Seventh Circuit holds that a trademark licensee is permitted to continue using licensed marks despite bankruptcy rejection of the license agreement

By John C. Paul and D. Brian Kacedon, Finnegan, Henderson, Farabow, Garett & Dummer LLP, USA

First published on www.lexology.com

An issue of potential concern for any licensee of intellectual property is the possibility of losing that license if its licensor files for bankruptcy protection. For a bankrupt licensor, its intellectual property may be a significant asset that could be sold or otherwise licensed as part of a dissolution or restructuring. But any license on such intellectual property essentially acts as an encumberance on that property that may reduce the value of the asset to a potential purchaser. Moreover, the bankruptcy laws do permit entities to "reject" or terminate contracts under certain circumstances as part of the bankruptcy process. Therefore, a licensee might be rightly concerned about a potential for loss of its license rights if its licensor enters bankruptcy.

In 1985, the Court of Appeals for the Fourth Circuit held, in Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985), that a licensee can lose the ability to use any licensed copyrights, trademarks, and patents if a bankrupt licensor chooses to reject the existing license agreement. Shortly thereafter, Congress passed legislation that explicitly allows licensees to continue using patents, copyrights, and trade secrets when an agreement is rejected in bankruptcy. Congress did not, however, explicitly address trademarks. No other court of appeals has since agreed or disagreed with the Fourth Circuit on whether a licensee may continue to use licensed trademarks if its bankrupt licensor wishes to reject the license agreement.

Recently, in Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC,1 the Seventh Circuit explored this issue and held that trademark licensees may continue using licensed marks even after the license agreements are rejected in bankruptcy.

Background

Chicago American Manufacturing ("CAM") was licensed to practice Lakewood Engineering & Manufacturing Co.'s patents and use Lakewood's trademarks on the box fans that CAM manufactured for Lakewood. Three months into the contract, Lakewood's creditors filed an involuntary bankruptcy petition against it, resulting in the sale of Lakewood's business, including its patents and trademarks, to Sunbeam Products, Inc., doing business as Jarden Consumer Solutions. Jarden did not want to purchase the Lakewood-branded fans in CAM's inventory, nor did it want CAM to sell those fans in competition with Jarden's products. CAM continued to make and sell the Lakewood-branded fans. Meanwhile, a bankruptcy judge determined that, based on the Lakewood- CAM contract, CAM was entitled to make and sell a specified number of fans bearing Lakewood's trademarks. The Seventh

Circuit, on appeal, addressed CAM's use of the trademark license and its continued manufacture and sale of the Lakewood-branded fans over Jarden's objection.

The Sunbeam Decision

The court in Sunbeam first discussed Lubrizol, which held that when a license is rejected in bankruptcy, the licensee loses the ability to use any licensed copyrights, trademarks, and patents. The court noted that three years after the Lubrizol decision, Congress added section 365(n) to the Bankruptcy Code. Section 365(n) allows licensees to continue using "intellectual property" after rejections similar to Sunbeam's rejection. Because the code defined intellectual property as patents, copyrights, and trade secrets, the statute did not expressly address trademarks. The Seventh Circuit acknowledged that some bankruptcy judges have inferred from the omission that Congress codified Lubrizol for trademarks; in other words, concluding that licensees in this situation may not continue to use the licensed trademarks. In the words of the Sunbeam court, however, "an omission is just an omission." In fact, the Senate committee report explained that the omission was designed to allow more time for study.

The bankruptcy judge allowed CAM to continue using the Lakewood marks "on equitable grounds" without deciding whether a contract's rejection under the Bankruptcy Code ends the licensee's rights to use the trademarks. Recognizing the potential for disparate approaches to equity in a given situation, the Seventh Circuit instead hinged its decision on the Bankruptcy Code. The code specifies that rejection of a license of the debtor "constitutes a breach of such contract" so the licensees rights turn on how the law treats breach by the licensor. The Seventh Circuit explained that outside of bankruptcy, a licensor's breach does not terminate a licensee's right to use intellectual property: a party's breach of a contract does not imply that the "rights of the other contracting party have been vaporized." In the court's example, a debtor's breach of a loan agreement does not destroy the lender's right to collect the loan. Thus, the Seventh Circuit rejected the Fourth Circuit's approach in *Lubrizol*, holding that bankruptcy rejection of the agreement between Lakewood and CAM did not eliminate CAM's contractual rights to Lakewood's trademark.

Strategy and Conclusion

The Seventh Circuit acknowledged that its decision in Sunbeam creates a conflict among the courts of appeals. This may not be resolved until Congress amends the Bankruptcy Code or until the Supreme Court weighs in. Until then, intellectual-property licensees may find some comfort in relying on Sunbeam in bankruptcy proceedings and while negotiating intellectual-property agreements. Licensors should consider Sunbeam when contemplating provisions in an agreement regarding which rights the parties will maintain in the event of bankruptcy.

For more information, please contact:

John C. Paul
Partner
Finnegan, Henderson, Farabow, Garrett & Dunner, LLP.
www.finnegan.com

D. Brian Kacedon
Partner
Finnegan, Henderson, Farabow, Garrett & Dunner, LLP.
www.finnegan.com

John C. Paul is a partner at Finnegan, Henderson, Farabow, Garrett & Dunner, LLP. Mr. Paul has over 30 years of experience in intellectual property licensing, litigation, and prosecution. He currently focuses on strategic planning, complex transactions, due diligence investigations, and licensing and enforcement of IP portfolios. He also chairs the firm's IP management section. Mr. Paul can be reached at 202.408.4109 or john.paul@finnegan.com.

D. Brian Kacedon is a partner at Finnegan, Henderson, Farabow, Garrett & Dunner, LLP. Mr. Kacedon focuses on patent licensing, litigation, prosecution, and opinion work. A substantial portion of his practice involves patent licensing and related litigation. His role in these matters has included assisting clients in conducting market assessments for their patents, conducting licensing negotiations, drafting licensing agreements, and participating in related litigations. Mr. Kacedon can be reached at 202.408.4301 or brian.kacedon@finnegan.com.