



supreme court leaves tm licensee up in the air when licensor files for bankruptcy

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Last week the Supreme Court refused to decide whether, when a trademark licensor files for bankruptcy relief or is placed in involuntary bankruptcy by its creditors, the licensee can keep the rights to the trademark. The Fourth Circuit had said "no" in a 1985 case so reviled that Congress enacted corrective legislation, and 27 years later, the Seventh Circuit said "yes." Despite this circuit split, the Supreme Court refused to weigh in on the issue. As a result, trademark licensees in New York (Second Circuit), California (Ninth Circuit), and the rest of the country have no certainty.

By way of background, generally the Bankruptcy Code allows a debtor to assume or reject an "executory contract," which is a contract for which some material performance remains to be undertaken by both parties. When that happens, the counterparty to the rejected contract is given an unsecured claim that is payable at whatever cents on the dollar, if any, allowed unsecured claims are granted. But when a trademark license is deemed executory (a complicated issue that I do not address today) and this executory contract is rejected by the licensor, what happens to the licensee's rights to use the trademark?

In 1985 the Fourth Circuit shook up the bankruptcy bar by holding in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), that a debtor licensor could reject a fully paid-up license of technology so that it could sell or license the technology to another party on more advantageous terms. The Court held that the license vaporized; the licensee could no longer use the technology, and, in consideration, it had only an unsecured claim for damages in the licensor's bankruptcy.

In 1988, Congress enacted corrective legislation, Section 365(n) of the Bankruptcy Code, which provides that, in the bankruptcy case of a debtor licensor that rejects a license of intellectual property, the licensee has the option of (1) treating the contract as terminated or (2) retaining its rights by



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continuing to make royalty payments and doing other things. The legislative history says that the purpose of the bill was to remove the *Lubrizol* decision's threat to technology by making it clear (a) that the rights of an intellectual property licensee to use licensed property cannot be unilaterally cut off by rejection of the license in the licensor's bankruptcy and (b) that Congress had never intended rejection to have the effect found by the *Lubrizol* court.

Note that the Bankruptcy Code definition of "intellectual property" includes patents, copyrights, and trade secrets, but not trademarks. Some courts have ruled as if trademarks were included in the definition, noting that the licensee of a trademark usually has the rights to the trademark in conjunction with its rights to the patent or copyright. Others have given the definition of intellectual property a stricter construction and have excluded trademarks.

In 2012, the Seventh Circuit held in *Sunbeam Products, Inc. v. Chicago American Manufacturing*, 686 F.3d 372 (7th Cir. 2012), that the licensee of patents and trademarks could keep both the patents and the trademarks. It concluded that the Fourth Circuit had wrongly decided *Lubrizol* and the *Lubrizol* licensee should have been able to keep the licenses. Reasoning from nonbankruptcy law, not from Section 365(n), it concluded that, when a licensor breaches its contract, the licensee has the option of treating the breach as ending its own obligations under the license or continuing to sell the product under the license. In other words, rejection does not vaporize the contract, but rather it merely frees the estate from the obligation to further perform affirmative acts.

Of course, *Sunbeam* in itself raises a number of issues. If licensees can continue to sell the product based on general rules of rejection rather than Section 365(n), which imposes various obligations on the licensees, why would licensees choose to make the election to retain their licenses under Section 365(n)? If a licensee does not make the Section 365(n) election in a *Sunbeam* jurisdiction, can the licensee still keep the rights under the general rules of rejection? There would have been more certainty had the Supreme Court chosen to consider these issues.

Given the uncertainty, when considering taking a license from a licensor whose financial condition is weak, a licensee should have bankruptcy counsel determine what, if anything, local bankruptcy and district courts have decided about whether a licensee can keep its trademarks. If a licensor does become a debtor, the licensee should consult bankruptcy counsel for an up-to-date analysis of the decisions in the particular jurisdiction.

If you have questions about anything presented in this Alert or about bankruptcy issues in general, contact Mary D. Lane.