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Client Alert: 7th Circuit: Trademark Owners in Bankruptcy Cannot Revoke License Agreements

The United States Court of Appeals for the Seventh Circuit recently issued its opinion in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, in which the court clarified that the rejection of a trademark license in bankruptcy does not end the licensee's right to use the licensed trademark. Prior to the decision, trademark licensees had effectively no guarantee of continued use of the licensed trademarks in a licensor bankruptcy. It is the first published decision by a federal appeals court in nearly 30 years that directly addresses the effect of bankruptcy on a trademark licensee's rights.

Case Background

In the case, Lakewood Engineering & Manufacturing Co. ("Lakewood"), a manufacturer of various consumer products, licensed its patents to Chicago American Manufacturing ("CAM") and allowed CAM to use the LAKEWOOD trademark on CAM-manufactured fans.[1] Soon after entering into the license agreement, Lakewood's creditors filed an involuntary bankruptcy petition against it, resulting in the appointment of a trustee for the debtor-licensor.

Section 365 of the United States Bankruptcy Code generally provides that a trustee "may assume or reject any executory contract or unexpired lease of the debtor."[2] Pursuant to that provision, Lakewood's trustee

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rejected the executory (unperformed) portion of the CAM contract.

Additionally, the trustee sold Lakewood's assets, including the licensed patents and the LAKEWOOD trademark, to Sunbeam Products. However, Sunbeam Products did not want the LAKEWOOD-branded fans in CAM's inventory, nor did it want CAM to continue selling LAKEWOOD-branded fans, given that Sunbeam Products now owned the LAKEWOOD mark.

When CAM nonetheless continued making and selling LAKEWOOD-branded fans after the trustee's rejection of the contract, Sunbeam Products brought an adversary action against it, seeking an injunction that would prevent CAM's further LAKEWOOD sales.

The federal bankruptcy court held a trial to address whether Sunbeam Products was entitled to such an injunction. The judge determined that, due to the substantial resources CAM had invested in making the LAKEWOOD-branded fans, CAM was entitled to continue using the LAKEWOOD marks for the remainder of the license agreement.[3] Sunbeam Products then appealed that decision to the United States Court of Appeals for the Seventh Circuit, with the key issue being whether rejection of a trademark license in bankruptcy ends the licensee's right to use the licensed trademark.

Court Deciphers Whether Bankruptcy Code Update Covers Trademarks

Until *Sunbeam*, no federal appeals court had specifically considered and rejected the Fourth Circuit's decades-old holding in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, where that court addressed the effect of bankruptcy on an intellectual property licensee's rights.[4]

In *Lubrizol*, the United States Court of Appeals for the Fourth Circuit held that when an intellectual property

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license is rejected in bankruptcy, the licensee loses the ability to use any licensed copyrights, trademarks or patents. There, the debtor-licensor sought to reject a license of its patents, which were its principal assets.

The Fourth Circuit ruled that while the licensee had a damages claim for breach of its license agreement, it did not have a "specific performance" remedy. In the court's view, allowing continued use of the licensed patented technology constituted such a specific performance remedy, and was therefore inappropriate. However, when *Lubrizol* was decided in 1984, Congress had not yet added § 365(n) to the Bankruptcy Code.

In essence, § 365(n), which was enacted in 1988, provides that if a trustee or debtor-licensor in bankruptcy rejects the unperformed portion of an "intellectual property" license, the licensee has two options:

- Treat the license as terminated and assert a claim for breach of contract; or
- Continue to use the intellectual property—consistent with the use and rights existing immediately before the commencement of the bankruptcy case—for the duration of the contract.[5]

However, the Bankruptcy Code defines "intellectual property" as including patents, copyrights, and trade secrets, and trademarks are conspicuously omitted. Bankruptcy judges have therefore generally interpreted this omission to imply Congress' intent to codify the outcome of *Lubrizol* with respect to trademarks.[6] This means that, prior to the Sunbeam decision, trademark licensees had effectively no guarantee of continued use of the licensed trademarks in a licensor bankruptcy.

In *Sunbeam*, the Seventh Circuit explained that the omission of the term "trademark" from § 365(n) is "just an omission."[7]The court held that the limited definition of "intellectual property" means only that § 365(n) does not

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affect trademarks one way or another.[8] The Senate committee report on the bill including § 365(n) makes clear that the omission was designed to allow more time for study, not to approve the Lubrizol decision.[9]

Decision Reached: Trademark License Rejection in Bankruptcy Does Not End Licensee's Rights

Accordingly, the Sunbeam court held that because a rejection of a trademark license constitutes a breach of contract, it should be treated accordingly.

The court further reasoned that "by classifying [the] rejection [of a license] as [a] breach [...] the other party's rights remain in place." Because a licensor's breach of contract outside of bankruptcy does not terminate a licensee's right to use intellectual property, neither should a rejection of the license in bankruptcy.[10] Bankruptcy law merely frees the estate from the obligation to perform; it "has absolutely no effect upon the contract's continued existence."[11]

As a result, the court held that the Lakewood trustee's rejection of the trademark license was equivalent to Lakewood's breach of contract. Accordingly, CAM was entitled to continue using the LAKEWOOD trademark on its fans.[12]The implication of the Sunbeam holding, in sharp contrast to that of Lubrizol, is that the rejection of trademark licenses in bankruptcy does not end the licensee's right to use the licensed trademark.

There is little doubt that other circuits will attempt to bridge the divide between the Fourth Circuit's *Lubrizol* decision and the Seventh Circuit's *Sunbeam* decision with various interpretations of the Bankruptcy Code. Accordingly, the time may be ripe for the Supreme Court to definitively rule on how the rights of intellectual property licensees, and particularly

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trademark licensees, are impacted by the bankruptcy of the licensor.

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[1] *Sunbeam Products, Inc. v. Chicago American Mfg. LLC*, 2012 WL 2687939 at *1 (7th Cir. July 9, 2012).

[2] 11 U.S.C. § 365(a).

[3] The *Sunbeam* court held that the bankruptcy judge's ruling was therefore based on "equitable grounds," which is an untenable basis for a decision pursuant to the Bankruptcy Code. The court held that "rights depend, however, on what the Code provides rather than on notions of equity." Sunbeam, 2012 WL 2687939 at *2.

[4] *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985).

[5] 11 U.S.C. § 365(n)(1)(B).

[6] *Sunbeam*, 2012 WL 2687939 at *1 (See also Jeffry A. Davis, et al, "Recent Developments Concerning Intellectual Property and Bankruptcy," American Bankruptcy Institute Battleground West, March 5, 2010).

[7] *Id.*

[8] *Id.*

[9] S. Rep. No. 100-505, 100th Cong., 2d Sess. 5 (1998), See also In re Exide Technologies, 607 F.3d 957, 966-67 (3d Cir. 2010) (Ambro, J., concurring) (concluding that § 365(n) neither codifies nor disapproves Lubrizol as applied to trademarks).

[10] *Sunbeam*, 2012 WL 2687939 at *4.

[11] *Id.* (citing *Thompkins v. Lil' Joe Records, Inc.*, 476 F.3d 1294, 1306 (11th Cir. 2007).

[12] The *Sunbeam* court held that although Lakewood's unfulfilled obligations could be converted to damages, "nothing about this process implies that any rights of the other contracting party [CAM] have been vaporized." Id at *4.

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