SUNBEAM AND ITS IMPACT ON THE REJECTION OF TRADEMARK LICENSES IN BANKRUPTCY

INTRODUCTION

Many U.S. companies trade intellectual property with other companies as part of their business models through the use of intellectual property licensing agreements. These transactions generate revenue for licensors through royalties and fees and allow licensees the right to use intellectual property in the development of their own products. According to the National Science Foundation, receipts for intellectual property licensing have continually risen over the last two decades, totaling over $50 billion in 2005.[1] One important area of the law affecting these licensing agreements is bankruptcy law; specifically, § 365 of the Bankruptcy Code deals with both parties' rights under a licensing agreement when one party has filed for bankruptcy.[2] A recent decision by the Seventh Circuit overturned decades-old precedent in this area and afforded a new level of protection to licensees whose licensors have entered bankruptcy.

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1. *Science and Engineering Indicators 2008*, NATIONAL SCIENCE FOUNDATION (Jan. 2008), http://www.nsf.gov/statistics/seind08/c6/c6s4.htm#c6s41.
2. 11 U.S.C. § 365 (2006).

In 1985, the Fourth Circuit held in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.* that if a licensor filed for bankruptcy, an executory contract for intellectual property rights could be rejected, and the licensee would lose all rights to the intellectual property.[3] In response to this decision, Congress passed an amendment to the Bankruptcy Code allowing licensees to retain their rights if licensors went bankrupt. However, Congress did not include trademarks as part of the protected class. Courts and scholars criticized this decision, but courts still followed it until July 2012, when the Seventh Circuit issued *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, an opinion protecting trademarks in spite of the statute, creating a circuit split. This Note will discuss the *Sunbeam* decision, its reasoning, and its changes to existing law. This Note will also discuss the reasons that trademarks, like other forms of intellectual property, should be protected and offer several judicial and legislative solutions.

A. Section 365 and Executory Contracts in Context

Before the enactment of § 365(n) in 1988, a debtor or trustee could reject an executory contract with another party, including if the contract was a licensing agreement involving intellectual property.[4] The Code allowed this so that the debtor or trustee could use valuable property to pay off creditors.[5] In the case of intellectual property, for example, a debtor would likely find it more advantageous to sell an unencumbered right to intellectual property rather than to continue licensing the right during bankruptcy. Before § 365(n), rejection of an executory contract by a debtor automatically qualified as breach of the contract.[6] The non-breaching party was entitled only to monetary damages; it could not retain any rights in the intellectual property.[7]

To determine whether to approve a request for rejection, courts applied a two-step test, asking first whether a contract was executory, and if so, whether rejection of the contract would be advantageous to the debtor.[8] The debtor carried the burden of proving that a contract was executory, but the Code did not define an executory contract.[9] Courts traditionally employed

3. Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1046 (4th Cir. 1985).

4. 11 U.S.C. § 365(a).

5. Aleta A. Mills, *The Impact of Bankruptcy on Patent and Copyright Licenses*, 17 BANKR. DEV. J. 575, 577 (2001).

6. 11 U.S.C. § 365(g).

7. *Id*.

8. *Lubrizol*, 756 F.2d at 1046.

9. Jonathan C. Balfus, Exide *Inside Out: New Third Circuit Decision Preserves Trademark Licensee's Rights Following Licensor's Rejection Under Bankruptcy Code § 365*, 31 CAL. BANKR. J. 523, 525 (2010).

the "Countryman test," which stated that a contract was executory only if the obligations 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."[10] Though debtors or trustees still had to prove that executory contracts existed, courts typically found that licenses of intellectual property did fall under § 365.[11]

I. THE *LUBRIZOL* DECISION AND CONGRESSIONAL REACTION

A. Lubrizol

The landmark case illustrating the application of the pre-1988 Code is *Lubrizol*. There, Richmond Metal Finishers (RMF) entered into a licensing agreement with Lubrizol to allow Lubrizol to use a metal coating process technology.[12] In turn Lubrizol would pay royalties to RMF for the use of the process until the contract expired.[13] Before Lubrizol could even begin using the technology, RMF filed for Chapter 11 bankruptcy and moved to reject the contract as executory under § 365 so that the technology could be sold unencumbered to another party.[14] The bankruptcy court approved the rejection, but the district court reversed, finding that the licensing agreement was neither executory nor advantageous to RMF.[15] On appeal, the Fourth Circuit first held that the contract was indeed executory because RMF still owed duties to Lubrizol, such as responsibilities to notify and defend lawsuits as well as account for and pay royalties.[16] The court then found that rejection of the contract would be advantageous to RMF because the trademark was their principal asset, and its sale would be easier if RMF no longer had an obligation to Lubrizol.[17]

Finally, the court addressed the policy concerns raised by its decision, noting that rejection of these types of agreements could impose "serious burdens upon contracting parties such as Lubrizol."[18] The court also realized that its decision "could have a general chilling effect" on parties

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10. *In re* Access Beyond Techs., Inc., 237 B.R. 32, 43 (Bankr. D. Del. 1999). The name for the "Countryman test" is derived from Professor Vern Countryman who wrote an influential article on executory contracts. Vern Countryman, *Executory Contracts in Bankruptcy: Part 1*, 57 MINN. L. REV. 439 (1972).
11. Balfus, *supra* note 9, at 526.
12. *Lubrizol*, 756 F.2d at 1045.
13. *Id*.
14. *Id*.
15. *Id*.
16. *Id*. at 1045–46.
17. *Id*. at 1047.
18. *Id*. at 1048.

when conducting future business.[19] The court responded to these possibilities by stating that "equitable considerations may not be indulged" in these types of contracts and that Congress "plainly provided" for the rejection of them in spite of their negative future business consequences.[20] Lubrizol and other companies faced the hazard that all similar companies faced when dealing with potentially bankrupt parties.[21]

B. Congressional Response to Lubrizol

The response to *Lubrizol* from the business community was negative because many businesses relied on contractual rights to intellectual property and faced "financial ruin" due to the prospect of losing intellectual property licenses.[22] Since businesses could recover only money damages and because intellectual property rights are unique and cannot be substituted, businesses had to find an alternative supply for any rights they lost.[23] Even the *Lubrizol* court recognized the potential for a "general chilling effect" on the willingness of future parties to seek licensing agreements.[24] Congress responded by enacting § 365(n) in 1988. Congress's intent in passing § 365(n) was to "make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to Section 365 in the event of the licensor's bankruptcy."[25] Congress pointed to "[c]ertain recent court decisions" imposing a burden on technology "that was never intended by Congress" in enacting § 365.[26] Accordingly, § 365(n) sought to "remove that burden and its attendant threat to the development of American Technology."[27] Section 365(n) provides, in pertinent part:

> (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—
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> (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would

19. *Id*.
20. *Id*.
21. *Id*.
22. David M. Jenkins, *Licenses, Trademarks, and Bankruptcy, Oh My!: Trademark Licensing and the Perils of Licensor Bankruptcy,* 25 J. MARSHALL L. REV. 143, 151–52 (1991).
23. Anthony Giaccio, *The Effect of Bankruptcy on the Licensing of Intellectual Property Rights*, 2 ALB. L.J. SCI. & TECH. 93, 102 (1992).
24. *Lubrizol*, 756 F.2d at 1048.
25. S. REP. NO. 100-505, at 1 (1988).
26. *Id*.
27. *Id*. at 2.

> 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
> (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 . . . .[28]

Thus, § 365(n) attempts to avoid the negative business consequence of rejection by allowing licensees to retain some of their rights.[29] First, licensees may only exercise their rights under § 365(n) if the debtor or trustee successfully moves to reject a contract as executory, so the two-part inquiry discussed in *Lubrizol* still applies.[30] Next, licensees have the option of either treating the rejection as breach of the contract[31] or electing to retain their rights under the contract.[32] If a licensee chooses to treat rejection as breach of contract, the licensee is then only entitled to monetary damages, the same remedy available under *Lubrizol* and before.[33] More importantly, § 365(n)(1)(B) allows the licensee to elect to retain his rights under the agreement as long as they are intellectual property interests created before the filing of bankruptcy.[34] This allows licensees to continue enforcing their rights under the agreement provided that they continue to pay royalties to the debtor.[35]

While § 365(n) was a step in the right direction to easing the harshness of the *Lubrizol* decision, Congress still created some difficulties.[36] Licensees may only elect to retain their rights under a rejected executory contract if those rights involve intellectual property.[37] Section 101 defines intellectual property as including, among other things, trade secrets, patents, patent applications, and copyrights.[38] More important is what the

28. 11 U.S.C. § 365(n) (2006).
29. *Id*.
30. 11 U.S.C. § 365(n)(1).
31. 11 U.S.C. § 365(n)(1)(A).
32. 11 U.S.C. § 365(n)(1)(B).
33. 11 U.S.C. § 365(n)(1)(A).
34. 11 U.S.C. § 365(n)(1)(B).
35. 11 U.S.C. § 365(n)(2)(B).
36. Giaccio, *supra* note 23, at 107.
37. 11 U.S.C. § 365(n)(1).
38. 11 U.S.C. § 101(35A) (2006).

definition does not cover: trademarks and other state-created intellectual property rights.[39] However, this omission was not a mere oversight by Congress.[40]

The Senate Report specifically recognized that the new bill did not cover trademarks, and they intended the omission, at least for a certain period of time.[41] Their reasoning was that licensors of trademarks are required to monitor the licensee's usage of the trademark to ensure the trademark's integrity.[42] This monitoring is a cost to licensors, and this cost would continue to be imposed on debtor-licensors if they could not reject the contract under § 365. Congress was not yet prepared to impose this burden on the debtor in bankruptcy "without more extensive study."[43] Instead, Congress "determined to postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts."[44] The legislative history of § 365 lends further insight into the issue. First, Congress was hesitant to broaden the scope of § 365(n) so much that it would not provide the intended relief to debtors.[45] Congress was specifically concerned that expanding the definition of intellectual property to include trademarks would grant every retail franchise the ability to retain rights under § 365(n).[46]

II. INITIAL INTERPRETATIONS OF § 365(N)

After Congress enacted § 365 several courts directly addressed the issue of whether trademarks would be included, and until *In re Exide Technologies* in 2010, all of them answered no.[47] These courts mostly used negative inference to reason that since Congress did not specifically include trademarks in its definition of intellectual property, § 365(n) did not apply to trademarks.[48] For example, in *In re HQ Global Holdings, Inc.*, a franchisee wanted to continue using the trademark it contracted for after

39. *In re* Exide Techs., 607 F.3d 957, 966 (3d Cir. 2010) (Ambro, J., concurring).

40. S. REP. NO. 100-505, at 5 (1988).

41. *Id*.

42. Giaccio, *supra* note 23, at 109.

43. S. REP. NO. 100-505, at 5 (1988).

44. *Id*.

45. H.R. REP. NO. 1012, at 7–8 (1988).

46. Laura D. Steele, Note, *Actual or Hypothetical: Determining the Proper Test for Trademark Licensee Rights in Bankruptcy*, 14 MARQ. INTELL. PROP. L. REV. 411, 426 (2010) (discussing comments made by the National Bankruptcy Conference in their review of the legislation that enacted § 365(n)).

47. *In re* Exide Techs., 607 F.3d 957, 966 (3d Cir. 2010) (Ambro, J., concurring).

48. *See, e.g.*, *In re* Old Carco LLC, 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009); *In re* HQ Global Holdings, Inc., 290 B.R. 507, 513 (Bankr. D. Del. 2003); *In re* Centura Software Corp., 281 B.R. 660, 674 (Bankr. N.D. Cal. 2002).

the debtor rejected the contract in bankruptcy.[49] While admitting that trademarks were not included under § 365(n), the franchisee argued that § 365(n) only excused the debtor from obligations under the contract, but the franchisee was still entitled to its rights.[50] Stated differently, a debtor's rejection of the contract does not completely terminate the contract, it just constitutes a breach by the debtor.[51] Breach by the debtor does not mean the debtor no longer has obligations under the contract (such as the obligation to allow the licensee to continued use of the intellectual property), rather it just leads to the licensee having a claim of damages against the debtor.[52] The court said this argument "misses the mark entirely" and instead held that since the Bankruptcy Code does not include trademarks in its protected class of intellectual property, *Lubrizol* controls.[53]

A. The Exide *Concurrence*

In re Exide Technologies, decided in 2010, was the first case to take a significant departure from previous interpretations of § 365(n).[54] Previously, Exide had sold most of its industrial battery business to EnerSys, including the Exide trademark.[55] Nearly ten years later, Exide wanted to re-enter the battery market and attempted to regain the Exide trademark; however, EnerSys refused.[56] Exide soon filed for bankruptcy and filed a motion to reject its contract with EnerSys in an attempt to gain back access to the trademark.[57] The court, following the two-step inquiry, held that the contract with EnerSys had been substantially performed by EnerSys and thus was not an executory contract.[58]

In a concurring opinion Circuit Judge Ambro went further, arguing that rejection of a contract under § 365 did not necessarily mean the licensee could no longer exercise his right to use the trademark.[59] He stated that until this time, courts had reasoned by negative inference that since trademarks were not included under the definition of intellectual property, they must not be covered under § 365(n).[60] Judge Ambro responded that "it

49. *In re HQ Global Holdings*, 290 B.R. at 513.
50. *Id*.
51. *In re* Lavigne, 114 F.3d 379, 386–87 (2d Cir. 1997).
52. *Id*. at 387.
53. *In re HQ Global Holdings*, 290 B.R. at 513.
54. Balfus, *supra* note 9, at 524.
55. *In re* Exide Techs., 607 F.3d 957, 960 (3d Cir. 2010).
56. *Id*. at 961.
57. *Id*.
58. *Id*. at 964.
59. *Id*. at 965 (Ambro, J., concurring).
60. *Id*. at 966.

is 'simply more freight than negative inference will bear' to read rejection of a trademark license to effect the same result as termination of that license."[61] Judge Ambro argued that, even though rejection of a contract would be breach, that rejection would not terminate the licensee's rights, and the licensee might still use a trademark even after rejection. Further, "[r]ather than reasoning from negative inference to apply another Circuit's holding," Judge Ambro urged that instead the Third Circuit should have used its powers of equity to allow EnerSys to continue using the Exide trademark.[62] Allowing Exide to take back its trademark, which it freely bargained away, would, in Judge Ambro's opinion, "make[] bankruptcy more a sword than a shield."[63]

Judge Ambro took a position, consistent with other courts,[64] that rejection of a contract was distinguishable from rescinding or terminating the contract.[65] In this view, rejection in bankruptcy did not affect the contract's continued existence; "the contract is not cancelled, repudiated, rescinded, or in any other fashion terminated."[66] The Court in *Lubrizol* took the opposite view, reasoning that breach calls for only monetary damages and that other remedies "would obviously undercut the core purpose of rejection under § 365(a)."[67] Congress clearly disagreed with *Lubrizol* and enacted § 365(n) in response, as Judge Ambro pointed out.[68] Judge Ambro also explained that the legislative history of § 365 showed that Congress intended to leave trademarks out, at least initially.[69] Judge Ambro never directly addressed Congress's rationale for doing this or examined why an exception for trademarks might no longer be necessary or desirable.[70] Instead, he asked the courts to use "their equitable powers" to avoid "stripping EnerSys of its fairly procured trademark rights."[71]

The rationale in the *Exide* concurrence, though only dictum, was a significant step toward resolving whether trademarks would be included as intellectual property under § 365(n).

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61. *Id*. at 967 (quoting Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1, 11 (1991)).

62. *Id*.

63. *Id*. at 967–68.

64. *See, e.g*., Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294, 1306 (11th Cir. 2007); *In re* Klein, 218 B.R. 787, 790 (Bankr. W.D. Pa. 1998); *In re* Hirschhorn, 156 B.R. 379, 388 (Bankr. E.D.N.Y. 1993); *In re* Drexel Burnham Lambert Grp., 138 B.R. 687, 703 (Bankr. S.D.N.Y. 1992).

65. *Exide*, 607 F.3d at 967 (Ambro, J., concurring).

66. *In re Drexel*, 138 B.R. at 708 (quoting Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1, 16 (1991)) (internal quotation marks omitted).

67. Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985), *superseded by statute*, 11 U.S.C. § 365(n) (2006).

68. *See, e.g*., *Exide*, 607 F.3d at 965.

69. *Id*. at 966–67.

70. *Id*. at 967.

71. *Id*.

III. THE *SUNBEAM* DECISION

A. Facts

Lakewood Engineering & Manufacturing Company (Lakewood) made and sold many products, including the box fans at issue in the case, that were covered by patents and trademarks.[72] In 2008, Lakewood experienced financial difficulties regarding its box fan sales and made a contract with Chicago American Manufacturing (CAM).[73] The contract authorized CAM to use Lakewood's patents and trademarks to manufacture box fans.[74] Lakewood would then take orders from retailers such as Sears and Wal-Mart and CAM would ship the fans directly to these retailers.[75] In addition, because CAM was hesitant due to Lakewood's financial difficulties, CAM would be allowed to sell any fans remaining at the end of the year and keep all the profits.[76]

Just three months into the contract, several of Lakewood's creditors filed for an involuntary bankruptcy against Lakewood, and the court appointed a trustee.[77] The trustee sold all of Lakewood's assets, including the patents and trademarks, to Sunbeam Products.[78] Because Sunbeam's products already competed against the Lakewood box fans, the trustee rejected the contract with CAM under § 365.[79] CAM continued to sell the fans anyway, giving rise to the original case.[80]

B. Procedural History

The bankruptcy court, following reasoning very similar to the *Exide* concurrence, held that CAM could continue using the trademarks it contracted for.[81] The court first noted that trademarks were not included in § 365(n), so normally *Lubrizol* would control.[82] However, the court stated that the recent *Exide* concurrence "must give a court pause" before following *Lubrizol*.[83] Refusing to read trademarks into the intellectual

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72. Sunbeam Prods., Inc. v. Chi. Am. Mfg., 686 F.3d 372, 374 (7th Cir. 2012).
73. *Id*.
74. *Id*.
75. *Id*.
76. *Id*.
77. *Id*.
78. *Id*.
79. *Id*.
80. *Id*.
81. *In re* Lakewood Eng'g & Mfg. Co., 459 B.R. 306, 347 (Bankr. N.D. Ill. 2011), *aff'd sub nom*. Sunbeam Prods., Inc. v. Chi. Am. Mfg., 686 F.3d 372 (7th Cir. 2012).
82. *Id*. at 343.
83. *Id*.

property definition, the bankruptcy court instead "step[ped] into the breach . . . and beg[a]n the 'development of equitable treatment' Congress anticipated would occur."[84] Relying heavily on reasons of equity, the court concluded that the trademark license did not disappear or terminate when the contract was rejected in the bankruptcy proceeding, and thus, CAM could still use the trademarks.[85]

C. The Seventh Circuit's Opinion

Chief Judge Easterbrook, the only sitting judge for the case, ultimately agreed with the outcome of the bankruptcy court's decision but disagreed with its reasoning.[86] First, Judge Easterbrook looked to previous cases that used negative inferences to say that since the § 101 definition of intellectual property did not include trademarks, Congress intended to exclude them.[87] Judge Easterbrook responded by saying that "an omission is just an omission" and that the limited definition just meant that "§ 365(n) does not affect trademarks one way or the other."[88] He went on to cite the legislative history of § 365 and suggested that the omission of trademarks was designed to give Congress more time to study the issue, not to approve the *Lubrizol* result for trademarks.[89] Judge Easterbrook then directly addressed the bankruptcy court's equity-based reasoning and stated that "[r]ights depend . . . on what the Code provides rather than on notions of equity."[90] However, even though he found the bankruptcy court's reasoning "untenable," he found that it did not necessarily require reversal.[91]

In his reasoning, Judge Easterbrook noted that under § 365, rejection of a contract constituted breach of that contract.[92] He then said that, outside bankruptcy, a licensor's breach of a contract would not affect the licensee's right to use the intellectual property contracted for.[93] Therefore, inside bankruptcy, the outcome would be the same: "[T]he other party's rights remain in place."[94] He analogized this situation to a lessor who enters bankruptcy by saying that a lessor who rejected a lease could not then force the tenant to leave and then rent out the property for a higher price.[95] The

84. *Id*. at 345.
85. *Id*. at 347.
86. Sunbeam Prods., Inc. v. Chi. Am. Mfg., 686 F.3d 372, 376 (7th Cir. 2012).
87. *Id*. at 375.
88. *Id*.
89. *Id*.
90. *Id*. at 376.
91. *Id*.
92. *Id*.
93. *Id*.
94. *Id*. at 377.
95. *Id*.

lessor may breach the contract by not performing his obligation to make repairs for the tenant. This breach would not rescind the lease but would merely require the lessor to pay damages for the repairs he did not make.[96] Therefore, Judge Easterbrook argued that when Lakewood rejected the contract, it "merely free[d] the estate from the obligation to perform."[97] The rejection had no effect on CAM's right to use the trademarks. Finally, Judge Easterbrook ended the opinion by discussing its own importance to the law. He said that "[s]cholars uniformly criticize *Lubrizol*" and that its reasoning did not persuade him.[98] He also recognized that *Lubrizol* created a split among the circuits.[99]

The *Sunbeam* decision was a complete departure from *Lubrizol* and its progeny. It was the first case in twenty-seven years holding that rejection of a contract did not terminate the rights of the licensee. The case will likely give encouragement to licensees and potential licensees that their rights will be protected in bankruptcy cases. It will likely also encourage attorneys to use the same arguments found in *Sunbeam* in other circuits to protect trademark licensees in bankruptcy proceedings. However, further litigation over the issue will be costly, time-consuming, and uncertain. Instead, there are several other avenues that could be used to include trademarks under the protection of § 365(n).

IV. THE ARGUMENT FOR PROTECTING TRADEMARKS AND POSSIBLE ROUTES OF CHANGE

A. Why Trademarks Should Be Protected Under § 365(n)

Congress's decision not to include trademarks within the definition of intellectual property has been criticized by scholars.[100] There are several reasons why trademarks should be included under the protection of § 365(n). First, Congress's fear of the effects that quality control would have on licensors is misguided and can be remedied. The exclusion of trademarks also has negative economic consequences for both businesses and consumers. Finally, trademarks are increasingly viewed as property rights and should be protected in bankruptcy as such.

First, it is likely that Congress's fear of burdening the debtor by requiring monitoring of the trademark is exaggerated.[101] An owner of a trademark is free to license that trademark, but the owner has a continuing

96. *Id*.
97. *Id*.
98. *Id*. at 377–78.
99. *Id*. at 378.
100. *See, e.g.*, Balfus, *supra* note 9, at 534; Giaccio, *supra* note 23, at 95–96.
101. Giaccio, *supra* note 23, at 109.

duty to provide quality control of the goods and services sold under the trademark.[102] This requirement gives protection to the public by ensuring a licensee's products are of the same quality as the owner of the trademark.[103] If a trademark owner fails to maintain control of the quality of the products, a court may deem the trademark license as "naked."[104] When naked licensing occurs, a court may find that the licensor abandoned the trademark and thus no longer has the rights to enforce the trademark.[105] Congress was hesitant in including trademarks under § 365(n) because of the possible burden quality control would place on a licensor in bankruptcy.[106]

Congress's fear of over-burdening the debtor-licensor can be put aside for two reasons. First, courts have become increasingly lenient in their standards for sufficient control.[107] Courts have noted the "heavy burden placed on a party seeking to establish a forfeiture."[108] Thus, a minimal level of control is often sufficient for a licensor to prevent abandonment of their trademark.[109] Also, the licensee of a trademark often invests substantial resources into building and maintaining the quality of the mark because it is in her economic interest to do so. There is an economic incentive driving licensees to engage in their own type of quality control, even if the licensor is only doing the minimum amount required.[110] Therefore, requiring licensor-debtors to maintain quality control creates only a minimum burden because of the lenient judicial standards and because of the practical result that licensees maintain quality even if not required since it is in their financial interest to do so.

Not protecting trademark licensees under § 365 also has negative economic consequences for both businesses and consumers. Many intellectual property rights that companies license involve multiple forms of intellectual property for the same product. For example, a company may license software that contains both copyrights and trademarks. If a business knows they may lose their right to use a trademark, they will be less likely to invest in intellectual property rights. Since the multiple forms of intellectual property are bundled together, this could have a negative

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102. Moore Bus. Forms, Inc. v. Ryu, 960 F.2d 486, 489 (5th Cir. 1992).

103. Laura Jelinek, *Equity for Brand Equity: The Case for Protecting Trademark Licensees in Licensor Bankruptcies*, 40 AIPLA Q.J. 365, 386 (2012).

104. FreecycleSunnyvale v. Freecycle Network, 626 F.3d 509, 515 (9th Cir. 2010).

105. *Id*. at 516.

106. S. REP. NO. 100-505, at 5 (1988).

107. Xuan-Thao N. Nguyen, *Bankrupting Trademarks*, 37 U.C. DAVIS L. REV. 1267, 1281 (2004).

108. KFC v. Diversified Packaging Corp., 549 F.2d 368, 387 (5th Cir. 1977).

109. Darren W. Saunders, Column, *Should the U.S. Bankruptcy Code Be Amended to Protect Trademark Licensees?*, 94 TRADEMARK REP. 934, 937 (2004).

110. Jelinek, *supra* note 103, at 391–92.

impact on all types of innovation.[111] Further, many businesses, including franchisees, invest substantial resources in reliance on a trademark's goodwill. Not allowing them to use the trademark if the licensor enters bankruptcy could destroy these businesses since they are built around the goodwill associated with the trademarks.[112] Finally, consumers rely on trademarks when making choices about what products to buy, so taking away a licensee's right to use a trademark could make consumers face higher costs in looking for substitute brands.[113]

Finally, not including trademarks under § 365 does not properly balance the policy rationales of bankruptcy and intellectual property law. One of the most fundamental concepts underlying bankruptcy law is to provide the debtor with a "fresh start."[114] Specifically, § 365(a) exists to relieve the debtor from burdensome obligations while it tries to get its finances in order.[115] It is also intended to maximize the value of the debtor's assets.[116] The primary purpose of intellectual property law is to provide protection to people's creations as well as to encourage creativity and technological development.[117] Congress recognized that licensing intellectual property "plays a substantial role in the process of technological development and innovation."[118] Licensing allows the original creator of the right to receive some economic benefit from it while allowing another party to develop and refine the technology.[119]

These interests are not properly balanced if trademarks are not protected under § 365(n). As described above, trademarks are routinely included with other intellectual property rights in an agreement.[120] If a licensee can elect to retain some rights but not trademarks, the debtor is still left with only a trademark right, which will hardly be marketable without the other accompanying rights. This goes against the rationale of maximizing the value of the debtor's assets. On the other side, a licensee no longer has the incentive to fully develop a piece of technology if he cannot retain all of the rights to it, thus going against one of the fundamental reasons for protecting intellectual property.[121]

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111. Giaccio, *supra* note 23, at 108-109.

112. Jelinek, *supra* note 103, at 385.

113. *See* Saunders, *supra* note 109, at 937.

114. Schwab v. Reilly, 130 S. Ct. 2652, 2667 (2010).

115. *In re* Pomona Valley Med. Grp., Inc., 476 F.3d 665, 672 (9th Cir. 2007).

116. *See In re* Rickel Home Centers, Inc., 209 F.3d 291, 298 (3d Cir. 2000).

117. KINNEY AND LANGE, P.A., INTELLECTUAL PROPERTY LAW FOR BUSINESS LAWYERS, § 1:1 (2012 ed.).

118. S. REP. NO. 100-505, at 3 (1988).

119. *Id*.

120. Giaccio, *supra* note 23, at 111 (discussing the common example of software licenses containing both trademark and copyright rights).

121. S. REP. NO. 100-505, at 3 (1988).

B. Possible Solutions

Congress and the judiciary are the two possible avenues to fixing the problem created by § 365(n). The courts could model a solution in two ways. First, they could follow the Bankruptcy Court in *Sunbeam* and use their powers of equity.[122] Indeed, Congress endorsed courts using their powers of equity to develop the law.[123] However, courts have been very reluctant to use their equitable powers with regards to trademark licenses.[124] The one time a court exercised equitable powers, it was overruled on appeal.[125] Thus, this is likely to be the least successful solution. The court could also follow the reasoning of Judge Easterbrook in *Sunbeam* that rejection of a contract does not necessarily result in termination of the licensee's rights.[126] Though not applied to the licensed trademark situation, at least one other appellate court has adopted Judge Easterbrook's argument that rejection "does not make the contract disappear."[127] One commentator has suggested the court could fashion a balancing test, weighing such factors as the burden of the contract on the debtor's estate, whether the debtor would benefit economically from rejection, and whether rejection would do more harm to the licensee than the lack of rejection would do to the licensor.[128]

The other possible avenue for change is for Congress to amend the Bankruptcy Code. There are several variations on how Congress could amend the Code to provide for better treatment of trademark licensees. The simplest solution would be to amend the Code's definition of intellectual property to include trademarks and other state-created intellectual property rights. Some commentators have endorsed this view.[129] Other scholars have suggested amending § 365(n) by giving courts the power to protect trademark licensees on principles of equity.[130] This would involve a congressionally-crafted balancing test similar to the judicial one discussed above.

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122. *In re* Lakewood Eng'g & Mfg. Co., 459 B.R. 306, 345–46 (Bankr. N.D. Ill. 2011), *aff'd sub nom*. Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372 (7th Cir. 2012).

123. S. REP. NO. 100-505, at 5 (1988).

124. Jelinek, *supra* note 103, at 398.

125. Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 377 (7th Cir. 2012).

126. *Id*.

127. Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294, 1306 (11th Cir. 2007) (quoting *In re* Drexel Burnham Lambert Grp., Inc., 138 B.R. 687, 703 (Bankr. S.D.N.Y. 1992)).

128. Jelinek, *supra* note 103, at 404.

129. *See, e.g.*, *id*. at 405.

130. Saunders, *supra* note 109, at 939–40; Giaccio, *supra* note 23, at 123.

CONCLUSION

Lubrizol held that intellectual property licensees could not retain their rights in bankruptcy because rejection of the contract constituted breach with the only remedy being money damages. The business community reacted negatively to the decision, pushing Congress to quickly enact § 365(n) to allow licensees to retain their rights. The amendment, however, did not include trademarks under its protection, leaving the courts to decide whether to include them. Until *Exide,* no court had considered doing so, and it was not until the *Sunbeam* decision in 2012 that a court expressly allowed trademark licensees to retain their rights in bankruptcy. This decision could possibly encourage other courts to come to similar holdings and might even reach the Supreme Court before the issue is finally decided. It is also possible that Congress may decide to step in once again to resolve the matter.

Keith Waters[*]

* University of Alabama School of Law, J.D. Candidate, May 2014; Murray State University, B.A, 2011. I am very thankful to my parents, grandparents, and Courtney Campbell for their love and support.