trustee’s modified purchase agreement.\textsuperscript{201}

Return to the facts of the Patent Test Case and note the argument not needed in the sale of the non-exclusively licensed patent. Distributor need not object to the sale of the non-exclusive patent license agreements with Distributor. The trustee cannot extinguish Distributor’s non-exclusive rights by selling the non-exclusive license agreements in either Test Case. In the License Test Case, this reasoning also applies to the sale of the non-exclusive sub-license. However, this reasoning \textit{does not apply} to the sale of the exclusive patent license agreement, which purports to extinguish the non-exclusive patent sub-license in the sale (Figure 3). Hence, the analysis below considers the arguments Distributor can use to object to the sale of the exclusive patent license.

\textit{b. Sale of the Exclusive Patent License}

This Part considers the License Test Case and the arguments Distributor may raise in opposition to the sale of the exclusive patent license agreement. First, Distributor may use the arguments against assignment of the agreement introduced in Part V.A. Those arguments

\begin{flushleft}
\textsuperscript{193} \textit{Id.} at *2.
\textsuperscript{194} \textit{Id.} at *1.
\textsuperscript{195} \textit{Id.} at *2. \textit{In re Ice Management Systems} involved a Chapter 7 bankruptcy proceeding. Under 11 U.S.C. § 365(d)(1), an executory agreement is deemed rejected by operation of law if neither assumed nor rejected within sixty days after the bankruptcy petition date and automatic stay.
\textsuperscript{196} \textit{In re Ice Mgmt.}, 2014 WL 6892739, at *2.
\textsuperscript{197} \textit{Id.}
\textsuperscript{198} \textit{Id.}
\textsuperscript{199} \textit{Id.}
\textsuperscript{200} \textit{Id.} at *2–3.
\textsuperscript{201} \textit{Id.} at *3–4.
\end{flushleft}
implicate the hypothetical and actual assignment tests that govern the
assignability of executory agreements in bankruptcy. Second,
Distributor may also use the same approach considered for the Patent
Test Case addressing the sale of the non-exclusively licensed patent.
That approach involved asking the court to protect Distributor’s rights
through the sale under both § 363(e) and also § 365(n) as discussed in
Part VI.C.2.a.

The sale of the exclusive patent license purports to extinguish the
non-exclusive patent sub-license. Recall that license agreements deal
with assignment language in three possible ways: (1) silence, (2)
express prohibition of assignment, or (3) conditional language
authorizing assignment. The exclusive patent license agreement
expressly prohibits assignment.

Under the hypothetical test, the trustee lacks the power to assume
the exclusive patent license agreement. External to bankruptcy, express
prohibition of assignment bars the assignment. Inside bankruptcy, the
trustee cannot assume the agreement because the trustee cannot assign
the agreement. Yes, this is a circular argument; but in this case the
trustee cannot assume what it cannot assign.

In an actual test jurisdiction, express prohibition of assignment of
the exclusive license agreement delivers the same result, but for
different reasons. The trustee for KnifeCo might, or might not, be able
to assume the exclusive license agreement. However, the trustee does
not have the power to assign the agreement to Competitor. Like silence,
which bars assignment, express prohibition yields the same result.

Consider two twists to the License Test Case. First, assume that the
exclusive patent license agreement does not expressly prohibit
assignment by either party. Instead, assume that the agreement is silent
as to assignment as with the non-exclusive patent license agreements in
either Test Case. Silence as to assignment is the same as express
prohibition of assignment. Therefore, the result should be the same as
discussed above under either the actual or hypothetical tests. The
trustee does not have the power to assign the exclusive license
agreement to Competitor.

For the second twist to the License Test Case, assume that the
exclusive patent license agreement does not expressly prohibit
assignment by either party. Instead, assume that the agreement provides
conditions under which the exclusive patent license agreement can be
assigned without the consent of Distributor. The bankruptcy court will
determine (1) which of the hypothetical or actual assignment tests
should apply, and (2) analyzing the assignment language, whether the

202 Bd. of Regents of Univ. of Neb. v. BASF Corp., No. 4:04CV3356, 2007 WL
trustee is permitted to assign the license agreement. The outcome will depend upon both aspects.

Here is the unfairness to licensees in a nutshell. Whether the license agreement is silent on assignment or expressly prohibits assignment, the result should be the same under either test. The trustee does not have the power to assign the agreement. In such circumstances, the sale should not go through whether or not the licensee objects. But this is not what happens in § 363(f) sales when licensees remain silent. Unless the licensee timely objects to the sale in writing, it is likely to encounter a bankruptcy court sale order that deems the licensee’s consent given. This is so even when the trustee does not have the power to assign the license agreement. Further, the licensee’s avenues for appeal on grounds other than inadequate notice will be virtually non-existent after the close of the sale.

Turn now to Distributor’s other considerations. Can Distributor’s non-exclusive patent sub-license agreement really be extinguished if the trustee sells KnifeCo’s exclusive patent license agreement in a § 363(f) sale? Most likely, yes. The exclusive patent license agreement has

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203 In the case that a license agreement provides some conditions under which assignment might be permitted and those conditions, in fact, do not exist, licensees still face the same unfairness. The sale should not go through. See Philip S. Warden et al., Bankruptcy Issues in Trademarks, 19 IP LITIGATOR 14, 19 (2013).

204 Id.

205 Id.

206 See, e.g., In re Atmospheric Glow Techs., Inc., No. 08-31320 (Bankr. E.D. Tenn. June 17, 2008). The debtor, Atmospheric Glow Technologies, Inc. (“ATG”), exclusively licensed certain patents from the University of Tennessee Research Foundation (“UTRF”) within a specified field of use and with the right to grant sub-licenses. Document 38, at 2, In re Atmospheric Glow Tech., Inc., No. 08-31320 (Bankr. E.D.Tenn. June 17, 2008). “01,LLC” entered into a patent and know-how sub-license agreement with ATG. Id. at 1. Therefore, like Test Case Two, ATG was both a debtor exclusive licensee (through the exclusive patent license with UTRF) and also a debtor sub-licensor (through the sub-license agreement with 01,LLC). The trustee for ATG submitted a motion for authority to sell debtor ATG’s assets. Document 34, at 1. The asset purchase agreement included provisions for both the sale of ATG’s patents (not UTRF’s) and also assignment of the exclusive license agreement between UTRF and ATG. Document 34-1, at 2. However, ATG never sought permission from the bankruptcy court to assign the exclusive patent license agreement with UTRF. Document 38, at 2–3. In its objection to the trustee’s motion for sale, 01,LLC also highlighted that the exclusive license agreement between ATG and UTRF required UTRF’s express permission to assign the agreement and that no such permission had been given by UTRF. Id. at 3–4. Curiously, however, 01,LLC never asked for protection from the bankruptcy court under any of § 363(e) or § 365(n) of the Code. Presumably, 01,LLC could have done so. In a second objection to the proposed sale, 01,LLC did specifically object to a possible assumption and assignment of the sub-license agreement to a § 363(f) buyer, but again, without reference to either § 363(e) or § 365(n). Document 55 at 2–3. One possible

continued . . .
the attributes of property. The non-exclusive sub-license agreement is the interest. As with the Patent Test Case, the arguments articulated in Part VI.C.2.a employing the protections of one or more of §§ 363(e), 365(n)(2), and 365(n)(4)(B) should be applicable.

What if the trustee for KnifeCo asks for the option to choose which of KnifeCo’s executory agreements are to be assumed and assigned, and which are to be rejected after the close of a § 363(f) sale to Competitor? Before the § 363(f) sale, Distributor should timely object to the trustee’s assignment of the exclusive license agreement.207 Distributor should also ask the bankruptcy court to protect its rights under § 365(n) through the sale and also under § 363(e).

VII. CONCLUSION

Bankruptcy law empowers a debtor licensor to sell patent rights “free and clear” of any patent license under certain conditions. This writing considered the sale of any one or more of: (1) a non-exclusively licensed patent; (2) either a non-exclusive patent license or sub-license; and (3) an exclusive patent license. Section 363(f) sales are unfair to licensees in aspects of timing, notice and consent. A properly noticed patent licensee is highly likely to lose its license in a § 363(f) sale if the licensee fails to act. This writing is intended to be reference for a licensee’s use in addressing a § 363(f) license-extinguishing sale.

This writing is limited to two of the conditions permitting a free and clear sale under § 363(f). Those two conditions permit the sale if “applicable non-bankruptcy law” would permit the sale or if the licensee consents to the sale that purports to extinguish the license. Using two over-simplified Test Cases and three questions, this writing explored the transfer of both licensed patents and patent licenses first outside of bankruptcy and then inside bankruptcy. The Test Cases raised and addressed the following issues in a § 363(f) sale:

- Whether a non-exclusive patent sub-license can be extinguished by the sale of the non-exclusively licensed patent. Yes.
- Whether a § 363(f) sale of an exclusive patent

Explanation for 01,LLC’s actions may be that it had already entered into a separate letter agreement with UTRF. Under that agreement, UTRF would license directly to 01,LLC in the event that the license was deemed either terminated or rejected. Document 38, at 2. The bankruptcy court excluded 01, LLC’s sublicense from the sale in its Order Approving Sale of Assets. Document 81, at 1, 4.

207 Distributor did not need those arguments for the non-exclusive patent license agreements only because those agreements cannot be extinguished by a § 363(f) sale. See 11 U.S.C. § 363(f) (2012).
license can extinguish the non-exclusive sub-license therefrom. Likely yes.

In terms of timing, a licensee is entitled to no more than twenty-one days’ advance notice of a § 363(f) sale. This notice period is further reducible for cause. In some cases, notice may be by general publication in a newspaper. A licensee is likely to have precious little time to act to protect its license through the sale that purports to extinguish its license.

Section 363(f) provides a debtor licensor opportunities to use timing to circumvent a licensee’s options for protecting its license, purportedly available under § 365(n). Section 365(n) protections are only available at the licensee’s option after the debtor licensor first rejects an executory license agreement. In a § 363(f) sale, the debtor licensor can extinguish the license in the sale without rejecting it. All the licensor has to do is sell the licensed patent and do nothing at all about the license. Absent objection by the licensee, the license will be extinguished.

The licensor can also circumvent § 365(n) licensee protections by delaying executory license agreement assumption and rejection decisions until after the sale that extinguishes the license. Bankruptcy courts usually grant requests for such delay, because the delay is attractive to buyers. In effect, buyers take control of assumption and rejection decisions regarding executory license agreements after the sale as a way to manage risk.

There are ways for licensees to deal with these timing issues in a timely written objection to the sale. For example, with a sufficiently strong argument, licensees can try to compel the debtor to assume or reject a license agreement before the § 363(f) sale. This approach is useful in the case of the trustee’s lack of rejection of a license agreement, or delay until after the sale. A licensee need not wait until a sale notice to use this tactic.

Turning to notice, a § 363(f) sale purports to deprive a person of property. Any failure of adequate notice to a licensee raises due process issues under the Fifth Amendment of the United States Constitution. Such failure of notice can include the debtor providing notice by general publication when specific notice is required. The licensee can also challenge the correctness of the notice addressee, address, property description, sale and hearing dates, or any other aspect of notice that fails to adequately apprise the licensee of its rights.

With respect to patent license agreements, the consent requirement under § 363(f)(2) turns “applicable bankruptcy law” on its head. Generally, license agreements are not assignable and transfers of licensed patents are subject to the license. Outside of bankruptcy, the transfer of a licensed patent or a patent license does not extinguish the
Section 363(f)(1) specifically refers to and adopts the general rules above as “applicable non-bankruptcy law.” Unfairly, this is not the law that bankruptcy courts apply in a § 363(f) sale of licensed patents or patent licenses. Instead, a bankruptcy court’s sale order will “deem” properly noticed licenses to have consented to the sale absent a timely written objection. The trustee will conduct the sale, hope nobody objects in time, and expedite the entry of the bankruptcy court’s final sale order including the “deemed” consent of licensees. Following a policy of finality of bankruptcy sales designed to entice buyers, bankruptcy courts are reluctant to overturn final sale orders.

Turning the consent requirement on its head is understandable but not fair. Most contracts other than license agreements are freely assignable—the opposite of that required for patent license agreements. There is a fair argument that it is both judicially and administratively inefficient to require a licensee’s affirmative consent in a § 363(f) sale. There is a fair argument that without the finality of sales in bankruptcy, willing buyers would not participate.

This writing does not suggest a change in the law. This writing addresses how licensees can play the hand they are dealt. To best play this hand, licensees have to timely object in writing to a sale notice. Silence is not an option if the licensee wants to keep its license.

For example, if the sale includes a license agreement, the licensee’s objection can challenge the trustee’s authority to assign the license agreement as provided in this writing. But what if the sale includes the licensed patent and the trustee delays or does nothing with respect to the license agreement? The licensee can still object and ask the bankruptcy court to protect its options under § 365(n) through the sale. Finally, the licensee can also ask for more generalized protections under § 363(e).

If there is one thing that surprised this author, it is the breadth of intellectual property-related interests that can be purportedly extinguished in a § 363(f) sale. These interests extend beyond a patent license or sub-license. For example, consider the recent § 363(f) sale of patents by debtor Aereo following Aereo’s loss in the Supreme Court of the United States.208 Aereo infringed a broadcaster’s copyrights in television programming by operating within the scope of its own patents.209 As of March 2015, the television broadcasters continue to object to the sale of Aereo’s patents. The interests asserted by the broadcasters include not just retrospective claims for copyright

209 Id. (holding Aereo publicly performed plaintiff’s copyrighted works and remanding for further proceedings).
infringement and injunctive relief, but also prospective.\textsuperscript{210}

A. Figure 1. Example of a § 363 Sale Timeline

If trustee intends to sell a license agreement, may submit motion to assume or reject with motion to approve sale, but may ask bankruptcy court to allow final decision of which agreements to assume or reject until after close of sale.
B. **Figure 2. Section 363(f) Sale in the Context of a Chapter 7 or 11 Bankruptcy Timeline**

Chapter 7 or 11 Timeline – Putting Section 363(f) in Perspective

A. Bankruptcy Petition & Automatic Stay

B. Section 363(f) Sale

C. Close of Section 363(f) Sale

D. Sale or NPR for Debtor Or Warrantors, Etc. (F. Chapter 11)

E. Confirmation of Plan & Sale of Estates

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If trustee intends to sell license agreement, may submit motion to assume or reject with motion to approve sale but may seek bankruptcy court to allow final decision of which agreements to assume or reject until after close of sale. Otherwise, trustee can wait until plan confirmation to assume or reject, or do nothing.
C. Figure 3. Summary of Rules External to Bankruptcy

<table>
<thead>
<tr>
<th>Patent Test Case Asset to Be Sold</th>
<th>Part Location &amp; Rule</th>
<th>License Test Case Asset to Be Sold</th>
<th>Part Location &amp; Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-exclusively licensed patent</td>
<td><strong>Part IV.C.</strong> Generally, transferee of licensed patent takes subject to the license whether or not transferee knows of license agreement.</td>
<td>Exclusive license agreement</td>
<td><strong>Part IV.B.</strong> Law unsettled. If exclusive license agreement not tantamount to patent assignment, general rule of non-assignment should apply.</td>
</tr>
<tr>
<td>Non-exclusive patent license agreement</td>
<td><strong>Part IV.B.</strong> Absent express agreement to the contrary, license agreement not assignable.</td>
<td>Non-exclusive patent sublicense agreement</td>
<td><strong>Part IV.B.</strong> Absent express agreement to the contrary, license agreement not assignable.</td>
</tr>
</tbody>
</table>
D. Figure 4. Summary of Rules External to Bankruptcy

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<tr>
<th>Asset to Be Sold</th>
<th>Part Location &amp; Rule</th>
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<th>Part Location &amp; Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-exclusively licensed patent</td>
<td>Part VI.C.2.a. Sale of patent can extinguish the non-exclusive patent license.</td>
<td>Exclusive license agreement</td>
<td>Part III.C. Sale cannot extinguish the exclusive patent license but can likely extinguish the non-exclusive patent sub-license</td>
</tr>
<tr>
<td>Non-exclusive patent license agreement</td>
<td>Part III.C. Sale cannot extinguish the non-exclusive patent license.</td>
<td>Non-exclusive patent sub-license agreement</td>
<td>Part VI.C.2.b. Sale cannot extinguish the non-exclusive patent license.</td>
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