Trademark Licenses

Is That the Way the Cookie Crumbles?

BY DANIEL A. DEMARCO

The International Trademark Association calls it "the most significant unresolved legal issue in trademark licensing". Suppose Crinkly Cookies, Inc. licenses its extremely valuable "Crinkly Cookie" trademarks to Betty Baker's Bakery LLC, which invests significantly in a bakery dedicated to baking delicious "Crinkly Cookies", which it markets using the "Crinkly Cookie" trademarks. Suppose further that one day Crinkly Cookies, which finds it is losing money on its trademark licensing agreement with Betty Baker's Bakery, files for bankruptcy and immediately moves to reject the agreement. It is virtually certain that the Bankruptcy Court will approve the rejection of the trademark licensing agreement. In most Circuits, however, it is less certain what rights, if any, Betty Baker's Bakery retains upon this rejection. Betty Baker's Bakery needs to know — can it still use the "Crinkly Cookie" trademarks? Courts of Appeal for the First and Seventh Circuits faced with this crucial question — can the licensee use the trademarks after rejection of the license — have arrived at conflicting outcomes under the Bankruptcy Code. A petition for certiorari before the United States Supreme Court now asks the high court to answer Betty Baker's Bakery's question.

The specific question on which Supreme Court review is sought is: "Whether, under Section 365 of the Bankruptcy Code, a debtor-licensor's "rejection" of a license agreement — which "constitutes a breach of such contract," 11 U.S.C. Section 365(g) — terminates rights of the licensee that would survive the licensor's breach under applicable non-bankruptcy law." The petition for certiorari arises out of a First Circuit case, *In re Tempnology*, LLC, 879 F.3d 389 (1st Cir. 2018), which concludes that upon rejection the licensee's rights to use the trademark are terminated, while a Seventh Circuit case, *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, 686 F.3d 372 (7th Cir. 2012), holds the licensee retains valuable rights post-rejection, setting up a Circuit split that the Supreme Court may decide to resolve this coming term.

The treatment of trademark rights in bankruptcy has far-reaching consequences. Intellectual property rights are increasingly valuable components of businesses, and trademark rights are frequently at the forefront of these assets. In 1988, in response to a much-critiqued opinion by the Fourth Circuit in *Lubrizol Enters, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), Congress enacted Bankruptcy Code Sections 365(n) and 101(35A) to provide clear rules for the treatment of licenses of patents, copyrights and trade secrets in bankruptcy. Congress specifically acknowledged that this legislation did not address trademarks. The Senate Report states that Congress demurred acting on the impact of rejection upon trademark licenses to allow for "more study" and "the development of equitable treatment of this situation by bankruptcy courts."

The evolution of the case law since the 1988 legislation, peaking with the *Sunbeam* decision, generally had trended in favor of licensees, until the *Tempnology* case moved through the courts. The case law impacting the rejection of trademark licenses began to take shape before the 1988 legislation

with the Fourth Circuit's ruling in *Lubrizol*. In *Lubrizol*, the Fourth Circuit held that a debtor-licensor's rejection of a patent license was in essence absolute, and resulted in the non-debtor licensee losing any rights to use the patented technology. Recognizing many businesses are based on the license of patent rights and that the *Lubrizol* case created the potential for a licensor to abuse its licensee by filing bankruptcy and rejecting the patent license, Congress took action. Section 365(n) carved out a series of rules applicable to the rejection of "intellectual property" licenses, essentially permitting licensors to be relieved of the burdens of a license through rejection, while permitting licensees the option of either (A) simply asserting a claim for money damages upon rejection, or (B) preserving its investment by retaining its contractual rights to use the intellectual property while paying the royalty due under the contract. However, Congress applied Section 365(n) to limited types of "intellectual property", specifically defined in Section 101(35A) to include patents, copyrights and trade secrets, but, significantly, not trademarks.

Section 365(n) has operated relatively smoothly as to patents and other specified "intellectual property", while bankruptcy courts were left to navigate the murkier waters of trademarks. One path the bankruptcy courts could take after the 1988 legislation when confronted with the rejection of a trademark license would be to follow *Lubrizol*. Although *Lubrizol* was not a trademark case, it was, for many years, the only Circuit Court case that addressed the rights of a licensee of intangible property rights whose license had been rejected. As such, many bankruptcy courts followed *Lubrizol*, concluding that the non-debtor licensee of trademarks from a debtor-licensor was, upon termination of the license, stripped of any rights to use the trademarks. Another path available to bankruptcy courts was to develop equitable treatments. The facts of *Sunbeam* lent themselves to a path around *Lubrizol* and to protecting the licensee.

Sunbeam purchased trademarks and other assets from a bankrupt company that, prior to its bankruptcy, had licensed a manufacturer to produce box fans bearing their trademark over a single, specific calendar year. The licensor rejected the trademark license to facilitate the sale of its trademarks and other assets to Sunbeam. After the Sunbeam purchase was approved and closed, Sunbeam sued the licensee, which had continued, post-rejection, to manufacture and sell the trademarked box fans. Judge Easterbrook of the Seventh Circuit had the final say. The *Sunbeam* court reasoned that the omission of trademarks from the roster of intellectual property applicable to Section 365(n) was merely an omission and not a mandate of any particular result Congress intended for a trademark licensee post-rejection. The court, observing that under Section 365(g) rejection "constitutes a breach of such contract", then turned to the question of what rights the licensee would have under applicable non-bankruptcy law upon the licensor's breach. *Sunbeam* held that while rejection allows the debtor-licensor to be relieved of the ongoing obligations under a license, rejection does not terminate the licensee's rights — to use the trademark — or the licensee's related obligations — such as maintaining quality control over the trademarked product. As Jude Easterbrook memorably concluded: "nothing about [rejection] implies that any rights of the [non-debtor licensee] have been vaporized." *Id*. at 377.

Tempnology had developed exercise gear that stayed cool even during exercise. The *Tempnology* court kept its cool, and refused to vaporize the licensee's rights, but concluded that upon rejection the licensee's rights consist of "a prepetition claim for [money] damages." *In re Tempnology*, LLC, 879 F.3d at 402. Turning to whether some basis existed to support the licensee retaining rights to use the trademark post-rejection, the First Circuit examined the non-bankruptcy treatment of a licensee when its licensor breaches, failing to support the trademark. The First Circuit observed that a licensor's failure to monitor and exercise control over its trademarked products "results in a so-called "naked license," jeopardizing the continued validity of the owner's own trademark rights." *Id*. Ultimately, a licensor's failure "to exercise reasonable control over the use of the designation by the licensee can result in abandonment." *Id*., at 403. The *Tempnology* court reasoned that imposing burdens like monitoring and control on the debtor-licensor "diminished [the trademarks'] value to Debtor, whether directly or through an asset sale." *Id*. The First Circuit in *Tempnology* declined to deprive the debtor-licensor of the benefits of being relieved of future obligations that underpins rejection under Section 365. The First Circuit perceived that permitting the licensee to use the trademark post-rejection would inevitably burden the debtor-licensor and undermine the benefits of rejection. *Id*., at 403 -04.

Betty Baker's Bakery is not keeping its cool, and fears the "Crinkly Cookies" will crumble! In the Seventh Circuit, Betty Baker's Bakery knows the "Crinkly Cookies" will not be vaporized. In fact, in the Seventh Circuit, Betty Baker's Bakery has a recipe (no pun intended) for continuing to produce delicious "Crinkly Cookies." In the First Circuit, however, Betty Baker's Bakery will lose the right to use the "Crinkly Cookies" trademark to produce and market the cookies. In the Sixth Circuit (as in most other Circuits), advising Betty Baker's Bakery whether a bankruptcy court will permit it to make any use of the "Crinkly Cookies" trademarks post-rejection certainly requires consideration of the Circuit Court decisions in *Tempnology* and *Sunbeam*, as well as an analysis of the recent bankruptcy court cases on trademark licenses. Among these, *In re Crumbs Bake Shop, Inc.*, 522 B.R. 766 (Bankr. N.J. 2014), and *In re SIMA International, Inc.*, Case No. 17-21761, 2018 WL 2293705 (Bankr. D. Conn. May 17, 2018), are particularly pertinent, and align with *Sunbeam*. While decided before *Tempnology*, the *Crumbs* decision is useful for its well-reasoned argument, commencing with the observation about Section 365(g) relied upon in *Sunbeam* (a rejection is a breach, not a vaporization), and then offering analysis including analogies to the treatment of non-debtor lessees under real property leases from debtor-lessors to address the scope of the non-debtor licensee's rights and obligations under the rejected trademark licenses at issue. Decided after *Tempnology*, the court in *SIMA* acknowledges the holding in *Tempnology* and then "respectfully declines to follow the First Circuit holding and similarly aligns with the plain language reading of Section 365 advanced by Judge Easterbrook in the Seventh Circuit."

Will the Supreme Court provide a clear answer to Betty Baker's Bakery's question? By the time of this publication we may know whether the Supreme Court will review the *Tempnology* case. And how will that cookie crumble?

Dan DeMarco is a partner at Hahn Loeser & Parks LLP and chairs the firm's Commercial Services and Restructuring group. Dan is certified in Business Bankruptcy by the American Board of Certification. He frequently represents creditors, debtors and buyers in restructuring transactions, as well as creditors' committees and trustees in reorganization proceedings. Dan has been a CMBA member since 1987. He can be reached at (216) 621-0154 or dademarco@hahnlaw.com.