

Trademark Issues in Bankruptcy

IP as Defined for Bankruptcy

11 U.S.C. sec. 101

(35A) The term “intellectual property” means—

(A) trade secret;

(B) invention, process, design, or plant protected under title 35;

(C) patent application;

(D) plant variety;

(E) work of authorship protected under title 17; or

(F) mask work protected under chapter 9 of title 17;

to the extent protected by applicable nonbankruptcy law.

What is Missing?
Trademarks
Foreign Patents

EXECUTORY CONTRACTS

Countryman Definition (commonly accepted)

A contract where "the obligation of both the bankrupt and the other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance by the other." (Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn L. Rev. 439, 460 (1973)).

Eleventh Circuit has a slightly different test but the differences are not significant in the IP area.

Licenses are Executory Contracts

Courts regularly consider intellectual property licenses as executory contracts under § 365 of the Code. Both parties to the contract have a continuing obligation to maintain the confidentiality of the licensed software, the licensee is obligated to pay some form of a royalty or refrain from prejudicing the licensor's intellectual property rights, and the licensor is obligated not to sue the licensee for infringement.

Assumption and Assignment

Generally if a contract is executory it is capable of being assumed and assigned under section 365 of the Bankruptcy Code. However IP licenses can fit within an exception in section 365(c)

365(c)

- (c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—
- (1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and
- (B) such party does not consent to such assumption or assignment.

Trademark Licenses and non-exclusive patent licenses always require consent, an agreement to consent or an agreement waiving consent rights.

Transactional Problems: lenders can't realize on a security interest; investors can't sell assets of a troubled investment; asset has no realizable value.

Will a bankruptcy court try to be creative? E.g. what is the definition of exclusive? Geographic area or type of use.

Practice Note: a debtor may try a novel definition to get a sale approved and hope to close the sale before the licensor can get a stay, mooting the appeal.

Circuit Split- Hypothetical or Actual Test

If 365(c) prohibits assignment to a third party the Code also prevents assumption by the debtor to operate its pre-existing business. Split in the Circuits.

Hypothetical Test

- In Re: Catapult Entertainment, Inc. 165 F.3rd 747 (9th Cir. 1999)
- Matter of West Electronics, 852 F.2nd 79 (3rd Cir. 1988)
- In Re: Sunterra Corporation, 361 F.3rd 257 (4th Cir. 2004)

Actual Test

- Institut Pasteur v. Cambridge Biotech Corporation, 104 F.3rd 489 (1st Cir. 1997)
- In re: Mirant Corp. , 440 F. 3rd, 238 (5th Cir. 2006)

Footstar Test

- In re: Footstar, 323 B.R. 566 (Bankr. S.D.N.Y. 2005)
- In re: Adelphia Communications Corp. 358 BR 65 (Bankr. S.D.N.Y. 2007)
- In re: Aerobox, 373 B.R. 135 (Bankr. D.N.M. 2007)

Note: if 365(c) applies ipso facto termination clauses are enforceable under 365(e). Licensor can immediately seek relief from stay to terminate.

THE LICENSOR'S BANKRUPTCY

Lubrizol and 365(n)

- (n) (1) If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—
- (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or

365(n) cont.

(B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), **as such rights existed immediately before the case commenced**, for—

- (i) the duration of such contract; and
- (ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.

365(n) cont.

- (2) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, under such contract—
- (A) the trustee shall allow the licensee to exercise such rights;
 - (B) the licensee shall make all royalty payments due under such contract for the duration of such contract and for any period described in paragraph (1)(B) of this subsection for which the licensee extends such contract; and
 - (C) the licensee shall be deemed to waive—
 - (i) any right of setoff it may have with respect to such contract under this title or applicable nonbankruptcy law; and
 - (ii) any claim allowable under section 503 (b) of this title arising from the performance of such contract.
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365(n) cont.

- (3) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, then on the written request of the licensee the trustee shall—
- (A) to the extent provided in such contract, or any agreement supplementary to such contract, provide to the licensee any intellectual property (including such embodiment) held by the trustee; and
 - (B) not 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.

365(n) cont.

- (4) Unless and until the trustee rejects such contract, on the written request of the licensee the trustee shall—
- (A) to the extent provided in such contract or any agreement supplementary to such contract—
 - (i) perform such contract; or
 - (ii) provide to the licensee such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law) held by the trustee; and
 - (B) not 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.
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Trademark Section

Congress decided there was not enough experience to extend 365(n) to trademarks. Explicitly declared neutrality on Lubrizol.

Possible Issue

Difference between protecting innovation and property versus consumer protection.

Courts are left with a pre 365(n) world and the issue of whether Lubrizol applies or is correctly decided.

In re Exide Technologies, Third Circuit 2010

Court refused to permit Exide Technologies to reject license granted to EnerSys, holding agreement was non-executory because EnerSys had substantially performed.

Perpetual exclusive royalty-free license to use Exide trademark in industrial battery business.

Applying the Countryman test and noting that New York law provides that only a breach which substantially defeats the purpose of the contract can be grounds for rescission, the court noted that since EnerSys had substantially performed Exide performance would not be excused.

The Court held that obligation to satisfy quality provisions, use restrictions, indemnity obligations and further assurance obligation on EnerSys were substantially outweighed by its payment of \$135,000,000.00 and performance for ten years.

Court held that these were conditions subsequent and not material obligations.

Ambro concurs in full but also notes that in his view rejection would not deprive the Licensee of the right to use the mark.

Sunbeam Products v. Chicago Manufacturing , LLC

Bankruptcy Trustee rejected a license that Lakewood, the Debtor, had granted to Chicago American Manufacturing , LLC, to manufacture fans. Sunbeam purchased from the Trustee all the assets of Lakewood.

Citing the concurring opinion by Judge Ambro in *Exide*, the Bankruptcy Court noted that it was an open question whether rejection of trademark license would deprive the licensee of authority to use the marks but instead ruled, for equitable reasons, the Court would continue to allow CAM to manufacture the fans.

On appeal the Court held that the equity basis utilized by the lower Court was “untenable,” it then turned to whether Lubrizol correctly interpreted rejection under 365(g).

Concluded that outside of bankruptcy a licensor's breach does not terminate a licensee's right to use intellectual property as CAM would have had the option to terminate or to cover and sue for damages.

Ultimately the Seventh Circuit concluded that the licensee could continue to utilize the trademark because the licensor's breach does not void the contract or rescind same, since the non-breaching party has the option to continue to utilize the trademarks and sue for damages.

In Re: Interstate Bakeries, Eighth Circuit 2012

Currently vacated and awaiting rehearing.

This trademark license contained a provision making certain ongoing obligations material.

This is similar to Exide in that it was a perpetual royalty-free assignable transferable exclusive license that was fully paid for but differed because Exide's quality and use provisions were never enforced and not material.

The license was unique because it was entered into as a result of a consent decree with the Department of Justice resolving an antitrust complaint.

The Court distinguished Exide because of the materiality of the quality standards which were explicitly material under the contract.

Importantly the licensor also had material obligations to defend the mark, other infringement obligations, and notice and forbearance obligations.

Strong dissent argued that the remaining obligations were not in fact material because the contracts taken as a whole essentially involved the sale of businesses in specific territories and not merely trademark licensing.

The decision has been vacated and set for rehearing. The Circuit Court solicited the views of the Department of Justice and Federal Trade Commission on the antitrust issues.