Trademark Licensing in the Shadow of Bankruptcy

*By James M. Wilton and Andrew G. Devore**

When a business licenses a trademark, transactional lawyers regularly advise that if the trademark licensor files for bankruptcy, the licensee could be left without a right to use the mark and with only a bankruptcy claim for money damages against the licensor. Indeed, the ability of a trademark licensor to reject a trademark license and to limit a licensee's remedies to a dischargeable claim for money damages has been a significant risk for licensees for twenty-five years based on the Fourth Circuit case, Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc. *This result is grounded in the Bankruptcy Code prohibition on remedies of specific performance for non-debtor parties to rejected contracts and is in accord with Bankruptcy Code policy of affording debtors an opportunity to reorganize free of burdensome contracts. In the summer of 2012, however, the Seventh Circuit, in its decision* Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC, *held that a non-debtor trademark licensee retains rights to use licensed trademarks following rejection of the contract by the debtor-licensor. The decision, derived from a pre-Bankruptcy Code paradigm for understanding the rights of non-debtors under rejected executory contracts that convey interests in property, creates a circuit split over the implications of trademark license rejection. This article asserts that the* Sunbeam Products *case misconstrues the rights of a trademark licensee as a vested property right and is therefore incorrect under both the holding of the* Lubrizol *case and the pre-Bankruptcy Code paradigm on which the* Sunbeam Products *case relies.*

In 1985, in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*,[1] the U.S. Court of Appeals for the Fourth Circuit, based on Bankruptcy Code provisions denying rights of specific performance to non-debtor parties to rejected executory contracts, held that a debtor-licensor's rejection and breach of a non-exclusive patent license denied the licensee any right to use the licensed technology. Although the *Lubrizol* court acknowledged that this result was contrary to the rights that a patent licensee would retain under state law in the event of a licensor's breach and "could have a general chilling effect upon the willingness of . . . parties to contract at all with businesses in possible financial difficulty,"[2] the court held that the result was mandated under the Bankruptcy

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1. 756 F.2d 1043 (4th Cir. 1985).
2. *Id.* at 1048.

Code and that only Congress and not the courts could provide licensees with relief.[3]

Soon after *Lubrizol* was decided, Congress responded to the Fourth Circuit's invitation by enacting section 365(n) of the Bankruptcy Code to clarify the rights of debtor-licensors and non-debtor licensees on rejection of certain intellectual property licenses in bankruptcy.[4] The protections that Congress afforded licensees under section 365(n), however, are limited in important respects. In particular, Congress omitted trademarks from the Bankruptcy Code's definition of "intellectual property,"[5] denying trademark licensees statutory protection in the event of license rejection in bankruptcy.

Over the past quarter century, intellectual property licensees have addressed the limitations of section 365(n) and related insolvency risks by various means. Commentators have proposed transaction structures, including use of so-called bankruptcy remote intellectual property holding companies and the grant of security interests, to protect licensees from insolvency risks.[6] In particular cases, licensees have had success litigating to preserve rights to licensed intellectual property in situations where section 365(n) fails to provide protection.[7]

Over the years, commentators have criticized the fundamental holding of the *Lubrizol* case, that exercise of a licensee's rights to use intellectual property following a debtor-licensor's default requires specific performance of an intellectual property license and that Bankruptcy Code provisions and policies, therefore, divest a licensee of intellectual property rights upon rejection of the license.[8] However, the congressional "fix" for the *Lubrizol* problem, section 365(n), provides substantial protection for most licensees in most situations. As a result, until recently, no other federal appellate court has had cause to evaluate whether the fundamental holding of the *Lubrizol* case is correct. This past summer in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*,[9] a case involving a trademark license where section 365(n) provides no statutory protection, the U.S. Court of Appeals for the Seventh Circuit rejected the holding of *Lubrizol*, creating a conflict among the circuits and new arguments for vindication of rights of trademark licensees in bankruptcy.

3. *Id.*

4. Act of October 18, 1988, Pub. L. No. 100-506, § 365(n), 100 Stat. 3115, 3117 (1988) (codified at 11 U.S.C. § 365(n) (2006)).

5. 11 U.S.C. § 101(35A) (2006).

6. *See, e.g.*, Richard M. Cieri & Michelle M. Morgan, *Licensing Intellectual Property and Technology from the Financially-Troubled or Startup Company: Prebankruptcy Strategies to Minimize the Risk in a Licensee's Intellectual Property and Technology Investment*, 55 Bus. Law. 1649, 1690–91 (2000); Stuart M. Riback, *Trademark Issues in Bankruptcy*, 93 Trademark Rep. 867, 889 (2003).

7. *See, e.g.*, *In re* Exide Techs., 607 F.3d 957 (3d Cir. 2010); *In re* Qimonda AG, 462 B.R. 165 (Bankr. E.D. Va. 2011), *cert. granted*, 470 B.R. 374 (E.D. Va. 2012).

8. Douglas G. Baird, The Elements of Bankruptcy 126 n.9 (5th ed. 2010) (criticizing the *Lubrizol* opinion as having "interpreted the power to reject [under section 365] too expansively"); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 59 U. Colo. L. Rev. 845, 932 (1988); James E. Meadows, Lubrizol*: What Will It Mean for the Software Industry?*, 3 Santa Clara Computer & High Tech. L.J. 311 (1987).

9. 686 F.3d 372, 375 (7th Cir. 2012).

Part I of this article reviews the factual background and holding of the *Lubrizol* decision, the underlying structure and policy rationale of the Bankruptcy Code's treatment of executory contracts, and specific exceptions created by Congress to protect rights of non-debtor parties to particular types of contracts in the event of contract rejection. Part I also discusses the limitations on statutory protections for trademark licensees and illustrates how the Bankruptcy Code policy rationale related to rejection of executory contracts applies in two recent cases involving exclusive trademark licenses, *In re Exide Technologies*[10] and *In re Interstate Bakeries Corp.*[11] The Seventh Circuit's *Sunbeam Products* case and the circuit split that has resulted from this case are discussed in Part II. In Part III, the authors discuss the foundations of the *Sunbeam Products* decision in decades-old commentary critical of the concept and treatment of executory contracts in bankruptcy in general and the *Lubrizol* decision, in particular. The authors observe that this commentary fails to take into account important differences between patent and copyright licenses and trademark licenses and conclude that the *Sunbeam Products* case is wrongly decided. Part III also examines the implications of the *Sunbeam Products* case for trademark licenses and other intellectual property licenses. Part IV discusses transaction structures and contract terms that can minimize insolvency risk for licensees in light of *Sunbeam Products* and other recent court decisions.

I. *Lubrizol* and the Rejection of Executory Contracts in Bankruptcy

A. *Lubrizol*

In the seminal case, *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*,[12] the U.S. Court of Appeals for the Fourth Circuit held that, upon rejection of a patent license in bankruptcy, a non-debtor licensee was limited to a bankruptcy claim for money damages and "could not seek to retain its contract rights in the technology by specific performance even if that remedy would ordinarily be available upon breach of this type of contract."[13] In so ruling, the *Lubrizol* court endorsed a view of bankruptcy that permits a Chapter 11 debtor to accomplish what cannot be accomplished under state law—the ability through contract rejection to buy a way out of contractual relationships, limiting non-debtor counterparties to damage claims in bankruptcy.

The *Lubrizol* decision resulted from the Chapter 11 case of Richmond Metal Finishers, Inc. ("RMF"). In July 1982, RMF granted Lubrizol Enterprises, Inc. ("Lubrizol") a non-exclusive license to a patented metal coating process technology.[14] The license provided that Lubrizol would defer use of the technology until May 1983 and, thereafter, would account for sales of products using the technol-

10. 607 F.3d 957 (3d Cir. 2010).
11. 690 F.3d 1069 (8th Cir. 2012).
12. 756 F.2d 1043 (4th Cir. 1985).
13. *Id.* at 1048.
14. *Id.* at 1045.

ogy and pay royalties.[15] RMF filed for Chapter 11 bankruptcy in August 1983.[16] In connection with its plan of reorganization, RMF decided to sell or license its metal coating process technology and concluded that the transaction would be more profitable if Lubrizol could be stripped of its non-exclusive right to use the technology.[17] Accordingly, RMF filed a motion for bankruptcy court approval of RMF's rejection of the license.[18]

The bankruptcy court determined that the Lubrizol license was an executory contract and approved the rejection as advantageous to RMF.[19] Lubrizol, however, appealed to the district court.[20] The district court reversed, finding that the license was not an executory contract and, alternatively, that rejection could not reasonably be expected to benefit RMF because, as a matter of law, rejection of the license would not deprive Lubrizol of its right to use the patented technology.[21]

The U.S. Court of Appeals for the Fourth Circuit reversed the district court, finding that the patent license was executory as a result of outstanding material performance obligations by both contract parties.[22] RMF, the Fourth Circuit found, was obliged under the non-exclusive license to grant Lubrizol "most favored nations" status, notify Lubrizol of other licensing transactions, and reduce Lubrizol's royalty rate if more favorable rates were granted to subsequent licensees.[23] RMF also owed Lubrizol contingent obligations of notice and indemnification in the event infringement claims were asserted by third parties.[24] The Fourth Circuit determined that Lubrizol similarly owed RMF material obligations as a result of confidentiality obligations, royalty reporting requirements, and payments due in connection with sales of products using licensed technology.[25]

The Fourth Circuit also reversed the district court's determination that contract rejection would not benefit RMF, holding that the district court "was under a misapprehension of controlling law in thinking that by rejecting the agreement the debtor could not deprive Lubrizol of all rights to the [patented metal coating] process."[26] The Fourth Circuit noted that, under section 365(g),

15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *In re* Richmond Metal Finishers, Inc., 34 B.R. 521, 525 (Bankr. D. Va. 1983).
20. *In re* Richmond Metal Finishers, Inc., 38 B.R. 341, 341–42 (D. Va. 1984).
21. *Id.* at 344–45.
22. *Lubrizol Enters.*, 756 F.2d at 1048. The *Lubrizol* court applied the familiar Countryman test, determining that a contract is executory 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 the performance would constitute a material breach excusing the performance of the other." *Id.* at 1045 (quotation marks and citation omitted).
23. *Id.* at 1045–46.
24. *Id.*
25. *Id.* at 1046.
26. *Id.* at 1048.

Lubrizol was entitled to treat rejection as a contract breach and could seek a money damages remedy, but could not enforce its contract rights in the technology by specific performance, even if that remedy would otherwise be available under state law.[27] This result, the *Lubrizol* court found, was intended by Congress.[28] The *Lubrizol* court noted, in determining congressional intent, that in other specific sections of the Bankruptcy Code, Congress had afforded remedies equivalent to specific performance for lessees of real property[29] and special treatment to union members under collective bargaining agreements,[30] but had failed to provide similar remedies for licensees of intellectual property.[31]

The *Lubrizol* court acknowledged that contract rejection would have serious adverse effects on non-debtor contract parties such as Lubrizol and that its decision "could have a general chilling effect upon the willingness of such parties to contract at all with businesses in possible financial difficulty."[32] The *Lubrizol* court, however, relied upon the text and legislative history of the Bankruptcy Code and held that these policy concerns and equitable considerations could not be considered by courts in view of clear congressional intent.[33]

B. The Rejection of Executory Contracts in Bankruptcy

Key to the basic structure of Bankruptcy Code section 365 is the concept of an executory contract, a contract with material performance due to some extent on both sides.[34] Executory contracts document active business relationships that may be advantageous or disadvantageous to a Chapter 11 debtor's reorganization. The measure of the advantages of an executory contract flow, in part, from the terms of the contract. In the context of an exclusive or non-exclusive trademark license, for example, a higher royalty rate will be more advantageous for a debtor-licensor than a lower royalty rate. Advantages of an executory contract, however, also result from the identity and relationship of the contract parties; even with a relatively low royalty rate or other disadvantageous contract terms, a license to a well-capitalized licensee that has an experienced, effective sales force and a superior product may benefit a licensor more than a license to a financially distressed licensee with a less established market presence and an inferior product.

27. *Id.*
28. *Id.*
29. *Id.* (citing 11 U.S.C. § 365(h)).
30. *Id.* (citing NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984)).
31. *Id.*
32. *Id.*
33. *Id.* (citing H. Rep. No. 95-595, at 349 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6305, and concluding that "[a]llowing specific performance would obviously undercut the core purpose of rejection under § 365(a), and that consequence cannot therefore be read into congressional intent").
34. S. Rep. No. 95-989, at 58 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5844 ("Though there is no precise definition of what contracts are executory, it generally includes contracts on which performance remains due to some extent on both sides."); H. Rep. No. 95-595, at 347, *reprinted in* 1978 U.S.C.C.A.N. at 6303–04 (same).

Section 365 fosters Chapter 11 reorganizations by allowing a debtor to evaluate and revise its active contractual relationships.[35] Profitable contracts with strong business partners may be assumed and performed by a Chapter 11 debtor. Unprofitable contracts with viable business partners may be renegotiated. Contracts that document dysfunctional contractual relationships or relationships that are out-of-sync with a debtor's reorganization plan may be rejected. Rejection does not constitute rescission of a contract, but instead is treated as a prepetition breach of the contract affording the non-debtor party a claim for money damages.[36]

Significantly, however, the non-debtor party's rights in respect of contract breach under the Bankruptcy Code are curtailed from the rights that would otherwise exist under applicable nonbankruptcy law. The intent of section 365 is that, through rejection in bankruptcy, debtors may escape from unprofitable and dysfunctional contractual relationships.[37] Non-debtor parties to exec-

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35. As the U.S. Supreme Court has noted, "the authority to reject an executory contract is vital to the basic purpose to a Chapter 11 reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization." *Bildisco*, 465 U.S. at 528. The ability of debtors in possession to renegotiate or reject contracts is so important in Chapter 11 reorganizations that Congress in its "considered judgment" granted debtors in possession more latitude in deciding whether to assume or reject contracts than is afforded to Chapter 7 trustees. *Id.* at 529.

36. *See* 11 U.S.C. §§ 365(g), 502(g) (2006). Section 365(g) provides:

> Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—
>
> (1) If such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition; or
>
> (2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title—
>
> (A) if before such rejection the case has not been converted under section 1112, 1208, or 1307 of this title, at the time of such rejection; or
>
> (B) if before such rejection the case has been converted under section 1112, 1208, or 1307 of this title—
>
> (i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or
>
> (ii) at the time of such rejection, if such contract or lease was assumed after such conversion.

Id. § 365(g). Section 502(g) provides:

> (1) A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.
>
> (2) A claim for damages calculated in accordance with section 562 shall be allowed under subsection (a), (b), or (c), or disallowed under subsection (d) or (e), as if such claim had arisen before the date of the filing of the petition.

Id. § 502(g).

37. *Bildisco*, 465 U.S. at 532 ("[T]he filing of the petition in bankruptcy means that the collective bargaining agreement is no longer immediately enforceable, and may never be enforceable again.").

utory contracts are afforded full claims for contract damages for the breach in the same manner as other unsecured creditors.[38] But, except in unusual circumstances, non-debtor parties to executory contracts are not entitled to remedies of specific performance.[39]

Thus, a prepetition contract that is rejected affords the non-debtor party a prepetition claim for money damages that is payable on a pro rata basis with prepetition claims of trade vendors, bondholders, and other creditors. The very broad definition of "claim" under the Bankruptcy Code encompasses all damages under the contract, including any "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, material, immaterial, disputed, undisputed, secured or unsecured."[40] As a claim, contract rejection damages are subject to discharge under a plan of reorganization, effectively freeing reorganized Chapter 11 debtors from disadvantageous contractual relationships.[41]

The Bankruptcy Code protects non-debtor parties to executory contracts by excluding equitable remedies from the Bankruptcy Code's definition of claim, if the contract breach that gives rise to an equitable remedy does not also give rise to a remedy for money damages.[42] The intent of Congress is clear. If a non-debtor party to a rejected contract has a remedy for money damages, the claim will be treated in bankruptcy on an equal basis with other prepetition claims and be subject to discharge. In that case, the non-debtor party will have no alternative remedy for specific performance. By contrast, if a rejected contract provides for specific performance and does not permit a remedy for money damages or if applicable law otherwise excludes an alternative remedy for money damages, then a non-debtor party's equitable remedy for specific performance of the contract will not fall within the definition of a dischargeable claim and will be preserved.[43]

C. Statutory Protections for Non-Debtor Parties to Executory Contracts Other than Intellectual Property Licenses

The *Lubrizol* court found support for its conclusion that, as a general rule, non-debtor parties to executory contracts are not entitled to remedies of specific

38. *Id.* at 530 (citing 11 U.S.C. § 365(g)(1)).

39. *Lubrizol Enters.*, 756 F.2d at 1048.

40. 11 U.S.C. § 101(5)(B) (2006).

41. *See* 11 U.S.C. § 1141(c), (d) (2006 & Supp. 2011).

42. *See* Ohio v. Kovacs, 469 U.S. 274, 280 (1985) ("For example, in some States, a judgment for specific performance may be satisfied by an alternative right to payment in the event performance is refused; in that event, the creditor entitled to specific performance would have a 'claim' for purposes of a proceeding under title 11.").

43. *See, e.g.*, *In re* Nickels Midway Pier, LLC, 255 F. App'x 633, 637–38 (3d Cir. 2007) (holding a right to specific performance is not discharged only if granting monetary damages is not a "viable alternative").

performance based on Bankruptcy Code exceptions that prove the rule.[44] Even before enactment of the Bankruptcy Code in 1978, Congress provided statutory protections for non-debtor parties to real estate leases.[45] The Bankruptcy Code provides a range of protections related to contract rejection for non-debtor parties to certain executory contracts, including real estate leases, real estate sale contracts, collective bargaining agreements, and, under section 365(n), licenses of intellectual property.[46] In some cases, the Bankruptcy Code permits non-debtor parties to rejected contracts to exercise remedies of specific performance, but also requires that the debtor likewise benefit from the non-debtor's exercise of rights notwithstanding the debtor's rejection and non-performance of the contract.[47] In other cases, statutory protections vest discretion in the bankruptcy courts to protect non-debtors by modifying procedural rights and substantive standards related to the process of contract rejection.[48] In still other cases, non-debtors must forgo claims against the estate for breach of contract as a condition to the right to specific performance of the contract.[49] In all cases, the remedies available for non-debtor parties are modified from protections available under applicable nonbankruptcy law or are balanced by provisions that grant the debtor rights not available outside of bankruptcy.

1. Protections for Non-Debtor Tenants Under Leases of Real Property (§ 365(h)(1))

The current version of section 365(h)(1) reflects Congress's long history of protecting tenants in a lessor's bankruptcy.[50] Section 365(h)(1) provides a

44. *See* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) (citing to the "special treatment" accorded to union members under collective bargaining contracts and lessees of real property and noting that "no comparable special treatment is provided for technology licensees").

45. The basic concept of executory contracts, the status of real estate leases as executory contracts subject to rejection, and statutory protections for tenants of real estate leases in the event of lease rejection predate the Bankruptcy Code by many years. Indeed, the concept of executory contracts has been traced to the English case, *Copeland v. Stephens*, decided in 1818. *See* Andrew, *supra* note 8, at 856 n.56 (citing Copeland v. Stephens, 106 Eng. Rep. 218 (K.B. 1818)). Section 70b of the Chandler Act, enacted in 1938, governing rejection of executory contracts by trustees in bankruptcy provides:

> The rejection of a real estate lease or of any covenant therein by the trustee of a lessor shall not deprive the lessee of his estate, unless the lease shall expressly provide otherwise.

Jacob I. Weinstein, The Bankruptcy Law of 1938, Chandler Act 159 (Nat'l Ass'n of Credit Men ed., 1938).

46. *See infra* Parts I.C.1–I.C.5.

47. *See, e.g.*, 11 U.S.C. § 365(n)(2)(B), (C) (2006) (providing that if a licensee of intellectual property elects to retain rights following rejection of a license, the licensee must continue to make all royalty payments due under the license for the duration of the license and is deemed to waive any right of setoff that it might have under the Bankruptcy Code or applicable nonbankruptcy law based on the licensor's non-performance).

48. *See, e.g.*, *id.* § 1113 (providing procedural and substantive protections for non-debtor parties to collective bargaining agreements).

49. *See, e.g.*, *id.* § 365(h) (affording tenants rights to continue to use leased premises following lease rejection, but limiting rejection damage claims to a right of setoff against rent).

50. *See* S. Rep. No. 95-989, at 60 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5846 ("Thus, the tenant will not be deprived of his estate for the term for which he bargained."); *see also In re* Taylor,

non-debtor tenant under a rejected lease with the option of either retaining its rights under the lease or treating the lease as terminated.[51] The rights that the tenant is entitled to retain are limited to rights "in or appurtenant to the real property," such as the use, possession, and quiet enjoyment of the premises.[52] If a non-debtor tenant elects to retain its rights under the rejected lease, the debtor-lessor is nevertheless relieved of its ancillary obligations under the lease, such as obligations to provide heating, cooling, tenant improvements, and other services. As the U.S. Court of Appeals for the Seventh Circuit has stated:

> In this way, the statute strikes a balance between the respective rights of the debtor-lessor and its tenant: the lessee retains the right to possess the property for the remainder of the term it bargained for, while the rejection frees the debtor/lessor of other burdensome obligations that it assumed under the lease (as, for example, the duty to provide services to the lessee).[53]

Section 365(h)(1)(B) also alters the remedies that are available to a tenant that elects to retain its rights under a rejected lease. Specifically, the statute provides that a lessee electing to remain in possession may offset any damages caused by the debtor's non-performance after the date of rejection against any rent that is to be paid for the balance of the lease term.[54] However, the statute provides that such offset is the exclusive remedy for the lessor's non-performance following the rejection date.[55] Accordingly, the tenant remaining in possession cannot assert any claim against the estate if the rejection damages claim exceeds the amount of remaining rent payments.

2. Protections for Non-Debtor Tenants Under Leases of Real Property in Shopping Centers (§ 365(h)(1)(C))

The Bankruptcy Code provides further protections for tenants in shopping centers. An important protection for tenants in many shopping center leases is a provision restricting the landlord from leasing other space to competitors with similar lines of business. For example, a tenant operating a shoe store in a mall may negotiate a radius restriction prohibiting the mall from leasing space to another shoe store within a certain distance from the tenant's store location. Section 365(h)(1)(C) permits continued enforcement of these negotiated provisions by providing that if, following rejection of a shopping center lease, a tenant elects under section 365(h) to retain its rights, any lease provisions "pertaining to radius, location, use, exclusivity, or tenant mix or balance" remain enforceable.[56] These additional protections for shopping center tenants

198 B.R. 142, 165–66 (Bankr. D.S.C. 1996) (tracing the history of section 365(h) to its predecessor, section 70(b) of the Bankruptcy Act).

51. 11 U.S.C. § 365(h) (2006).
52. *Id.* § 365(h)(1)(A)(ii).
53. Precision Indus., Inc. v. Qualitech Steel SBQ, LLC, 327 F.3d 537, 546 (7th Cir. 2003).
54. 11 U.S.C. § 365(h)(1)(B).
55. *Id.*
56. 11 U.S.C. § 365(h)(1)(C).

reflect a statutory exception to the general bar on remedies of specific performance following contract rejection.

3. Protections for Non-Debtor Buyers of Timeshare Interests (§ 365(h)(2))

Prior to 1984, owners of timeshare interests were not explicitly protected by section 365(h). In the 1982 case of *In re Sombrero Reef Club, Inc.*, the debtor owned a resort-marina complex in the Florida Keys and sought to reject approximately 200 timeshare purchase agreements under which the purchasers had the right to use the chosen type of accommodation for one week per year for thirty years.[57] The court in *Sombrero Reef* noted that the timeshare agreements did not relate to any particular unit and were available to the timeshare user on an "as available reservation basis" and refused to consider the timeshare as a real estate lease (section 365(h)) or a contract for the sale of real property (section 365(i)).[58] The *Sombrero Reef* court found that the timeshare agreements were executory,[59] held that the timeshare purchasers had no heightened protection under section 365, and, accordingly, ruled that the timeshare purchasers were entitled only to a prepetition rejection damages claim.[60]

In response to the decision in *Sombrero Reef*,[61] in 1986 Congress extended the protections for tenants under section 365(h) to owners of timeshare interests,[62] which are now set forth separately in section 365(h)(2). Specifically, if a timeshare interest is rejected, the purchaser of the timeshare interest can either (i) treat the timeshare interest as terminated, or (ii) retain its rights in the timeshare interest, in which case the only remedy for the debtor's non-performance after the rejection is the ability to offset the contract rejection damages claim against any amounts still owed to the debtor.[63]

4. Protections for Non-Debtor Buyers of Real Property (§§ 365(i), (j))

Statutory protections for non-debtor parties to real estate purchase agreements (such as installment purchase contracts) rejected in bankruptcy trace back to the 1956 case of *In re New York Investors Mutual Group, Inc.*[64] The court in the *New*

57. 18 B.R. 612, 614 (Bankr. S.D. Fla. 1982).

58. *Id.* at 618–19.

59. *See id.* at 616 ("[S]ubstantial obligations remain to be performed on both sides. The debtor-in-possession must maintain the property and provide accommodations and services . . . [and] the buyers obligated themselves to pay these annual fees whether or not they utilized the accommodations." (citation omitted)).

60. *Id.* at 620.

61. *See* S. REP. NO. 98-65, at 50 (1983) (describing the protection of timeshare interests as "urgently needed").

62. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 283(e), 98 Stat. 361, 367 (1984) (codified at 11 U.S.C. § 365(h) (2006)).

63. 11 U.S.C. § 365(h)(2) (2006).

64. 143 F. Supp. 51 (S.D.N.Y. 1956); *see also* Frank R. Lacy, *Land Sale Contracts in Bankruptcy*, 21 UCLA L. REV. 477, 480 (1973).

York Investors case addressed whether a non-debtor purchaser under a real estate sales contract has the right to compel specific performance of the contract against the bankruptcy trustee.[65] The non-debtor purchaser contended that, under New York law, it was the equitable owner of the property and entitled to specific performance of the contract.[66] The court held that the purchaser did not have the right to specific performance because any equitable rights the purchaser may have acquired under state law were "subject to the right of the trustee to reject or assume executory contracts."[67] As a result, the trustee was free to divest itself of the burdensome contract and the purchaser was limited to a claim for damages.[68]

In the absence of statutory protections for purchasers of real estate, Congress enacted section 365(i) of the Bankruptcy Code in 1984.[69] Section 365(i) tracks the protections afforded to lessees of real estate contained in section 365(h)(1), providing that the purchaser under a real property sales contract that is rejected by the debtor-seller may, if the purchaser is in possession, either treat the contract as terminated or remain in possession of the property.[70] If the purchaser elects to remain in possession, the purchaser's damages claim is limited to offsetting any rejection damages against the amount the purchaser still owes to the debtor-seller,[71] and the debtor-seller is required to deliver title to the purchaser in accordance with the terms of the contract.[72] If, however, the purchaser is not in possession or elects to treat the contract as terminated, there is no statutory limit on the prepetition rejection damages claim that may be asserted.

Under section 365(j), a purchaser that treats a contract as terminated under section 365(i) or that is not in possession of the real property and whose contract is rejected has a lien on the debtor's interest in the property to recover any amount of the purchase price that has been paid.[73] The statute follows a holding of the *New York Investors* court acknowledging that an earnest money deposit is secured by a lien granted to the purchaser in the asset purchase agreement and recorded in the registry of deeds.[74] But the statute expands upon this holding by granting a lien to secure money deposited with the debtor whether or not provided for by contract.[75]

65. *New York Investors*, 143 F. Supp. at 54 ("Stripped to its essentials, the question as I see it is: does a vendee under a contract for the purchase of real property who has made a payment on account of the purchase price to the vendor, who before delivery of the deed is declared a bankrupt, have the right to compel specific performance against the vendor's trustee—or to cast it in different terms, is the vendee's right as an equitable owner of the property superior to the right of a trustee under § 70, sub. b to reject.").

66. *Id.* at 53.

67. *Id.* at 54 ("Section 70, sub. b [of the Bankruptcy Act] is all-embracing and makes no distinction between contracts for personalty and those for the sale and purchase of realty but grants power to the trustee to assume or reject any executory contract . . . ." (internal quotation marks omitted)).

68. *Id.*

69. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 92 Stat. 2574 (1984) (codified at 11 U.S.C. § 365(i) (2006)).

70. 11 U.S.C. § 365(i)(1) (2006).

71. *Id.* § 365(i)(2)(A).

72. *Id.* § 365(i)(2)(B).

73. *Id.* § 365(j).

74. *New York Investors*, 143 F. Supp. at 54.

75. 11 U.S.C. § 365(j) (2006).

5. Protection for Employees Under Collective Bargaining Agreements (§ 1113)

Congress enacted section 1113 in response to a Supreme Court decision permitting rejection of collective bargaining agreements. In *NLRB v. Bildisco & Bildisco*,[76] the Supreme Court held that a Chapter 11 debtor could reject a collective bargaining agreement and that it would not be an unfair labor practice under the National Labor Relations Act for the debtor to modify or terminate unilaterally one or more provisions of the agreement *before* rejection is approved by the bankruptcy court.[77] In response to *NLRB v. Bildisco & Bildisco*, Congress enacted section 1113 as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984.[78]

Section 1113 sets forth exclusive procedures and standards for rejecting collective bargaining agreements. Under section 1113, a debtor must continue to abide by its collective bargaining agreement until the bankruptcy court approves rejection or modifications.[79] In order to file a motion to reject a collective bargaining agreement, a debtor must first make a proposal to the authorized representative of the employees that provides for necessary modifications to permit the reorganization of the debtor and that ensures all affected parties "are treated fairly and equitably."[80] Section 1113(b)(2) then requires the debtor to continue to meet with the authorized representative to confer in good faith to try to reach mutually acceptable modifications to the agreement.[81] If these negotiations fail, the bankruptcy court may approve the rejection only if (i) the debtor made a proposal that met the requirements of section 1113(b)(1)(A), (ii) the proposal was rejected "without good cause," and (iii) the balance of the equities "clearly favors rejection."[82]

D. Statutory Protections for Non-Debtor Licensees of Intellectual Property (§ 365(n))

The foregoing statutory protection for non-debtor parties, including remedies of specific performance under certain circumstances, supported the *Lubrizol* court's conclusion that non-debtor parties are generally not entitled to remedies of specific performance upon contract rejection.[83] After the *Lubrizol* case was decided, Congress responded to protect licensees of intellectual property from adverse consequences of license rejection in bankruptcy. The response, however, was not to change the Bankruptcy Code's general approach to executory contracts or the remedies generally available in bankruptcy to non-debtor parties

76. 465 U.S. 513 (1984).
77. *Id.* at 516–17.
78. Pub. L. No. 98-353, § 541, 98 Stat. 333, 390–91 (1984) (to be codified at 11 U.S.C. § 1113 (2006)).
79. 11 U.S.C. § 1113(f) (2006).
80. *Id.* § 1113(b)(1).
81. *Id.* § 1113(b)(2).
82. *Id.* § 1113(c).
83. Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985).

of rejected executory contracts.[84] Rather, as it had previously done with other specific types of executory contracts, Congress created a statutory exception for intellectual property licenses to ameliorate the harsh effects of contract rejection for non-debtor licensees while preserving Bankruptcy Code policy favoring reorganization of businesses.

Congress enacted section 365(n) in 1988.[85] The statute protects the rights of licensees of intellectual property "in a manner that parallels generally the treatment of real estate leases in the existing provisions of Section 365(h)(1)."[86] In enacting the new statute, however, Congress went beyond the scope of section 365(h)(1) to provide additional protections for debtor-licensors in the event of rejection of intellectual property licenses. Section 365(n) represents a "careful compromise between the needs of the debtor and the licensee."[87] Like section 365(h), section 365(n) grants an election to non-debtor licensees of intellectual property in the event a license is rejected by a debtor-licensor.[88] Licensees may elect either (i) to treat the license as terminated by the rejection, or (ii) to retain rights to intellectual property, including rights to enforce exclusivity provisions of the license as such rights existed immediately before the bankruptcy case commenced for the duration of the license and any optional extension periods in favor of the licensee.[89] But because "[t]he debtor's ability to reorganize may de-

84. Over the years, commentators have called for radical reform of the treatment of prepetition contracts in bankruptcy. For example, in 1997, the National Bankruptcy Review Commission called for abolition of even the concept of executory contract. *See* Jay Lawrence Westbrook, *The Commission's Recommendations Concerning the Treatment of Bankruptcy Contracts*, 5 AM. BANKR. L. REV. 463, 465–70 (1997). Despite substantial revisions to the Bankruptcy Code in 2005, including amendments to section 365, Congress has not made any meaningful change to the Bankruptcy Code's approach to prepetition contracts.

85. Act of October 18, 1988, Pub. L. No. 100-506, § 365(n) 100 Stat. 3115, 3117 (1988) (codified at 11 U.S.C. § 365(n) (2006)).

86. S. REP. NO. 100-505, at 4 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3203.

87. *Id.* at 10.

88. 11 U.S.C. § 365(n) (2006).

89. *Id.* § 356(n)(1). Section 365(n)(1) provides:

> 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
>
> (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.

Id.

pend upon preservation of the royalty payments called for under the contract,"[90] in exchange for electing to retain its rights under section 365(n), the licensee is obligated to continue to make all royalty payments to the licensor for the term of the license.[91] The licensee is deemed to waive any right of setoff with respect to royalties due to the licensor or any right to an administrative claim under section 503(b). As a result, a debtor-licensor is entitled to continue to collect royalties notwithstanding the debtor-licensor's breach and non-performance of the rejected license.

In the event of the licensee's election to retain intellectual property rights, section 365(n) also provides that the non-debtor licensee may compel the debtor-licensor to specifically perform certain contractual obligations.[92] A licensee is entitled to enforce certain negative covenants that require no action on the part of the debtor-licensor. Specifically, if a licensee elects to retain intellectual property rights under section 365(n), the licensee is entitled to use the underlying intellectual property and to enforce the debtor-licensor's covenant not to sue for infringement.[93] The licensee is also entitled to obtain judicial relief to specifically enforce exclusivity rights granted to the licensee under the license.[94]

The text of section 365(n) makes clear that Congress intended, in the event of a section 365(n) election, that the specific enforcement of exclusivity provisions

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90. S. Rep. No. 100-505, at 4, *reprinted in* 1988 U.S.C.C.A.N. at 3207.

91. 11 U.S.C. § 365(n)(2). Section 365(n)(2) provides:

> 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.

Id.

92. *Id.* § 365(n)(3). Section 365(n)(3) provides:

> 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.

Id.

93. *Id.* § 365(n)(3)(A), (B).

94. S. Rep. No. 100-505, at 9–10, *reprinted in* 1988 U.S.C.C.A.N. at 3206 ("To this extent, the licensee is given the right to compel specific performance, i.e., to enjoin the licensing to another of rights granted by the contract to the licensee.").

of a license would be an exception to general provisions of the Bankruptcy Code barring specific performance remedies. Section 365(n)(1)(B) states that rights retained pursuant to a licensee's section 365(n) election include "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."[95] Enforcement of exclusivity provisions of a license are, therefore, expressly a "right under applicable nonbankruptcy law to specific performance" that would be unenforceable in bankruptcy absent the exception created under section 365(n).

Section 365(n) also permits the licensee to specifically enforce a limited set of affirmative contractual covenants. In the event of a section 365(n) election and to the extent provided in the license or any agreement supplementary to the license, a bankruptcy trustee must provide access to intellectual property or embodiments of intellectual property held by the debtor-licensor.[96] Permitting enforcement of agreements "supplementary to" a license is intended to address agreements, such as software source code escrow arrangements, that are supplementary to rights under a license.[97] Section 365(n) also permits specific enforcement of rights to "embodiments" of intellectual property, such as prototypes of a patented invention, computer source codes, or patented genetic material.[98] In this way, section 365(n) grants remedies of specific performance that would not ordinarily be available to a non-debtor licensee in the event of a license rejection.

In short, section 365(n) balances the interests of debtor-licensors and non-debtor licensees. Contrary to provisions of the Bankruptcy Code generally applicable to executory contracts, intellectual property licensees are entitled under section 365(n) to elect specific performance of provisions of licenses granting rights to use intellectual property, to exclude others from use of intellectual property, to access "embodiments" of intellectual property, and to enforce certain "supplemental agreements" affording rights of access to licensed technology. In exchange, non-debtor licensees making a section 365(n) election must continue to pay royalties, without any right to effect a setoff or to make an administrative claim with respect to damages from the contract rejection.

95. 11 U.S.C. § 365(n)(1)(B) (emphasis added).

96. *Id.* § 365(n)(3).

97. *See* S. Rep. No. 100-505, at 9, *reprinted in* 1988 U.S.C.C.A.N. at 3206 ("It is not unusual for the licensing arrangements to involve parties other than the licensor and licensee. For instance, the licensor may have contracted to supply the licensee with a product incorporating the licensed intellectual property and may have agreed that the licensee would only have access to information necessary to produce the licensed intellectual property in the event of the licensor's inability or unwillingness to supply the licensee. To assure the licensee of access to such secret information at the defined time, the licensor may have agreed to turn over such information to a third party to be held in escrow until the triggering event. The third-party escrow agent would be a party to such an agreement, and the agreement would be set forth in a document separate from the basic license. Section 365(n)(1)(B), thus, speaks of the retention by the licensee of rights to the intellectual property under 'any agreement supplementary to such contract.' The licensee retains both the rights set forth in the rejected license itself and any agreement supplementary thereto, whether the supplementary agreement was itself the subject of a rejection by the trustee.").

98. The Senate Report clarifies that "there are many possible examples of embodiments" and that the right of access to embodiments of intellectual property depends on specific performance of prepetition contract rights. *Id.* at 10.

E. THE LIMITATIONS OF SECTION 365(N)

Congress intentionally excluded trademarks from the Bankruptcy Code definition of "intellectual property" and the protections of section 365(n) for the reasons discussed below.[99] Absent statutory protection, trademark licensees have attempted, with some success, to avoid the loss of use of licensed trademarks under the holding of the *Lubrizol* case by arguing that trademark licenses in particular cases are not executory contracts subject to rejection in bankruptcy.

1. Reasons for the Omission of Trademarks from the Scope of Section 365(n)

Non-debtor licensees of trademarks have no protections under section 365(n). The definition of "intellectual property" under the Bankruptcy Code does not include trademarks.[100] The omission was intentional.[101] Section 365(n) was intended to protect and facilitate licensing as a means of fostering technological

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99. In addition to trademark licenses, there are other gaps in statutory protections for licensees of intellectual property. Section 365(n), as a law of the United States, is not generally applicable if a licensor is organized and located, and files for bankruptcy, in a non-U.S. jurisdiction. *But see In re* Qimonda AG, 462 B.R. 165, 185 (Bankr. E.D. Va. 2011) (failure to make section 365(n) applicable in Chapter 15 proceeding is "manifestly contrary to U.S. public policy" where licensor is in bankruptcy in Germany and German law would allow cancellation of U.S. patent licenses). Another potential gap in section 365(n) protection for licensees results from the fact that the Bankruptcy Code defines intellectual property with reference to the United States Code. *See generally* Edo Royker, *Foreign Patents Under U.S. Bankruptcy Code Section 365(n)*, 27 EMORY BANKR. DEV. J. 497 (2010). For example, the Bankruptcy Code defines a patent as an "invention, process, design or plant protected under title 35," 11 U.S.C. § 101(35A)(B) (2006), and a copyright as a "work of authorship protected under title 17," *id.* § 101(35A)(E). Does the reference to U.S. law mean that licensees under worldwide patent or copyright licenses have protection under section 365(n) only in the United States? Or do international treaties that have the force of law in the United States (and are effectively incorporated into the protections codified in titles 35 and 17 of the United States Code) afford protection for licensees under territorial licenses that include non-U.S. jurisdictions? *See, e.g.*, Berne Convention Implementation Act of 1988, § 3(a), 102 Stat. 2853 (1988) ("The provisions of the Berne Convention—(1) shall be given effect under title 17, as amended by this Act . . . ; and (2) shall not be enforceable in any action brought pursuant to the provisions of the Berne Convention itself."). A discussion of the application of section 365(n) to licenses of patents and copyrights in foreign jurisdictions, however, is beyond the scope of this article.

100. Intellectual property is defined as:

(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 non-bankruptcy law.

11 U.S.C. § 101(35A) (2006); *see also* Sunbeam Prods., Inc. v. Chi. Am. Mfg., Inc., 686 F.3d 372, 375 (7th Cir.) (acknowledging omission of "trademarks" from 11 U.S.C. § 101(35A)), *cert. denied*, 133 S. Ct. 790 (2012); *In re* Exide Techs., 607 F.3d 957, 966 (3d Cir. 2010) (Ambro, J., concurring) (same); *In re* Dynamic Tooling Sys., Inc., 349 B.R. 847, 856 (Bankr. D. Kan. 2006) (same); *In re* HQ Global Holdings, Inc., 290 B.R. 507, 512–13 (Bankr. D. Del. 2003) (same).

101. *See* S. REP. NO. 100-505, at 5–6 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3204 ("[T]he bill does not address the rejection of executory trademark, trade name or service mark licenses by debtor-licensors.").

innovation and development.[102] Patents, copyrights, and trade secrets are all categories of intellectual property related to innovation, technological development, and the expression of ideas. Trademarks are not.[103]

In addition, while patent and copyright licenses grant rights to categories of property created under federal law, trademark licenses do not.[104] Trademark licenses document and regulate the relationship and connection between the trademark as symbol for a business or product and the business or product that is symbolized. As the author of a major treatise on trademarks has noted: "Goodwill and its trademark symbol are as inseparable as Siamese twins who cannot be separated without death to both."[105] For example, the owner of a trademark for hotels or restaurants might enter into franchise agreements conveying non-exclusive licenses for use of a trademark in various locations with many different franchisees.[106] The license agreement regulates the relationship, allowing the trademark owner to set uniform standards of quality and appearance that preserve the value of the trademark. The license agreement may also provide for procedures and use requirements that govern and permit the evolution and modernization of the trademark.[107]

In all cases, a trademark licensor retains ownership of the trademark and the *sine qua non* of ownership is control of products or services bearing the mark. A trademark owner not only has a right to control the quality of trademarked goods and services sold under a license, but the owner has an affirmative duty

102. *Id.* at 3, *reprinted in* 1988 U.S.C.C.A.N. at 3202.

103. *See* Qualitex Co. v. Jacobson Prods. Co., 514 U.S. 159, 164 (1995) ("It is the province of patent law, not trademark law, to encourage innovation by granting inventions a monopoly over new patent designs or functions for a limited time . . . ."); Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 439 n.19 (1984) ("We have consistently rejected the proposition that a . . . kinship exists between copyright law and trademark law, and in the process of doing so have recognized the basic similarity between copyrights and patents.").

104. Trademark protection is historically a creature of state law, unlike patents and copyrights that originate under the U.S. Constitution. *See* U.S. CONST. art. I, § 8, cl. 8 (empowering Congress "[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries"); *see also* J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 5:3, at 5-10 to -12 (4th ed. 2012) (tracing the history of federal trademark legislation). By contrast, the power of the federal government to provide for trademark registration arises only under the Commerce Clause. *See id.* The federal Lanham Act regulating trademarks was not enacted until 1946. Trademark Act of 1946 ("Lanham Act"), Pub. L. No. 79-489, 60 Stat. 427 (1946) (codified at 15 U.S.C. § 1051 (2006)).

105. MCCARTHY, *supra* note 104, § 18:2, at 18-6.

106. Complex licensing relationships among multiple parties may also be documented as exclusive licenses. A trademark owner for a consumer brand of mustard or relish may enter into various exclusive product licenses that divide the market into different geographical regions with different licensees for different types of products. For example, the trademark owner might license the trademark in different geographical markets with different licensees for use with plastic single serving packets, retail-sized bottles for sale to consumers, and large institutional-sized containers for sale to restaurants and food service businesses. As with franchise arrangements or other non-exclusive licenses, exclusive license agreements allow coordination of the quality of the brand and consistency of the use of the trademark among multiple parties in different markets.

107. *See* MCCARTHY, *supra* note 104, § 17:28, at 17-73 to -77 (illustrating the evolution of trademarks for Beech-Nut Tobacco, Quaker Oats, Prudential's Rock of Gibraltar, and the IBM logo).

to do so.[108] Control of quality refers to the consistency and predictability of a product or service, simply that the product or service is held to a "standard of quality—good, bad or otherwise."[109] Equating quality control with ownership is rooted in consumer protection; a trademarked product or service is not "genuine" unless it is manufactured and distributed under quality control standards established and enforced by the trademark owner.[110] Because consumer protection is the objective of quality control, the extent of the control that is required varies in accordance with consumer expectations for the trademarked product or service.[111] For example, it is likely that greater product quality control would be required for a brand name pharmaceutical product than for a t-shirt bearing the trademark logo of a popular sports team.

A trademark licensee's status as a licensee depends upon a licensor's active control of the quality of products or services. Under the Lanham Act, a "related company," such as a licensee whose right to use a trademark is granted by the trademark owner, is defined as "any person whose use of a mark is controlled by the owner of the mark with respect to the nature and quality of the goods or services on or in connection with which the mark is used."[112]

Goodwill generated by a licensee's use of a trademark inures to the benefit of the licensor as trademark owner,[113] and a licensee has no right to use a trademark independent of a licensor's quality control. Under the doctrine of trademark merger, even if a licensee originally had an independent right to use a trademark, such right is lost upon entry into the license. For example, if Party A and Party B dispute ownership of a common law trademark and the dispute is resolved by Party B accepting a license from Party A, upon expiration of the license, Party B can no longer rely upon its prior independent use of the trademark as defense to an infringement claim. Party B's rights are limited to the scope of the license.[114] Because quality control is necessary for a license, a licensee's manufacture and sale of products that fail to meet quality standards constitute trademark infringement as well as breach of contract.[115] The duty to maintain quality control is so important that an ex-licensee may become an infringer of a trademark precisely because a licensor

108. *See id.* § 18:42, at 18-91; *see also* Siegel v. Chicken Delight, Inc., 448 F.2d 43, 51 (9th Cir. 1971) ("The licensor owes an affirmative duty to the public to assure that in the hands of his licensee the trademark continues to represent that which it purports to represent.").

109. Barcamerica Int'l USA Trust v. Tyfield Importers, Inc., 289 F.3d 589, 598 (9th Cir. 2002).

110. *See* McCarthy, *supra* note 104, § 18:55, at 18-122.9 to -122.10; Taco Cabana Int'l, Inc. v. Two Pesos, Inc., 932 F.2d 1113, 1121 (5th Cir. 1991) ("The purpose of the quality-control requirement is to prevent the public deception that would ensue from variant quality standards under the same mark or dress."), *aff'd*, 505 U.S. 763 (1992).

111. *See* McCarthy, *supra* note 104, § 18:38, at 18-83.

112. Lanham Act § 45, 15 U.S.C. § 1127 (2006).

113. *See* Lanham Act § 5, 15 U.S.C. § 1055 (2006).

114. *See* McCarthy, *supra* note 104, § 18:41, at 18-89.

115. *See id.* § 18:42, at 18-94.

is no longer able to exercise quality control as a result of the termination of a license relationship.[116]

In enacting section 365(n), Congress recognized that trademarks differ from patents and copyrights because a trademark license documents a relationship in which a licensor must maintain quality control of products and services sold by a licensee.[117] As a result, Congress excluded trademark licenses from protections under the statute. Although the report of the Senate Judiciary Committee expressed concern about the effect of contract rejection on non-debtor trademark licensees, the report concluded that "[s]ince these matters could not be addressed without more extensive study, it was determined to postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts."[118]

Although not discussed in the legislative history of section 365(n), trademark licenses differ from patent and copyright licenses in another important respect. Patents and copyrights are property rights of limited duration. Trademarks, by contrast, derive from use in the marketplace, evolve over time, and are of potentially unlimited duration. As a result, it is not uncommon for trademark licenses to continue for many years. The long-term nature of many trademark licenses means that the contracts cannot readily be amended or modified in anticipation of contract renewal. Perpetual or long-term trademark licenses can, therefore, impose significant constraints on a licensor in ways that can impair the licensor's survival as business circumstances change over time. For example, a trademark licensor in 1950 may have granted a licensee an exclusive right to manufacture, use, and sell trademarked products in Asia. In 1950, Asian markets would, perhaps, have constituted a small market for products that were, at the time, manufactured only in the United States. Sixty years later, the grant to the licensee of exclusive rights to manufacture in Asia, if specifically enforced, would prevent the licensor from manufacturing in China or India for import to the United States. If exclusivity provisions of trademark licenses were specifically enforceable under section 365(n) following rejection of the license, the debtor/licensor might well be unable to reorganize in competition with businesses able to engage lower cost Asian manufacturers. Although similar issues may arise under exclusive patent licenses, the relatively short duration of patent

116. Gorstein Enters., Inc. v. Quality Care-USA, Inc., 874 F.2d 431, 435 (7th Cir. 1989) ("If the owner of the trademark has broken off business relations with a licensee he cannot ensure the continued quality of the (ex-)licensee's operation, whose continued use of the trademark is therefore a violation of trademark law." (citations omitted)); *see also* Dawn Donut Co. v. Hart's Food Stores, Inc., 267 F.2d 358, 366 (2d Cir. 1959) ("[T]he Lanham Act places an affirmative duty upon a licensor of a registered trademark to take reasonable measures to detect and prevent misleading uses of his mark by his licensees or suffer cancellation of his federal registration.").

117. *See* S. Rep. No. 100-505, at 5–6 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3204 (noting that trademark licenses "raise issues beyond the scope of this legislation" because these "licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee").

118. *Id.*

licenses makes a licensee's retention of exclusivity rights under section 365(n) less problematic.

2. Rejection of Trademark Licenses in Bankruptcy: *Exide Technologies* and *Interstate Bakeries*

Since the enactment of section 365(n), the effect of trademark license rejection has been litigated, most prominently in the context of licenses granted in connection with the sale or spin-off of a product line or business unit of the licensor. In this context, a trademark license is often a prepaid, perpetual license that is exclusive for particular products or for a particular geographic location.[119] Because these licenses are granted in connection with consummated asset acquisitions, licensees have argued that the licenses are fully performed and not executory contracts subject to rejection in bankruptcy. As a fully performed contract, a license would not be an executory contract subject to rejection and the licensee would be entitled to continue to use the licensed trademark.[120]

In *In re Exide Technologies*,[121] the debtor sold its industrial battery business to EnerSys Delaware, Inc. ("EnerSys").[122] As part of the sale, the debtor granted EnerSys a perpetual, exclusive, royalty-free license to use the Exide trademark in the industrial battery business.[123] Ten years later, the debtor filed for bankruptcy and sought to reject the trademark license so that it could regain the Exide trademark for use in the industrial battery business.[124] The bankruptcy court and district court both held that the agreement was executory and that, by rejection, EnerSys's rights to the trademark were terminated.[125] On appeal, the U.S. Court of Appeals for the Third Circuit reversed, holding that the asset purchase agreement and the license were an integrated contract and that the contract was no longer executory because EnerSys had substantially performed by paying the $135 million purchase price under the asset purchase agreement.[126] The *Exide*

119. Prepaid licenses, of course, generate no ongoing benefit to a debtor-licensor's bankruptcy estate and, if constituting executory contracts, would normally be rejected and not assumed.

120. The most widely recognized test for determining whether a contract is an executory contract is the Countryman test. *See supra* note 22. Under this test, obligations such as a licensor's duty to maintain trademark quality and consistency, and a licensee's corresponding contractual obligation to conform use of a trademark to the licensor's standards, are consistent with a contract not being an executory contract—if breach of the obligations would not permit termination of the license. Although the licensee under a non-executory license would continue to be responsible to the licensor for quality control and consistency of the product sufficient to maintain the trademark, non-performance of these covenants would not constitute a material default resulting in loss of the license. Rather, a licensee's obligation to maintain quality would be enforceable by equitable remedies of specific performance.

121. 607 F.3d 957 (3d Cir. 2010).

122. *Id.* at 961.

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.* at 963 (noting that EnerSys's obligations to satisfy quality standards, observe use restrictions, provide indemnity, and further assurance obligations did not outweigh its substantial performance of the contract).

Technologies court also noted that the licensee's covenant to maintain quality standards was "minor" because the debtor-licensor never provided or discussed quality standards with the licensee and the parties acted as if they did not know of the existence of the covenant.[127]

The *Exide Technologies* court protected the holder of a prepaid, perpetual, exclusive trademark license, determining that the license was an integrated contract with an asset purchase agreement. However, faced with a very similar fact pattern, the U.S. Court of Appeals for the Eighth Circuit in *In re Interstate Bakeries Corp.*[128] reached the opposite conclusion, holding that a prepaid, perpetual, exclusive trademark license was an executory contract subject to rejection by a debtor-licensee. There, the debtor, Interstate Bakeries Corporation ("IBC"), acquired the owner of the Wonder Bread and Hostess brands and trademarks.[129] To resolve an antitrust challenge brought by the U.S. Department of Justice, IBC was required to sell its Butternut Bread and Sunbeam Bread business in the Chicago and central Illinois region and consummated a sale to Lewis Brothers Bakeries ("LBB").[130] Pursuant to a license agreement delivered at the closing of the asset purchase agreement, IBC granted to LBB a perpetual, royalty-free, exclusive license to the brands and trademarks in the licensed territory.[131] IBC retained use of the brands and trademarks outside of the licensed territory.[132]

The licensor, IBC, filed bankruptcy. The *Interstate Bakeries* bankruptcy court held that the trademark license was an executory contract because each party to the agreement had numerous continuing obligations to take, or refrain from taking, action relating to the trademarks.[133] On appeal, the district court affirmed, relying principally on the fact that the parties expressly acknowledged in the agreement that the failure to maintain the quality of the goods sold would constitute a material breach.[134] The Eighth Circuit affirmed, holding that the licensee's obligations to maintain quality standards and the licensor's obligations to forbear from use of the trademarks in the territory were material ob-

127. *Id.* at 964. The court, viewing the license as an integrated contract with the asset purchase agreement, also held that the quality standards were not material because they related to each battery produced and not to the main substance of the transaction, the transfer of the industrial battery business. *Id.* In a concurring opinion, that would later become the foundation for the Seventh Circuit's ruling in *Sunbeam Products*, Judge Ambro opined that even if the agreement were executory, rejection would not extinguish EnerSys's rights to the trademarks. *Id.* at 967 (Ambro, J., concurring). Judge Ambro noted that the purpose of rejection is not to be the functional equivalent of rescission:

> Courts may use § 365 to free a bankruptcy trademark licensor from burdensome duties that hinder its reorganization. They should not—as occurred in this case—use it to let a licensor take back trademark rights it bargained away. This makes bankruptcy more a sword than a shield, putting debtor-licenses in a catbird seat they often do not deserve.

Id. at 967–68.

128. 690 F.3d 1069 (8th Cir. 2012).

129. *Id.* at 1071.

130. *Id.* at 1071–72.

131. *Id.* at 1072.

132. *Id.*

133. *Id.*

134. *Id.*

ligations that rendered the agreement executory.[135] In reaching this result, the Eighth Circuit distinguished the *Exide Technologies* case, noting that the quality standards covenant was not enforced by the parties in *Exide Technologies* and was deemed by the Third Circuit to be a "minor" obligation.[136]

The *Exide Technologies* and *Interstate Bakeries* courts addressed similar factual records: each involved a prepaid, perpetual, exclusive trademark license acquired as an element of a larger acquisition of a business unit of the seller-licensor. Each court was confronted with the same legal issue: whether the license was an integrated contract with a fully performed asset purchase agreement and, therefore, not an executory contract that is subject to rejection. Although the two courts reached different conclusions, the results can be reconciled. The difference between the two cases is that quality control of the *Interstate Bakeries* license was an express material term of the contract; the license could be terminated by the licensor if the licensee did not adhere to quality standards for use of the trademark. By contrast, quality control was not a material term of the *Exide Technologies* license. The differing importance of quality control in the contract terms likely resulted from important differences in the licensor/licensee relationship in the two cases. The *Interstate Bakeries* license was a license with a narrow geographic scope; the license granted exclusive use of the trademarks only in Chicago and central Illinois. The debtor-licensor retained use of the same trademarks for the same products in other geographic areas and, therefore, had an ongoing, material interest in ensuring that use of the trademarks in Illinois was consistent with use of the trademarks elsewhere by the debtor-licensor (or by its other licensees). Because of this distinction, breach of the quality control covenant of the license was an event of default that permitted termination of the license. This distinguishing fact caused the U.S. Court of Appeals for the Eighth Circuit to determine the *Interstate Bakeries* license to be an executory contract subject to rejection and divestment of the licensee's right to use the trademark. By contrast, the license in the *Exide Technologies* case contained no geographic restriction and, because the license was prepaid, the licensor retained no economic interest in maintaining trademark quality. In short, the *Exide Technologies* license conveyed rights similar to a vested property right, while the *Interstate Bakeries* license defined an ongoing business relationship and was, therefore, an executory contract.

II. *SUNBEAM PRODUCTS*

The implications of rejection of trademark licenses was largely settled law[137] until the Seventh Circuit's July 2012 decision in *Sunbeam Products, Inc. v. Chicago*

135. *Id.* at 1075.

136. *Id.* at 1074–75.

137. *See, e.g.*, *In re* HQ Global Holdings, Inc., 290 B.R. 507, 513 (Bankr. D. Del. 2003) (following *Lubrizol* in holding that rejection of trademark license "extinguished" franchisee's rights to use the marks); *In re* Centura Software Corp., 281 B.R. 660, 674 (Bankr. N.D. Cal. 2002) (holding licensee is not entitled to retain any rights in marks under rejected trademark license); *In re* Blackstone Potato

American Manufacturing, LLC.[138] In *Sunbeam Products*, the Seventh Circuit disagreed with the reasoning of *Lubrizol*, holding that rejection of a trademark license does not terminate the non-debtor's contractual rights provided by the rejected contract, thus permitting the non-debtor licensee to continue to use licensed trademarks.[139]

The *Sunbeam Products* case arose out of a non-exclusive license of patents and trademarks by Lakewood Engineering & Manufacturing Co. ("Lakewood") to Chicago American Manufacturing ("CAM"). Lakewood was a major manufacturer of box fans and, in summer 2008, made the strategic decision to outsource its manufacturing to CAM.[140] After having fulfilled various orders for Lakewood, CAM became concerned about the state of Lakewood's finances following notification from its insurance carrier that receivables due from Lakewood would no longer be insured.[141] In December 2008, CAM and Lakewood entered into a one-year supply agreement intended, at least in part, to allow CAM to recoup its start-up costs if Lakewood failed to perform the contract.[142] CAM considered taking a security interest to protect itself, but settled on a transaction structure that granted CAM a springing license to use Lakewood's patents and trademarks and permitted CAM to sell, for its own account, any fans that CAM manufactured (or for which CAM had acquired the raw materials) and which Lakewood was unable to purchase.[143]

In February 2009, after CAM had invested in raw materials and manufactured an inventory of unsold fans, an involuntary bankruptcy case was filed against Lakewood.[144] After the bankruptcy filing, CAM pursued a dual path.[145] On one hand, CAM sought to purchase Lakewood's assets from Lakewood's Chapter 7 trustee.[146] On the other hand, utilizing the technology and expertise acquired as a supplier to Lakewood, CAM sought to set itself up as a manufacturer without purchasing Lakewood's name and assets.[147] Almost immediately and prior even to the Chapter 7 trustee's rejection of the supply contract, CAM began dealing directly with, and accepting orders from, manufacturing representatives of Lakewood's customers.[148]

The Chapter 7 trustee appointed in Lakewood's bankruptcy case moved to reject the supply agreement on March 27, 2009.[149] After discovering that

Chip Co., 109 B.R. 557, 562 (Bankr. D.R.I. 1990) (relying on *Lubrizol* to hold that, upon rejection, licensee had no further rights to use licensed marks).

138. 686 F.3d 372 (7th Cir. 2012).

139. *Id.* at 377–78.

140. *See In re* Lakewood Eng'g & Mfg. Co., 459 B.R. 306, 312–13 (Bankr. N.D. Ill. 2011).

141. *Id.* at 315 (describing CAM's concerns to ensure that it would be paid for the fans that it directly shipped to Lakewood's customers).

142. *Id.* at 316–17.

143. *Id.* at 315, 317.

144. *Id.* at 319–20.

145. *Id.* at 320.

146. *Id.* Ultimately, CAM was the stalking horse bidder at the bankruptcy auction for Lakewood's operating assets but failed to be the winning bidder at the auction. *Id.*

147. *Id.*

148. *Id.* at 321. For example, on the same day that the Lakewood Chapter 7 trustee was appointed, CAM ordered 90,720 box fan motors bearing the Lakewood trademark for use in manufacturing box fans for sale to third parties. *Id.*

149. *Id.* at 323.

CAM was selling Lakewood-branded products in competition with the trustee's efforts to liquidate inventory, the trustee sent CAM a cease-and-desist letter.[150] The Chapter 7 trustee ultimately filed an adversary proceeding seeking to halt CAM's manufacture and sale of the trademarked fans.[151] The trustee also conducted an auction for Lakewood's operating assets and sold the assets to Sunbeam over a lesser bid submitted by CAM.[152]

Sunbeam joined the Chapter 7 trustee as a plaintiff in the adversary proceeding.[153] The bankruptcy court found the supply agreement to be ambiguous and extrinsic evidence was admitted to establish that the parties intended that CAM would have a broad license to use the Lakewood trademarks to sell excess fans in inventory as well as fans manufactured with excess raw materials.[154]

The bankruptcy court held that the supply agreement was an executory contract.[155] In analyzing the effect of rejection, the bankruptcy court held that CAM properly retained rights under the patent licenses pursuant to section 365(n).[156] The bankruptcy court noted, however, that section 365(n) does not, by its terms, apply to trademarks. In rejecting the reasoning of *Lubrizol*, the bankruptcy court was persuaded by the reasoning of Judge Ambro's concurring opinion in *Exide Technologies*, concluding that the court could, on equitable grounds, "avoid a situation that let[s] a licensor take back trademark rights it bargained away,"[157] and it entered judgment in favor of CAM.[158]

The bankruptcy court certified its decision for direct appeal to the Seventh Circuit.[159] The Seventh Circuit affirmed the bankruptcy court's conclusion that CAM retained rights to use the licensed trademarks after rejection, but rejected the bankruptcy court's reasoning that bankruptcy courts have discretion following rejection of a trademark license to allow a licensee continued use of trademarks based "on equitable grounds."[160] Instead, the Seventh Circuit held that, in the *Lubrizol* case, the Fourth Circuit failed to understand correctly section 365(g), which specifies the consequences of rejection under section 365(a), and held that section 365(g), by classifying rejection as a breach, establishes that in bankruptcy, as outside of it, "the other [non-debtor] party's rights remain in place."[161]

After contract rejection, the Seventh Circuit acknowledged that a debtor is not subject to an order of specific performance.[162] But the *Sunbeam Products* court

150. *Id.*
151. *Id.* at 324.
152. *Id.* at 324–25.
153. *Id.* at 310.
154. *Id.* at 337–38.
155. *Id.* at 339.
156. *Id.* at 339–43.
157. *Id.* at 343–45 (citing *In re Exide Techs.*, 607 F.3d 957, 964 (3d Cir. 2010) (Ambro, J., concurring)).
158. *Id.* at 347.
159. Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 375 (7th Cir.), *cert. denied*, 133 S. Ct. 790 (2012).
160. *Id.*
161. *Id.* at 377.
162. *Id.*

held that "nothing about this process implies that any rights of the other contracting party have been vaporized."[163] As principal support for this conclusion, the *Sunbeam Products* court analogized the treatment of licensees under trademark licenses to the treatment of tenants under real estate leases, noting that:

> [A] lessor that enters bankruptcy could not, by rejecting the lease, end the tenant's right to possession and thus re-acquire premises that might be rented out for a higher price. The bankrupt lessor might substitute damages for an obligation to make repairs, but not rescind the lease altogether.[164]

In making this analogy, the *Sunbeam Products* court failed to recognize that, in section 365(h), Congress explicitly granted non-debtor tenants favorable treatment in the event of rejection of real estate leases, a favorable treatment that was denied to trademark licensees when similar protections were granted to licensees of patents and copyrights under section 365(n).[165]

In this and in other respects, the *Sunbeam Products* decision is unsatisfactory. For example, the Seventh Circuit in *Sunbeam Products* reasoned that rejection "is not 'the functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions they occupied before the contract was formed.'"[166] However, neither the *Lubrizol* case nor any of the cases following *Lubrizol* are premised on a concept of rejection as rescission. Rejection indisputably constitutes a breach of contract entitling the non-debtor party to a contract damages remedy.[167] The issue addressed by the *Lubrizol* case is whether a non-debtor party is limited to a contract damages remedy or, in addition to a remedy for money damages, is entitled to specifically enforce a license to intellectual property.

III. Foundations of *Sunbeam Products*

Perhaps the strongest arguments for the result reached in the *Sunbeam Products* case are found not in the *Sunbeam Products* opinion itself, but in Judge Ambro's concurring opinion in *Exide Technologies* and in two-decade-old arguments of commentators critical of the *Lubrizol* decision that are cited in Judge Ambro's concurrence. Judge Ambro, citing to the legislative history of Bankruptcy Code section 365(n), concluded that drawing an inference from the enactment of section 365(n) that Congress intended to deny protections to non-debtor par-

163. *Id.*

164. *Id.*

165. Michael T. Andrew traces section 365(h) of the Bankruptcy Code to its antecedent in the Chandler Act, section 70(b) of the Bankruptcy Act, and argues that (i) the statutory protection under both the Bankruptcy Act and the Bankruptcy Code for tenants under real estate leases simply codifies pre-existing case law, and (ii) codification does not support an inference that non-debtor parties to other types of contracts, such as licenses to intellectual property, are not entitled to similar protection. *See* Andrew, *supra* note 8, at 902–03. The *Sunbeam* court, unfortunately, does not make this argument.

166. *Sunbeam Prods.*, 686 F.3d at 377 (citing Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294 (11th Cir. 2007)).

167. *See* 11 U.S.C. §§ 365(g), 502(g) (2006).

ties to other types of executory contracts is "inapt for trademark license rejections."[168] Judge Ambro reached this conclusion based on an expression of concern in the legislative history concerning the *Lubrizol* case as well as a statement in the Senate Report that the Senate bill did not intend any inference to be drawn concerning how executory contracts not covered by the statute might be treated.[169]

Having concluded that the legislative history of section 365(n) forecloses this drawing of inferences concerning how trademark licenses should be treated, Judge Ambro found that two-decade-old commentary critical of the *Lubrizol* court's treatment of patent licenses applies equally to the treatment of trademark licenses.[170] The enactment of Bankruptcy Code section 365(n), with its explicit protections for licensees of patents and copyrights, made this commentary irrelevant as applicable to U.S. patent and copyright licensees. That commentary, however, as adopted by Judge Ambro, forms the intellectual foundation for the *Sunbeam Products* decision and must be addressed in understanding the decision.

In the aftermath of the *Lubrizol* decision and the enactment of Bankruptcy Code section 365(n), various commentators criticized *Lubrizol* and other case law dealing with executory contracts and the "congressional patchwork" of exceptions created to address rights of non-debtors under certain executory contracts.[171] The criticism falls into two somewhat inconsistent categories: first, arguments for legislative action to revise the Bankruptcy Code and overrule *Lubrizol* by eliminating entirely the concept of executory contract and reconceptualizing the rights of debtor and non-debtor parties to contracts,[172] and, second, arguments based on pre-Bankruptcy Code case law that, even absent statutory amendments or exceptions, non-debtor parties to executory contracts that convey "property rights" as opposed to "contract rights" retain the property rights notwithstanding rejection of the contracts in bankruptcy.[173]

168. *In re* Exide Techs., 607 F.3d 957, 964 (3d Cir. 2010) (Ambro, J., concurring) (citing S. REP. NO. 100-505, at 5 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3205).

169. *Id.* at 966–67 (quoting S. REP. NO. 100-505, at 5, *reprinted in* 1988 U.S.C.C.A.N. at 3205).

170. *See id.* at 964.

171. *See* Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 228–29 (1989).

172. *See* Andrew, *supra* note 8, at 849 ("The law of executory contracts is in need of a thorough rethinking."); Westbrook, *supra* note 171, at 228–29 ("[W]e must completely reconstruct the fundamentals of bankruptcy contract law. My purpose in this Article is to begin the task by preparing a new and relatively simple conceptual framework to replace the bemusing complexity of current case law."); Westbrook, *supra* note 84, at 464–65 (summarizing recommendations that "the very term 'executory contract' be banished from the Bankruptcy Code, replaced by something like 'bankruptcy contract,' that Congress eliminate the requirement that a contract be 'executory' as a prerequisite to being 'assumed or rejected,' and that the terms 'assumption' and 'rejection' be assigned to the ashcan of history").

173. *See* Andrew, *supra* note 8, at 856 (arguing that the Bankruptcy Code's basic treatment of executory contracts comes "essentially without change" from the Bankruptcy Act); Westbrook, *supra* note 171, at 257 (discussing interests in "property rights" as important exceptions to bankruptcy principles of equality of distribution); DOUGLAS G. BAIRD, *supra* note 8, at 122 ("Nothing about the nature of 'rejection' requires that the trustee be able to undo (or 'avoid') what is tantamount to a consummated property transfer.").

Since Congress has failed to amend the Bankruptcy Code to eliminate or modify the concept of executory contract and has considered and refused to create explicit statutory protections for trademark licensees,[174] the first criticism is effectively an appeal for *deus ex machina*, or change through legislation, and cannot effectively be made before courts. However, under the second category of criticisms, commentators argue that both Bankruptcy Act concepts and case law survived enactment of the Bankruptcy Code and that numerous later amendments to the Bankruptcy Code to balance the interests of non-debtor parties to specific types of executory contracts with the interests of debtors was not meant to codify a general rule permitting debtors to deny non-debtors "property rights" granted by contract.

The most cogent criticisms of the *Lubrizol* decision came in a pair of law review articles by Professor Michael T. Andrew prior to the enactment of Bankruptcy Code section 365(n).[175] Professor Andrew traces the concept of rejection of executory contracts to pre-Bankruptcy Code case law, arguing that rejection arose historically as an election to exclude burdensome contracts from the bankruptcy estate in order to avoid the incurrence of administrative liabilities.[176] Professor Andrew maintains that historically, under the Bankruptcy Act, rejection was never intended and did not have the effect of altering property rights of non-debtor parties.[177] Professor Andrew calls the situation where a contract conveys property rights the "two asset problem."[178] The two asset problem, Andrew explains, arises in the prototypical situation where a real estate lessor files for bankruptcy.[179] In that case, Andrew argues, there are two distinct assets at issue, the debtor's rights as landlord under the lease, and the debtor's interest in the underlying asset, the property that is subject to the lease.[180] Focusing on the underlying asset, Andrew asserts that, at the moment of bankruptcy, the debtor/landlord's interest is limited to a reversionary right upon expiration or termination of the lease.[181] Since rejection is the debtor-landlord's breach

174. S. Rep. No. 100-505, at 6 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3204.

175. *See* Andrew, *supra* note 8; Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. Colo. L. Rev. 1 (1991).

176. Andrew, *supra* note 8, at 860–61.

177. *Id.*

178. *Id.* at 903–05.

179. *Id.*

180. *Id.*

181. *Id.* At least in the context of real estate leases and contracts of bailment, Andrew is correct that the Bankruptcy Act preserved rights under state law of non-debtor parties (although for non-debtor tenants under real estate leases, the protections were afforded by statute). The problem of the effect of rejection under the Bankruptcy Act on the rights of non-debtors to executory contracts that convey particular types of property rights is succinctly summarized in Thomas Finletter's treatise published just after the enactment of the Chandler Act in 1938:

> Where the debtor is the lessor or bailor of property, whether real or personal, a special case is presented. The rights of the trustee depend on what is meant by the power to reject a lease. If it means that any contractual arrangement can be terminated by the court upon giving the other party the right to damages, the debtor as lessor or bailor may be authorized by the court to terminate the legal relationship and demand back the property for the good of the estate. If on the other hand this power to reject is merely the power to default in performance, as is believed is

of the lease under Bankruptcy Code sections 365(g) and 502(g) and does not terminate the lease, the non-debtor tenant retains a right to continued use of the leased premises.[182]

Andrew asserts that the "two asset problem" applies in the context of licenses of intellectual property. Specifically, with regard to patent and copyright licenses, Andrew reasons:

> Does rejection of the agreement terminate the non-debtor party's right to the licensed or franchised use of the underlying asset? Because the estate succeeds only to the debtor's [right] in that asset, the answer should be no. Rejection is not a rescission of the license or franchise, but merely the estate's determination not to assume it. Thus, so long as the license or franchise is not otherwise avoidable, the estate should be in the same position as any other non-assuming transferee of the debtor's rights in the asset.[183]

Andrew provocatively terms the concept of rejection as a termination of a non-debtor's property rights "avoiding power rejection," equating the *Lubrizol* court's holding that rejection constitutes termination of a patent licenesee's contractual rights to use intellectual property with a bankruptcy trustee's ability by statute to "avoid" fraudulent or preferential transfers. Andrew criticizes both the concept of termination of property rights itself as being unsupported by statutory authority as well as the conditioning of the concept on the executory or non-executory character of a contract.[184]

Andrew acknowledges that the Bankruptcy Code precludes a non-debtor from remedies of specific performance, but argues that the bar against specific performance is intended only to "insulate the estate from itself becoming unadvisedly obligated on executory contracts of the debtor, thereby elevating the non-debtor parties to administrative priority."[185] Although Andrew concedes that the inclusion of specific performance remedies within the Bankruptcy Code's broad definition of "claim" is relevant to "whether the non-debtor can specifically enforce a contract against the debtor post-bankruptcy," Andrew argues that rejection does not cut off all specific performance remedies, but only remedies that depend on the estate itself being obligated on the contract.[186]

Andrew explicitly rejects the *Lubrizol* court's argument by negative inference that, because Congress has codified protections for non-debtors under specific

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> the law, there is nothing on which the debtor-lessor or bailor can default. It has already performed by delivering possession to the lessee or bailee and it has neither the right nor the power to reacquire possession.

THOMAS K. FINLETTER, THE LAW OF BANKRUPTCY REORGANIZATION 240–41 (1939).

182. Andrew, *supra* note 8, at 902–06.

183. *Id.* at 916.

184. *Id.* at 917–18. Andrew notes that, under the *Lubrizol* court's analysis, it "seems quite clear that if the license had been found to have been non-'executory,' the court would have enforced it" and marvels that the "happenstance of executoriness" should control an issue so important as the licensee's continued ability to use the technology. *Id.* at 918.

185. *Id.* at 925.

186. *Id.* at 921.

types of contracts and failed to provide similar protections for licensees of intellectual property, Congress implicitly endorsed the holding of the *Lubrizol* case.[187] Using a phrase later quoted in Judge Ambro's concurring opinion in the *Exide Technologies* case, Andrew argues that the *Lubrizol* case's denial of non-debtor rights to licensed intellectual property is "more freight than negative inference will bear," requiring rejection to be assigned a meaning fundamentally at odds with the pre-Bankruptcy Code history and purpose of the executory contracts doctrine.[188]

Finally, Andrew rejects the argument that Bankruptcy Code policy favoring reorganization supports the *Lubrizol* court's denial of rights of non-debtor parties to retain use of licensed intellectual property. Andrew acknowledges that, in *NLRB v. Bildisco & Bildisco*, the U.S. Supreme Court highlighted the vital importance of contract rejection to Bankruptcy Code policy favoring business reorganization.[189] Andrew notes, however, that with limited exceptions, the statutes governing contract rejection are the same under Chapter 7 as under Chapter 11, thereby weakening arguments that the executory contract doctrine is somehow uniquely related to rehabilitation rather than liquidation.[190]

The Andrew articles were written without consideration of how trademark licenses differ from patent and copyright licenses. Professor Andrew describes the "two asset" problem in the context of patent and copyright licenses without considering that trademark law requires unified ownership of trademarks by the licensor. Unified ownership of trademarks means that the licensor at all times retains the ownership interest in the trademark and is required to regulate use of the trademark by licensees. A trademark license, therefore, does not create Professor Andrew's "two asset" problem or raise concerns that application of the *Lubrizol* case to a trademark license would improperly disturb vested property rights.

The Andrew articles were also written more than twenty years ago, prior to Congress's enactment of Bankruptcy Code section 365(n). The text of Bankruptcy Code section 365(n) makes clear that Congress viewed enforcement of exclusivity provisions of patent and copyright licenses as a remedy of specific performance that was unenforceable on rejection of a license, absent statutory

187. *Id.* at 928. In doing so, Andrew overstates his case, arguing that "whenever Congress has been confronted with the consequences of the avoiding-power rejection doctrine in a specific context, it has expressed its disapproval of the doctrine with a specific provision." *Id.* In fact, as noted above, Congress has never enacted statutory protections for non-debtor contract parties that are as expansive as the rights of non-debtor parties that Andrew asserts are implicit on contract rejection. *See supra* Parts I.C, I.D. Rather, in each case, Congress has attempted to strike a balance between the rights of non-debtor contract parties with Bankruptcy Code policies favoring the reorganization of debtors. Most notably, after the publication of Andrew's article and in the context of intellectual property licenses, a non-debtor's right to retain rights to intellectual property is conditioned upon payment of royalties without right of setoff for the debtor's non-performance because "[t]he debtor's ability to reorganize may depend upon preservation of the royalty payments called for under the contract." S. Rep. No. 100-505, at 10 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3207.

188. Andrew, *supra* note 175, at 11.

189. Andrew, *supra* note 8, at 929 (citing NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984)).

190. *Id.* at 930.

protection under section 365(n).[191] Section 365(n) provides that a patent or copyright licensee is entitled to elect "to enforce any exclusivity provision of such contract but excluding any *other right* under applicable nonbankruptcy law to specific performance."[192] As Congress acknowledged, enforcement of exclusivity provisions of an intellectual property license requires specific performance, which remedy, absent the protections of section 365(n), is unenforceable following contract rejection in bankruptcy. Thus, in enacting section 365(n), Congress understood that exclusivity provisions of a trademark license, which are not entitled to protection under section 365(n), are unenforceable following contract rejection.[193]

Enforcement of a non-exclusive trademark license by a licensee similarly requires specific performance. For a non-exclusive licensee to maintain use of a trademark, the licensor must undertake to control use of the trademark and maintain consistent quality of the trademarked products or services among various non-exclusive licensees. Under state law, a court may order a breaching licensor to perform its contract and comply with contract provisions defining standards of product or service quality in order to maintain the integrity of licensed trademarks. In a trademark licensor's bankruptcy, however, a non-exclusive licensee under a rejected trademark license is limited to a claim for monetary damages.[194] As Professor Andrew acknowledges, the Bankruptcy Code's bar against specific performance remedies is intended "to insulate the estate from itself becoming unadvisedly obligated on executory contracts."[195] A licensor in bankruptcy may, for example, formulate a business plan that contemplates an increase in product quality to attract more "high end" customers and may reject trademark licenses that permit lower and inconsistent product standards. In this case, a non-exclusive trademark licensee may not, through specific performance, prevent the debtor-licensor from altering its business plan and compel the debtor-licensor to maintain the different contractual standard of trademark quality control necessary to keep a rejected trademark license in effect.[196]

191. 11 U.S.C. § 365(n) (2006).

192. *Id.* § 365(n)(1)(B) (emphasis added).

193. The Bankruptcy Code, in this respect, is consistent with applicable nonbankruptcy law. An exclusive licensee cannot sue its licensor for trademark infringement if the licensor uses a trademark or grants another license in violation of exclusivity provisions of the license contract. An exclusive licensee, in this case, would have a claim for breach of contract, but not for infringement. *See* Shoney's Inc. v. Schoenbaum, 686 F. Supp. 554, 564 (E.D. Va. 1988), *aff'd*, 894 F.2d 92 (4th Cir. 1990). Similarly, an exclusive trademark licensee does not have a claim for trademark infringement against a subsequent licensee, although a cause of action may exist for inducing breach of contract or tortious interference with contract. *See* MCCARTHY, *supra* note 104, § 25:30, at 25-94; Ballet Makers, Inc. v. U.S. Shoe Corp., 633 F. Supp. 1328, 1335 (S.D.N.Y. 1986).

194. *See supra* notes 37–38 and accompanying text.

195. Andrew, *supra* note 8, at 929.

196. A licensee may, of course, argue that a licensor's rejection of a license in bankruptcy constitutes abandonment of a trademark (for example, where rejection is quickly followed by liquidation or other discontinuation of the business related to the trademark). Under trademark law, an owner of a trademark can abandon rights to the mark either by affirmative action, or, more commonly, by cessation of use of the trademark. MCCARTHY, *supra* note 104, § 17:5, at 17-10 to -11; *id.*

The International Trademark Association ("INTA"), a prominent trade organization, has recommended that section 365(n) of the Bankruptcy Code be amended to include trademarks within the Bankruptcy Code's definition of "intellectual property," thereby entitling trademark licensees to the benefits of section 365(n). But significantly, the INTA has also recognized that a licensee's rights under section 365(n) depend on an ability to require, through specific performance, that a debtor licensor maintain quality control. Accordingly, the INTA also recommended that:

> In light of the unique nature of trademarks as a repository and symbol of goodwill, Section 365(n) should be further amended to explicitly state that the statute does not relieve debtor licensors from any existing contractual obligations or authority to monitor and control the quality of licensed products bearing a licensed trademark.[197]

§§ 17:10–17:11, at 17-15 to -23. Abandonment opens rights to use of a trademark to the entire world. *Id.* § 17:1, at 17-2.

Strictly speaking, abandonment requires non-use of a trademark, as well as an express or an implied intention not to resume use. *Id.* § 17:5, at 17-10. However, a range of actions instituted or tolerated by a trademark owner may result in abandonment. *Id.* §§ 17:6–17:8, at 17-11 to -12. These include licensing of a trademark without control, commonly known as "naked licensing." *Id.*

Abandonment requires a fact-specific inquiry with a high burden of proof. ITC Ltd. v. Punchgini, Inc., 482 F.3d 135, 148 (2d Cir. 2007) ("[T]he statutory presumption of abandonment requires that one fact, *i.e.*, abandonment, be inferred from another fact, *i.e.*, non-use of the mark for three years or more."); Doeblers' Pa. Hybrids, Inc. v. Doebler, 442 F.3d 812, 824 (3d Cir. 2006); Creative Gifts, Inc. v. UFO, 235 F.3d 540, 548 (10th Cir. 2000) ("[A]nyone attempting to show such abandonment via naked licensing faces a stringent burden of proof."); Rivard v. Linville, 133 F.3d 1446, 1449 (Fed. Cir. 1998) (abandonment is a finding of fact reviewed for clear error); Exxon Corp. v. Oxxford Clothes, Inc., 109 F.3d 1070, 1075–76 (5th Cir. 1997); Stanfield v. Osborne Indus., 52 F.3d 867, 871 (10th Cir. 1995) ("high burden of proof" of abandonment required (citation omitted)), *cert. denied*, 516 U.S. 920 (1995); U.S. Jaycees v. Phila. Jaycees, 639 F.2d 134 (3d Cir. 1981) ("[T]he proponent of a claim of insufficient control must meet a high burden of proof."); Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368, 387 (5th Cir. 1977); Edwin K. Williams & Co. v. Edwin K. Williams & Co.-East, 542 F.2d 1053, 1059 (9th Cir. 1976), *cert. denied*, 433 U.S. 908 (1977); Am. Foods, Inc. v. Golden Flake Inc., 312 F.2d 619, 624–25 (5th Cir. 1963); Winnebago Indus., Inc. v. Oliver & Winston, Inc., 207 U.S.P.Q. 335 (T.T.A.B. 1980) (clear and convincing proof needed for abandonment). Moreover, because a licensee's use of a trademark inures to the licensor's benefit, a trademark will not be abandoned if other licenses are in effect and the trademark licensor is exercising control of the quality of the trademark. *See* McCarthy, *supra* note 104, § 18:42, at 18-92 to -94. Furthermore, particularly in circumstances where a licensee asserts that a rejected license is not terminated but remains in effect, a licensee may be estopped from arguing that a licensor has abandoned use of a trademark. *Creative Gifts*, 235 F.3d at 548 (licensee estoppel bars licensee from claiming abandonment by naked licensing during the term of the license); Prof'l Golfers Ass'n v. Bankers Life & Cas. Co., 514 F.2d 665, 671 (5th Cir. 1975) (same); *see also* Alpha Tau Omega Fraternity, Inc. v. Pure Country, Inc., No. IP 01-1054-C-B/F, 2004 WL 3391781, at *10 (S.D. Ind. Oct. 26, 2004); STX, Inc. v. Bauer USA, Inc., 43 U.S.P.Q.2d 1492, 1500–01 (N.D. Cal. 1997); Estate of Biro v. Bic Corp., 18 U.S.P.Q.2d 1382 (T.T.A.B. 1991). As a result, in a situation where a Chapter 11 debtor rejects trademark licenses as part of a business plan that contemplates continued use of the trademarks, rejection should not equate with abandonment.

197. *Board Resolutions—Trademark Licenses Under the U.S. Federal Bankruptcy Code*, Int'l Trademark Ass'n (Nov. 7, 2010), http://www.inta.org/Advocacy/Pages/TrademarkLicensesundertheUSFederalBankruptcyCodeResolution.aspx (last visited Apr. 29, 2013).

The INTA's recommendation to preserve specific performance remedies to enforce quality control covenants of debtor licensors grew out of a concern that the *Sunbeam Products* decision would inadvertently result in the destruction of trademarks. The INTA's U.S. Legislation Subcommittee of the Legislation and Regulatory Analysis Committee described how the *Sunbeam Products* case gave rise to this concern:

> Balanced against the obvious peril to trademark licensees are concerns about the continued validity of a licensed trademark following the debtor-licensor's rejection. If, as the Sunbeam decision holds, the debtor's rejection "frees the estate from the obligation to perform," and therefore eliminates the obligation to monitor and control the quality of the licensee's goods or services, the result could be a statutorily mandated naked license, which would destroy the trademark asset which the debtor's trustee is bound to preserve. Therefore, in addition to addressing the protection of trademark licensees against rejection of their licenses in Section 365(n), the Subcommittee also believes that it is necessary to explicitly state in the statute that that the trustee is not freed from any existing contractual obligations under the license to exercise quality control.[198]

Thus, the INTA, in proposing to amend section 365(n), rejects a central premise of the *Sunbeam Products* decision, that a trademark license constitutes a transfer of property independent of ongoing licensor obligations that may be enforced through specific performance.

Events since the publication of Professor Andrew's articles have also undermined arguments he makes based on the Bankruptcy Code's text and legislative history. Professor Andrew, prior to the enactment of section 365(n), rejected arguments based on negative inference that Congress, in enacting numerous specific exceptions protecting rights of non-debtor parties to various types of rejected executory contracts, intended to deny protections to non-debtor licenses of patents and copyrights. The text and legislative history of Bankruptcy Code section 365(n), however, indicate that Congress expressly considered and denied statutory protection to trademark licensees because trademarks differ substantially from patents and copyrights in that "[trademark] licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee."[199] In doing so, it is doubtful that Congress contemplated that another appellate court would decide a case counter to the *Lubrizol* decision. Congress simply determined to "postpone congressional action" to protect trademark licensees pending further "equitable treatment of this situation" in the bankruptcy courts.[200] As such, section 365(n) and its legislative history require the negative inference that trademark licensees are afforded no right, as a general matter, to continued use of trademarks following rejection of a trademark license.

The text and legislative history of Bankruptcy Code section 365(n) also undermine Professor Andrew's argument that, in enacting statutory exceptions to the

198. *Id.*
199. S. Rep. No. 100-505, at 5–6 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3204–05.
200. *Id.* at 5, *reprinted in* 1998 U.S.C.C.A.N. at 3205.

harsh effect of contract rejection on non-debtors, Congress did not intend to further a policy favoring corporate reorganization. As noted above, in each case where statutory protections are provided for non-debtor contract parties in the event of contract rejection, Congress has also protected the interests of Chapter 11 debtors. Nowhere is the congressional policy in favor of reorganization more apparent than in Bankruptcy Code section 365(n). In section 365(n), a non-debtor party may elect to continue to use licensed patents and copyrights, but must continue to pay royalties to the debtor-licensor notwithstanding rejection and without any administrative claim or right of setoff for the debtor-licensor's non-performance. The legislative history of section 365(n) makes clear that Congress intended section 365(n) as "a careful compromise between the needs of the debtor and the licensee" and that a debtor-licensor's right to royalties were preserved precisely because "[t]he debtor's ability to reorganize may depend upon preservation of the royalty payments called for under the contract."[201] Under these circumstances, Congress denied section 365(n) statutory protections for trademark licensees with the expectation that trademark licensees as a general matter would not be able to continue to utilize licensed trademarks. To conclude otherwise, one would have to believe that Congress intended more favorable treatment for trademark licensees than for licensees of patents and copyrights and that trademark licensees should be able to continue to use licensed trademarks either without paying royalties or with an ability to set off royalties against the licensee's damages resulting from the debtor/licensor's breach of the license. Such an intent by Congress has no support in the text or legislative history of section 365(n).

A. Implications of *Sunbeam Products* for Trademark Licenses Rejected in Bankruptcy

In a case involving a trademark license, the *Sunbeam Products* court unequivocally rejected the holding of *Lubrizol* that, "when an intellectual property license is rejected in bankruptcy, the licensee loses the ability to use any licensed copyrights, trademarks and patents,"[202] and held that a trademark licensee's rights to use licensed trademarks continue notwithstanding rejection of the license.[203] In reaching its decision, the *Sunbeam Products* court treats rights granted under a trademark license as indefeasible property rights vested in a licensee in the same way that a tenant has rights under a real estate lease.[204] Implicit in this holding is the mistaken assumption that trademark licenses involve what Professor Andrew termed the "two asset problem," a situation where the licensor re-

201. *Id.* at 10, *reprinted in* 1998 U.S.C.C.A.N. at 3208.
202. Sunbeam Prods., Inc. v. Chi. Am. Mfg., Inc., 686 F.3d 372, 378 (7th Cir.) (citing Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985)), *cert. denied* 133 S. Ct. 790 (2012).
203. *Id.* at 377–78.
204. *Id.* at 377.

tains only rights under the license and a reversionary interest upon expiration or termination of the license.

What the *Sunbeam Products* court fails to understand is that the rights of a trademark licensee are quite different from the rights of a tenant under a real estate lease or, for that matter, the rights of a licensee of patents or copyrights.[205] A trademark is not severable from the goodwill of the business, product, or service that it represents.[206] The trademark owner retains rights at all times in the trademark and, indeed, ensures that the rights continue and are not abandoned by controlling and regulating the behavior of the trademark licensee. In addition, in most cases, the trademark owner's economic interest is substantially greater than a single reversionary interest upon expiration or termination of the license. Even in the context of exclusive licenses, the licensor often retains a paramount economic interest in the value and integrity of the licensed trademark that is independent of royalties received under the license. Thus, a trademark license commonly embodies and documents an active relationship, not a conveyance of property. A trademark licensor, as owner of the trademark, has an affirmative duty to police the use of the mark to ensure that it has a consistent quality and usage in the marketplace.[207] A trademark licensee invariably has a contractual obligation to the licensor to maintain the quality of the mark to ensure its consistent use across various geographic and product markets and among various licensees.

The amount of activity required to maintain the licensor/licensee relationship will vary depending upon the terms of the trademark license. The provisions of a trademark license may reflect, on one end of a spectrum, the importance of the relationship between the licensor and licensee and, on the other end of the spectrum, the importance of the integrity of the licensee's contract right to use the trademark. For example, a prepaid, exclusive, perpetual trademark license may be documented in a way that deemphasizes the licensor/licensee relationship and treats the licensed right as a non-executory, fully vested property right. Because the license is prepaid, the licensor receives no future benefit from the license and will have less direct incentive to monitor the licensee's use of the trademark. In this way, the *Exide Technologies* court was able to conclude that a prepaid, exclusive, perpetual trademark license was not an executory contract but instead was, effectively, a consummated transfer of a vested property right.[208]

However, even in the prepaid, exclusive license situation, the relational aspect of a trademark license can be very significant. As illustrated by the *Interstate Bakeries* case, if a licensor grants a perpetual, exclusive trademark license for use with a single product in a single geographic market but retains the trademark

205. *See* United Drug Co. v. Theodore Rectanus Co., 248 U.S. 90, 97 (1918) (noting it is a "fundamental error" to suppose "that a trademark right is a right in gross or at large, like a statutory copyright or a patent for an invention, to either of which, in truth, it has little or no analogy").

206. *See id.* ("There is no such thing as property in a trademark except as a right appurtenant to an established business or trade in connection with which the mark is employed.").

207. *See* McCarthy, *supra* note 104, § 18:42, at 18-91 to -93.

208. *See supra* notes 124–25 and accompanying text.

for use with other products or in other geographic markets, the licensor will have a much greater incentive and obligation to monitor and control use of the trademark by the exclusive licensee.[209]

The status of a trademark license as an executory contract that embodies an active relationship is even more apparent in the context of non-exclusive trademark licenses. Non-exclusive trademark licenses typically contemplate multiple licensees engaged in use of a trademark for the same product or service in the same market. In this circumstance, control of the quality and consistency of the product or service is essential for both the licensor and the licensees. For example, consider the situation of a franchisor of a nationwide chain of hotels or restaurants and the dozens or even hundreds of franchisees granted non-exclusive rights to use the nationally recognized "flag" of the hotel or the trademarked name of the restaurant. The franchise agreement will provide for a centralized marketing team to maintain and update the brand, logo, and websites and central management that, with or without consultation with franchisees, decides on criteria for consistent presentation of the brand to the public through coordinated menus, policies, services, and use of approved vendors. The agreement will also contain detailed provisions for termination of franchise agreements with franchisees that do not maintain standards of quality and consistency. In short, a trademark license in a franchise agreement is almost entirely about coordinating the relationship of the licensor and licensee so that the trademark symbol is protected and linked strongly with the goodwill generated by the efforts of a diverse universe of franchisees.

The shortcomings of the *Sunbeam Products* court's analogy of a trademark license as creating an indefeasibly vested property right akin to a real estate lease are readily apparent in the context of the numerous Chapter 11 bankruptcy cases that have involved franchisors of trademarked goods and services.[210] In these cases, a key element of the debtor's reorganization may involve rejection of franchise agreements with licensees managing underperforming franchise locations, termination of franchise operations altogether, the sale or rebranding of franchisor-owned store locations, or other actions that require the rejection of

209. *See supra* notes 132–33 and accompanying text.

210. Examples of recent Chapter 11 cases involving franchisors of national or regional consumer brands include various restaurant chains, such as Friendly's, Real Mex, Perkins, Marie Callender's, Sbarro, Charlie Brown's Steakhouse, Fuddruckers, Bennigan's, Baker's Square, Village Inn, Schlotzky's, Ground Round, and Sizzler. *See* Chapter 11 Voluntary Petition, *In re* Amicus Wind Down Corp., No. 11-13167-KG (Bankr. D. Del. Oct. 5, 2011); Chapter 11 Voluntary Petition, *In re* Real Mex Rests., Inc., No. 11-13122-BLS (Bankr. D. Del. Oct. 4, 2011); Chapter 11 Voluntary Petition, *In re* Perkins & Marie Callender's Inc., No. 11-11795-KG (Bankr. D. Del. June 13, 2011); Chapter 11 Voluntary Petition, *In re* Sbarro, Inc., No. 11-11527-SCC (Bankr. S.D.N.Y. Apr. 4, 2011); Chapter 11 Voluntary Petition, *In re* CB Holding Corp., No. 10-13683-MFW (Bankr. D. Del. Nov. 17, 2010); Chapter 11 Voluntary Petition, *In re* Deel, LLC, No. 10-11310-BLS (Bankr. D. Del. Apr. 21, 2010); Chapter 11 Voluntary Petition, *In re* S & A Rest. Corp., No. 08-41898 (Bankr. E.D. Tex. July 29, 2008); Chapter 11 Voluntary Petition, *In re* VI Acquisition Corp., No. 08-10623-KG (Bankr. D. Del. Apr. 3, 2008); Chapter 11 Voluntary Petition, *In re* SI Restructuring, Inc., No. 04-54504-LMC (Bankr. W.D. Tex. Aug. 3, 2004); Chapter 11 Voluntary Petition, *In re* The Ground Round, Inc., No. 04-11235 (Bankr. D. Mass. Feb. 19, 2004); Chapter 11 Voluntary Petition, *In re* Sizzler Rests. Int'l, Inc., No. 96-16075-AG (Bankr. C.D. Cal. June 2, 1996).

franchise agreements as executory contracts. If the *Sunbeam Products/Lubrizol* circuit split were to be resolved in favor of the *Sunbeam Products* court's conception of a non-exclusive trademark license as a vested property right, what would be the result? In the Chapter 11 case of the franchisor-licensor of a national brand, would the franchisor be unable to reject any of its franchise agreements without losing operational and quality control of its trademarks? If multiple franchise agreements were rejected, would each franchisee-licensee be free to use the national brand without quality control from the franchisor and without coordination with other licensees? If not, how would trademark quality and consistency be maintained without specific enforcement of the rejected franchise agreements against the debtor-licensor? If so, would license rejection not equate with abandonment of the trademark and destruction of the brand?[211]

With the *Sunbeam Products* decision, the U.S. Court of Appeals for the Seventh Circuit steps into territory where Congress feared to tread. As we have seen, Congress expressly excluded trademark licensees from the protections of section 365(n) because of the need for debtor-licensors of trademarks to maintain quality control of trademark use by licensees.[212] In holding that trademark licensees in all cases retain rights to use licensed marks free of any right of supervision and quality control by the debtor-licensor of the trademark, the *Sunbeam Products* court jeopardizes prospects of reorganization for trademark licensors and risks the destruction of valuable commercial brands. If, as has been stated, "[g]oodwill and its trademark symbol are as inseparable as Siamese twins who cannot be separated without death to both,"[213] the *Sunbeam Products* court has mandated emergency surgery for all trademark licenses rejected in bankruptcy, surgery that will separate trademark symbols from the goodwill created by the licensees of the marks and destroy both the trademark and associated goodwill.

The *Sunbeam Products* decision also errs in implying protections for trademark licensees despite express congressional exclusion of trademark licensees from protections under section 365(n). In other words, why, if rights in trademarks under a license are equivalent to rights in real estate under a lease and both sets of rights survive contract rejection, would Congress have enacted section 365(h) expressly to protect rights of tenants under real estate leases and have considered and expressly rejected similar protections for trademark licensees? Statutory protections for tenants under real estate leases have been in place for seventy-five years, since the passage of the Chandler Act in 1938,[214] while no similar protections have ever existed for trademark licensees. Similarly, as described above,[215] in other situations involving real estate sales contracts, time-

211. In reaction to the *Sunbeam Products* decision, the U.S. Legislation Subcommittee of the Legislation and Regulatory Analysis Committee of the International Trademark Association expressed concern about destruction of trademarks as a result of continued licensee trademark use after license rejection by a debtor licensor, if the debtor licensor has no continuing obligation to maintain quality control. *See supra* notes 192–93 and accompanying text.

212. *See supra* notes 115–16 and accompanying text.

213. *See* McCarthy, *supra* note 104, § 18:2, at 18-6.

214. Weinstein, *supra* note 45, at 159.

215. *See supra* Parts I.C, I.D.

share sales contracts, shopping center leases, collective bargaining agreements, and intellectual property licenses, where Congress was concerned that non-debtor parties should have procedural rights or rights of specific performance, the Bankruptcy Code provides exceptions to the general rule that remedies of specific performance are not available to non-debtor parties to rejected executory contracts. Under basic principles of statutory construction, the inclusion of specific exceptions implies the existence of a general rule (*exceptio probat regulum in casibus non exceptis*) and the existence of express exceptions establishes that other exceptions should not be implied (*expressio unius est exclusio alterius*). The *Sunbeam Products* court fails to explain why principles of statutory construction should not be applied under the Bankruptcy Code to exclude trademark licensees that are parties to rejected licenses from remedies of specific performance.[216]

The *Sunbeam Products* court does not even recognize, much less discuss, the full range of statutory exceptions created to protect rights of non-debtor parties to specific types of executory contracts. Furthermore, in each of the cases where Congress created a statutory exception and effectively granted rights of specific performance to non-debtors, Congress created benefits for debtors as well.[217] Thus, Congress granted tenants under real estate leases and buyers of timeshare interests and real estate continued rights to property in exchange for limitation of claims against the debtor's estate.[218] With regard to collective bargaining agreements, Congress created procedural rules and substantive standards to benefit non-debtors, but permitted debtors to modify unilaterally agreements to facilitate reorganization.[219] And with regard to rejected licenses of patents and copyrights, Congress permitted licensees to continue to use licensed intellectual property but required, in exchange, that royalties be paid to the debtor without any right of setoff or administrative claim based on the debtor's non-performance.[220] The *Sunbeam Products* court, in creating a default rule that allows trademark licensees to retain use of trademarks following license rejection without any mandate for continued payment of royalties, ensures *more favorable* treatment for trademark licensees than Congress permitted even for the licensees of patents

216. The *Sunbeam Products* court rejects the view that omission of trademarks from the Bankruptcy Code definition of "intellectual property" entitled to the protections of section 365(n) of the Bankruptcy Code implies that Congress intended to codify the *Lubrizol* result with respect to trademarks, stating that "an omission is just an omission." Sunbeam Prods., Inc. v. Chi. Am. Mfg., Inc., 686 F.3d 372, 375 (7th Cir.), *cert. denied*, 133 S. Ct. 790 (2012). The *Sunbeam* court never addresses implications that should, under principles of statutory construction, be drawn from the existence of other statutory exceptions to the *Lubrizol* rule. *See* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 522–23 (1984) (noting that because section 1167 of the Bankruptcy Code expressly exempts collective bargaining agreements subject to the Railway Labor Act, Congress knew how to draft an exclusion for collective bargaining agreements, thereby indicating that section 365(a) of the Bankruptcy Code, in the absence of a similar exclusion, applies to collective bargaining agreements).

217. In this way, statutory protections for non-debtors under the Bankruptcy Code differ markedly from statutory protections under the Bankruptcy Act. *See* WEINSTEIN, *supra* note 45, at 159 (providing under section 70b of the Chandler Act that lease rejection "shall not deprive the lessee of his estate," but failing to alter rights under applicable nonbankruptcy law).

218. 11 U.S.C. § 365(h)(2) (2006).

219. *Id.* § 1113.

220. *Id.* § 365(n).

and copyrights that the Bankruptcy Code protects by statute. Such a default rule is inconsistent with a statutory framework in which Congress, in each case under the Bankruptcy Code where it has acted to protect non-debtor parties to executory contracts, has balanced protections for non-debtors with provisions favoring reorganization of Chapter 11 debtors.

For all of these reasons, the *Sunbeam Products* case is wrongly decided and creates serious adverse consequences for trademark licensees as well as trademark licensors.

B. Implications of *Sunbeam Products* for Patent and Copyright Licenses Rejected in Bankruptcy

Section 365(n) is the result of a "careful compromise" between the interests of licensees of patents and copyrights and debtors in bankruptcy.[221] In the event of license rejection, licensees are afforded an election to continue to use licensed intellectual property.[222] Debtors, in the event of a section 365(n) election, continue to receive royalties that otherwise would have been due under rejected licenses notwithstanding the debtors' breach of the license. Furthermore, licensees making a section 365(n) election are deemed to waive any right of setoff and any administrative claim arising from the debtors' non-performance of the license.[223]

In the event that a non-debtor licensee does not make the section 365(n) election to continue to use intellectual property, the license is treated as terminated by the rejection.[224] In that case, because the license is not only deemed breached by the election but also is terminated, even under the Seventh Circuit's *Sunbeam Products* decision, the licensee would not be able to assert any continuing rights in the licensed intellectual property. In other words, for rejected intellectual property licenses covered by section 365(n),[225] continued rights to use intellectual property may be obtained only through an election under that section.

IV. Market Responses to Address Insolvency Risk for Licensees of Intellectual Property

Transaction structures have evolved, and will continue to evolve, to address licensor insolvency risk while preserving the versatility of traditional intellectual property licensing arrangements. As the Senate Judiciary Committee has noted, intellectual property licensing permits the economic potential of a useful inven-

221. S. Rep. No. 100-505, at 10 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3207.
222. 11 U.S.C. § 365(n)(1)(B) (2006).
223. *Id.* § 365(n)(2)(B).
224. *Id.* § 365(n)(2)(C).
225. If the *Sunbeam Products* decision becomes accepted precedent in the United States, there will be additional support for patent and copyright licensees in situations where section 365(n) is not applicable, such as where a licensor is in bankruptcy in a foreign jurisdiction. In such a case, the *Sunbeam Products* decision would provide additional reasons for choice of United States law rather than the law of a foreign jurisdiction in determining whether a licensee's right in intellectual property would continue notwithstanding the licensor's rejection, disclaimer, or breach of the license.

tion to be divided and separately financed and developed for different products, purposes, and geographic markets.[226] Through licensing, the original inventor retains ownership and is afforded a share of the profits if the licensed products are successfully developed and marketed.[227] Similarly, in trademark licensing, the owner of a trademark can generate revenue from uses of the mark in association with products for which the trademark owner lacks developmental or marketing expertise. For example, a trademark associated with an event, such as a motion picture, or an organization, such as a sports team, can be licensed for use with consumer products or in co-promotion transactions with other businesses. The goal in structuring licensing transactions is to retain the versatility of licensing arrangements while, in appropriate cases where licensor insolvency is a meaningful risk, taking steps to reduce the risk.

Licensor insolvency risk is perhaps greatest in the situations that courts addressed in the *Exide Technologies* and *Interstate Bakeries* cases where the licensor is in financial distress and the license is a prepaid, perpetual license. This situation commonly arises in the context of the sale or spinoff of a business unit of a company that is raising capital to pay down debt or to increase investment in its core business. In such cases, the seller may be in financial distress and bankruptcy may be a meaningful risk. Because the license is structured as a prepaid license, the seller-licensor retains no ongoing benefit from the license and the risk of rejection of the license in bankruptcy is therefore increased. A perpetual, prepaid license can be structured to minimize the risk of characterization of the license as an executory contract that is subject to rejection in a licensor's bankruptcy. Depending on the negotiating strength of the licensee, seller-licensor insolvency risk can also be eliminated by structuring the transaction as an absolute sale of trademarks to the financially stable buyer of the sold business unit, with a license back to the financially distressed seller for use with products or in markets related to the seller's retained, core business. Or a transaction can be structured to reduce licensor insolvency risk through use of a bankruptcy remote intellectual property holding company. Other approaches that commentators have suggested to address licensor insolvency risk, such as granting security interests to licensees, are less practical and only infrequently used in licensing transactions.

A. Structuring Licenses as Non-Executory Contracts

Structuring a license so that it is not an executory contract is intended to take advantage of the rationale of the Third Circuit case, *In re Exide Technologies*, in which the court held that a prepaid trademark license was not an executory contract subject to rejection in a licensor's bankruptcy.[228] Significant care needs to be taken in structuring trademark licenses as non-executory contracts to preserve the licensor's ability to control quality and consistency of the licensee's use of the mark while avoiding contractual covenants and defaults that would

226. S. Rep. No. 100-505, at 3–4, *reprinted in* 1988 U.S.C.C.A.N. at 3202–03.
227. *Id.*
228. 607 F.3d 957, 964 (3d Cir. 2010).

render licenses executory under the recent Eighth Circuit opinion in *In re Interstate Bakeries Corp.*[229] If the license is a prepaid license granted in connection with a transaction by which product lines or a business are sold, risk of characterization of the license as an executory contract can be minimized by expressly incorporating the license as an integrated contract with the asset or stock purchase agreement that documents the sale of the products or business unit. The license should also recite the parties' intention that the license is not an executory contract and provide that default by the licensee, including default for the licensee's failure to maintain the quality of trademarked goods or services, is not a material default that permits the licensor to terminate the license of the trademark.[230] A trademark licensor must maintain control of the quality and consistency of the licensee's use of the mark, but if breach of the licensee's covenant to maintain quality control does not permit termination of the license, the license should not be an executory contract under the Countryman test.[231]

B. Absolute Assignments or Use of Bankruptcy Remote Intellectual Property Holding Companies

Another option for acquirers of product lines or business segments is to require an absolute assignment of the trademark instead of a license. In exchange, the acquirer would license certain trademark rights back to the seller.[232] Technically speaking, a sale/license back structure reverses rather than eliminates licensor insolvency risk; the licensor becomes the licensee subject to licensor insolvency risk and the licensee becomes the licensor. If the acquirer of the business unit, however, is a well-capitalized, highly solvent company, licensor insolvency risk is eliminated for all practical purposes.

Use of so-called bankruptcy remote intellectual property holding companies is also an effective structural method for minimizing licensor insolvency risk.[233] A bankruptcy remote intellectual property holding company is a corporation, limited liability company, trust, or other entity that has limited authority to engage in business (other than holding and licensing intellectual property) and that is prohibited from incurring debt.[234] Similar to an absolute assignment and license back, a bankruptcy remote intellectual property holding company structure requires contribution of intellectual property to a holding company that then becomes a licensor to the entity contributing the intellectual property as well as to prospective arm's-length licensees. A bankruptcy remote holding company structure minimizes licensor bankruptcy risk by ensuring that licensed intellec-

229. No. 11-1850, 2012 U.S. App. LEXIS 18403 (8th Cir. Aug. 30, 2012).
230. *See id.* at *11–14.
231. *See supra* note 22.
232. *See* Cieri & Morgan, *supra* note 6, at 1686–88.
233. *Id.* at 1689–90.
234. *Id.* at 1690. The entity is governed by a board of directors that includes one or more independent directors selected by intellectual property licensees or one or more classes of stock held by licensees. *Id.* Unanimous consent of the board of directors or stockholders is required to amend the entity's organizational documents or to file for bankruptcy.

tual property is owned and licensed by a solvent entity that, as an organizational matter, is disabled from filing for bankruptcy.

Bankruptcy remote intellectual property holding company structures are not practical in all cases. Holding company structures are administratively complex and add to transaction costs. In addition, for many venture capital backed start-up companies, intellectual property is the primary asset used to attract successive rounds of equity investment. Use of a bankruptcy remote holding company emphasizes insolvency risk and can be an impediment to successful completion of the investor due diligence necessary to close subsequent rounds of equity financing. In this way, ironically, a structural solution that minimizes risk in the event of bankruptcy can result in a situation that impedes a start-up company's access to capital and potentially increases the risk that a bankruptcy will occur.

C. Security Interests in Licensed Intellectual Property

Commentators have suggested that licensees take security interests in licensed intellectual property to create a disincentive for rejection of an intellectual property license in bankruptcy.[235] While acknowledging that a security interest in underlying licensed intellectual property "does not insure continued performance of a license agreement," at least one commentator has argued that grant of a security interest is an effective means to minimize insolvency risk because it converts what would otherwise be a pre-bankruptcy general unsecured license rejection damage claim to a secured claim.[236] As a result, the grant of security creates an economic disincentive for a debtor-licensor to reject a license agreement.

In practice, a licensor's grant of a security interest in underlying intellectual property to a licensee is only rarely a practical solution for addressing licensor insolvency risk. For established companies with secured term loans or bank credit lines, granting a security interest to a licensee would require a difficult renegotiation of credit terms with lenders. For start-up companies, granting a security interest in intellectual property may be perceived by potential future investors as mortgaging the company's "crown jewels" and limit the company's prospects for raising capital and continued growth. Because the collateral pledged to a licensee secures a contingent obligation (contract rejection damages in the event of a licensor's bankruptcy), the security interest cannot readily be released through a refinancing, even if the licensor's financial situation later improves. Finally, the security interest can increase insolvency risk for later licensees of intellectual property in other product fields or geographic territories who, even if they are granted similar security interests, cannot achieve the same lien priority as the original licensee. In short, a grant of a security interest to licensees is rarely a practical solution because licensor bankruptcy is often a relatively re-

235. *See id.* at 1691–92.
236. *See id.* at 1691.

mote risk and the grant of a security interest to licensees can be an immediate and significant impediment to the conduct of a licensor's business.

V. Conclusion

After more than a quarter century of settled law, the Seventh Circuit's decision in *Sunbeam Products* has created a circuit split and uncertainty as to the treatment of licensed trademark rights following rejection of the license in bankruptcy. In its seven-page decision, the Seventh Circuit addressed a trademark license as if it were a real estate lease and ignored the unique nature of licensed trademark rights, which in most cases are not analogous to a property transfer but document the active relationship between the licensor and licensee that is necessary to maintain the validity of the trademark. The ability of a licensee to retain rights to use trademarks following rejection of the license in bankruptcy requires specific performance of a debtor-licensor's obligation to maintain quality control of trademarked products or services, a remedy that is prohibited under the Bankruptcy Code. Trademark licenses were intentionally excluded by Congress from statutory protections afforded licensees of patents and copyrights under the Bankruptcy Code, protections that are carefully balanced with provisions intended to foster and promote reorganization of distressed companies. For these reasons, *Sunbeam Products* is wrongly decided and should not be adopted by other courts.

In the absence of statutory or court-created protections for trademark licensees, various transaction structures can be utilized to protect the rights of trademark licensees following bankruptcy of the licensor. The easiest and most practical solution in some situations is to draft the license as a non-executory contract that cannot be rejected in bankruptcy, although care is required to fit within the criteria set by the *Exide Technologies* court while at the same time preserving a licensor's control of the quality and consistency of use of licensed trademarks. Additional options include using bankruptcy remote intellectual property holding companies and sale/license back structures, although the viability of these options depends on the negotiating strength of the prospective licensee. To the extent that transaction structures are inadequate to protect trademark licensees from licensor insolvency risk, the remedy should be with Congress rather than with the courts.