NOTES

Trademarked for Death? A Licensee's Trademark Rights After an Executory Contract Is Rejected in Bankruptcy

I. INTRODUCTION: A FAMILY FEUD

In 1872, a young man named Claudio Alvarez Lefebre began manufacturing and selling high-quality rum in Cuba under the brand name "Ron Matusalem."[1] In 1948, as the family-run business prospered, the company registered a trademark and corporate logo in the United States.[2] Upon his death, Lefebre left the business—and the secret formulas for making his rum—to his wife and children. By the early 1960s, Lefebre's wife and children had immigrated to the United States, and they split the rum-making business into two separate corporations.[3] These two distinct entities negotiated an executory contract[4] in the form of a franchise agreement with a trademark license. This agreement granted the franchisee corporation the right to sell Ron Matusalem rums worldwide under the Ron Matusalem trademark.[5] The franchisor corporation retained the right to control the nature and quality of the rums sold and the right to terminate the agreement if the franchisee failed to meet its standards.[6] For the next two decades, the two corporations operated as a cohesive family business, or, as a court described them, a "loose knit strada of corporations."[7]

1. *In re* Matusalem, 158 B.R. 514, 517 (Bankr. S.D. Fla. 1993).
2. *Id.*
3. *Id.*
4. *See id.* An executory contract is one that is wholly or partially unperformed on both sides. BLACK'S LAW DICTIONARY (9th ed. 2009).
5. *In re* Matusalem, 158 B.R. at 517.
6. *Id.*
7. *Id.* at 518 (detailing the opinion of the district court).

However, in late 1981, a family "squabble" emerged, and the leadership of the two corporations ceased cooperating.[8] Years of "litigation for litigation's sake" followed the quarrel.[9] Ten years later, the franchisor corporation filed a voluntary Chapter 11 bankruptcy proceeding. Unlike a typical Chapter 11 reorganization, this bankruptcy petition was not to reorganize and revitalize the corporation. Instead, the franchisor asked the court to reject the trademark license and end the franchisee's rights to the Ron Matusalem trademark. The franchisor had discovered a strategic path for ending the family squabble: pushing the franchisee out of the business entirely.[10]

When a trustee or debtor-in-possession rejects an executory contract involving trademark rights, courts have two potential approaches for determining who retains the right to use the trademark.[11] One approach terminates the licensee's right, only providing the licensee with the opportunity to sue for rejection damages.[12] The other approach grants the licensee continued use of the trademark rights under the theory that rejection is not rescission but instead is a contract breach whereby the nonbreaching party's rights remain in place.[13] Without a controlling Supreme Court opinion on point, differing approaches create confusion as courts struggle to balance intellectual property rights with the contractual rights of licensees.

Part II of this Note examines relevant sections of 11 U.S.C. § 365, subsequent amendments under the Intellectual Property Licenses in Bankruptcy Act ("IPLBA"), and theoretical interpretations and definitions of what "rejection" means within the context of bankruptcy law. Part III analyzes the circuit split, discussing the merits and weaknesses of each approach. Part IV suggests that the Supreme Court resolve the circuit split by adopting a modified version

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8. *Id.*

9. *Id.* at 517–18.

10. *See id.* at 520 ("The principal purpose of the Chapter 11 is to cause the rejection of Inc.'s franchise agreement . . . filed on December 10, 1992."). The court found that the filing was not an effort at reorganization but was rather a "vendetta." *Id.*

11. *Compare* Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 376–78 (7th Cir. 2012) (holding rejection as separate from rescission, thus leaving trademark licensee rights in place), *with* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) (finding that the only remedy is rejection damages, and not the retention of contract rights through specific performance).

12. *See Lubrizol*, 756 F.2d at 1048 (determining that licensees could not continue to use the intellectual property upon rejection).

13. *See Sunbeam*, 686 F.3d at 376–78 (holding that as the non-breaching party, the trademark licensee's rights remained in place).

of the Seventh and Third Circuits' approach, but adding the requirement that trademark licensees maintain the quality control standards initially contained in the parties' original licensing agreement.

II. BACKGROUND: 11 U.S.C. § 365, THE SIGNIFICANCE OF EXECUTORY CONTRACTS IN BANKRUPTCIES, AND THE 11 U.S.C. § 365(N) ISSUE

Section 365(a) of the Bankruptcy Code states that a trustee in bankruptcy may assume or reject any executory contract or unexpired lease of the debtor.[14] Because the Bankruptcy Code does not define "rejection" or "executory contract," the meaning of these terms requires further examination. Although the codification of the Intellectual Property Licenses in Bankruptcy Act[15] provides protections for licensees, it does not protect trademark licensees because trademarks are not included in the Bankruptcy Code's definition of "intellectual property."[16] However, a court may still grant a trademark licensee continued use of a trademark by treating a trustee's rejection as a "breach" of an executory contract.[17]

A. Regulating Executory Contracts in Bankruptcy: 11 U.S.C. § 365(a)

After filing a bankruptcy petition, the trustee or executor of the bankrupt estate may need to liquidate assets to raise capital needed to satisfy creditors.[18] Some situations require shedding contracts that were binding on the prepetition estate, whether to free up assets for sale or to prevent impairment of the postpetition entity.[19] Trustees must collect and liquidate property of the estate as quickly as possible, which requires the expeditious resolution of prepetition license agreements, a type of executory contract.[20] Bankruptcy trustees facing this dilemma can find a solution in 11 U.S.C. § 365, which regulates executory contracts and unexpired leases in bankruptcy.[21]

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14. 11 U.S.C. § 365(a) (2012).

15. *Id.* § 365(n).

16. *Id.* § 101(35A).

17. *Id.* § 365(g).

18. *See, e.g.*, *Sunbeam*, 686 F.3d at 374 (providing an example of a trustee's need to sell or liquidate assets of the bankrupt estate in order to satisfy creditors).

19. *See id.* In *Sunbeam*, the asset at issue was the use of Lakewood's trademark on boxed fans. The trustee decided to sell the "Lakewood" trademark to Jarden Consumer Solutions, but needed to resolve a trademark license with Chicago American Manufacturing (CAM).

20. Petition for Writ of Certiorari at *13–14, Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 133 S. Ct. 790 (2012) (No. 12-431).

21. 11 U.S.C. § 365.

Section 365(a) provides: "In subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."[22] Despite the importance of this section, the Bankruptcy Code leaves "executory contract" undefined, forcing courts to resort to extrinsic evidence of its meaning.

1. Providing a Functional Definition of "Executory Contract" Under 11 U.S.C. § 365

Although the Bankruptcy Code does not define "executory contract" as used in § 365(a),[23] the Code's legislative history provides guidance.[24] Statements made in the House of Representatives suggest that Congress intended "executory contract" to refer to a contract in which "performance is due to some extent on both sides."[25] Most courts have adopted legal scholar Vern Countryman's definition of "executory contract," which narrows the House's definition.[26] Under this definition, the obligations of both the debtor and the other party must be so far unperformed that the failure of either party to complete performance would entail a "material breach," thereby excusing the other party's performance.[27]

Like other intellectual property licenses, most trademark licenses are executory contracts.[28] Trademark licenses generally exchange rights for royalty payments, thus creating continuing

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22. *Id.* § 365(a).

23. *Id.*; *In re* Exide Techs., 607 F.3d 957, 962 (3rd Cir. 2010).

24. *See* H.R. REP. NO. 95-595, at 347 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5963. Legislative history suggests that while there is "no precise definition of what contracts are executory, [the term] generally includes contracts on which performance remains due to some extent on both sides." *Id.*

25. *See In re* Colombia Gas Sys. Inc., 50 F.3d 233, 238 (3rd Cir. 1995) (noting that Countryman's definition is narrow and that under Congress's definition, almost any contract can be considered an executory contract).

26. *In re* Exide, 607 F.3d at 962; *see* 2 WILLIAM L. NORTON JR. & WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW & PRACTICE § 46:6 (3d ed. 2008) (detailing the now-prevailing standard for determining an executory contract, Countryman's definition: "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other" (citation omitted)); *see also* Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 450 (1973) (providing an expanded and functional definition of executory contracts used by many courts).

27. Countryman, *supra* note 26, at 450.

28. Peter M. Gilhuly, Kimberly A. Posin & Ted A. Dillman, *Intellectually Bankrupt?: The Comprehensive Guide to Navigating IP Issues in Chapter 11*, 21 AM. BANKR. INST. L. REV. 1, 5 (2013) (discussing when patent, copyright, or trademark licenses are executory contracts and deducing that "IP licenses are almost always viewed as executory contracts unless the license is an assignment or one side has completely performed its obligations").

obligations between the parties.[29] In exchange for royalties, a license contractually prevents the licensor from suing the licensee for its use of the trademark.[30]

2. The Problem with "Naked Licenses"

Licenses commonly obligate the licensee to maintain the licensor's quality control standards for products marketed under the trademark.[31] These provisions protect the licensor from judicial forfeiture of its legal rights in those symbols.[32] A "naked license" does not include such control provisions.[33] Courts may interpret naked licenses as a signal that the trademark owner has abandoned the trademark.[34] More significantly, naked licenses might mislead the public.[35] Trademarks are often valuable specifically because of the goodwill they provide; thus, they are also implicit guarantees of quality.[36] A licensor's failure to control the quality of the goods or services produced by the licensee defrauds the public.[37] For these reasons, naked licenses should be avoided if possible.

3. The Business Judgment Test and Granting Rejection

Because a trustee or debtor-in-possession must both maximize value to the estate and reduce obligations to creditors, most seek to reject disadvantageous executory contracts or unexpired leases once a bankruptcy petition has been filed. Under § 365(a), rejection of

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29. *See id.* at 9–10:

> [B]oth parties to the license agreement have ongoing obligations; were this not the case, the trademark would be invalidated for lack of quality control. The licensor has the continuing statutory obligation to monitor the quality of the trademark, notify licensees of any infringements, enforce the trademark for the benefit of the licensee, and indemnify the licensee for any damages, expenses and attorney's fees. The licensee has the continuing obligation to adhere to the licensor's quality control . . . pay for the use . . . and to market the trademark.

30. *Id.* at 5 ("At a fundamental level, the grant of a license is intended to be a continuing obligation not to sue the licensee making any license executory."). For the sake of simplicity, "licensee" is synonymous with franchisee when discussing trademarks in bankruptcy.

31. Timothy W. Gordon, *Tenth Circuit Survey: Intellectual Property,* 73 DENV. U. L. REV. 829, 837 (1996) ("The trademark owner, however, must ensure that the licensee maintains the quality of goods bearing the trademark.").

32. JAY DRATLER, LICENSING OF INTELLECTUAL PROPERTY § 11.03 (1994).

33. *Id.*

34. Gordon, *supra* note 31, at 837.

35. Haymaker Sports, Inc. v. Turian, 581 F.2d 257, 261 (C.C.P.A. 1978) ("The purpose of [the adequate control] requirement is to protect the public from being misled.").

36. Kevin Parks, *"Naked" Is Not a Four-Letter Word: Debunking the Myth of the "Quality Control Requirement" in Trademark Licensing,* 82 TRADEMARK REP. 531, 533 (1992).

37. Gordon, *supra* note 31, at 837 n.80.

executory contracts or unexpired leases requires court approval.[38] Courts frequently grant deference to the trustee's request to reject an executory contract.[39] The Bankruptcy Code focuses on rehabilitating the debtor's estate, and courts recognize that the trustee or debtor-in-possession is usually in the best position to determine whether an executory contract will enhance or detract from the value of the estate.[40]

Accordingly, courts apply the business judgment test to evaluate whether a proposed rejection warrants approval.[41] Under this test, the court denies the request to reject an executory contract or unexpired lease only if the rejection detrimentally affects the estate or has an improper purpose.[42] A minority of courts use a balancing test, weighing the asserted benefit to the bankruptcy estate against the impact on the other party, to determine whether to grant rejection.[43] However, the majority version of the business judgment test considers only the needs of the bankrupt debtor's estate.[44] Because the test focuses on the

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38. 11 U.S.C. § 365(a) (2012).

39. *See* Peter S. Menell, *Bankruptcy Treatment of Intellectual Property Assets: An Economic Analysis*, 22 BERKELEY TECH. L.J. 733, 769 (2007) (characterizing the attitude of the Bankruptcy Code as "generally permissive").

40. *See* Gilhuly et al., *supra* note 28, at 34 ("The ability to reject executory contracts is one of the most powerful rights afforded to a debtor in bankruptcy and generally aids greatly in the debtor's successful reorganization.").

41. *See, e.g.*, Grp. of Institutional Investors v. Chi, Milwaukee, St. Paul & Pac. R.R. Co., 318 U.S. 523, 550 (1943) ("The question whether a lease should be rejected and, if not, on what terms it should be assumed is one of business judgment."); *In re* Chi-Feng Huang, 23 B.R. 798, 800 (B.A.P. 9th Cir. 1982) ("We believe the 'business judgment' rule is the standard which controls the court's right to disapprove the trustee's decision to reject an executory contract."); *In re* Hurricane Elkhorn Coal Corp. II, 15 B.R. 987, 989 (Bankr. W.D. Ky. 1981) ("The rigidity of the burdensome test makes its use unappealing. . . . [I]n light of the Supreme Court's reliance on the business judgment test . . . we think the business judgment rule to be the preferable standard.").

42. For an example of a detrimental effect on an estate, see *In re* Midwest Polychem, Ltd., 61 B.R. 559, 562 (Bankr. N.D. Ill. 1986) (denying rejection because it would make no business or equitable sense); *see also In re* Waldron, 785 F.2d 936, 940–41 (11th Cir. 1986) (determining that the debtor exercised rejection in bad faith); Gilhuly et al., *supra* note 28, at 35 (providing several further authorities).

43. *See, e.g.*, *In re* Matusalem, 158 B.R. 514, 522 (Bankr. S.D. Fla. 1993) (finding that rejection would provide little to no benefit to the debtor, while strongly damaging the licensee's business).

44. *See generally* Warren E. Agin, *Here Today and Gone Tomorrow: Section 365 and the Unfortunate Intellectual Property Licensee*, ANDREWS BANKR. LITIG. REP., Aug. 27, 2004, at 4 (discussing the disadvantages bankruptcy law presents for licensees, because the focus of bankruptcy law is rehabilitation of the bankrupt estate).

estate's rehabilitation,[45] courts grant rejection liberally, often inadvertently harming intellectual property licensees.[46]

4. Theoretical Interpretations of "Rejection"

What does the "rejection" of an executory contract actually entail? Does rejection require the courts to place the debtor-licensor and the solvent licensee in the positions they occupied before the license agreement? Common law provides the answer: no.[47] In *Thompkins v. Lil' Joe Records, Inc.*, the Eleventh Circuit determined that rejection of an executory contract was not the functional equivalent of rescission.[48] Upon rejection, the parties do not need to be returned back to their precontract positions.[49] Rejection under § 365 "does not embody . . . contract-vaporizing properties. . . . Rejection merely frees the estate from the obligation to perform; it does not make the contract disappear."[50] Scholarly opinions echo the Eleventh Circuit's finding in *Thompkins,* theorizing that rejection as defined in § 365(a) is synonymous with "not assume."[51] By not assuming the executory contract, the estate renounces future obligations of, and rights to, specific performance. However, the licensee's continuing rights are fully enforceable.[52]

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45. *See* Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) ("[Bankruptcy] gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns *at the time of bankruptcy*, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.") (emphasis added).

46. Agin, *supra* note 44, at 4.

47. *See* Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294, 1306 (11th Cir. 2007) (discussing how executory contract rejection under § 365 is not equivalent to a rescission); *see also,* 2 NORTON, *supra* note 26, § 46:57 ("The Bankruptcy Code instructs us that rejection is a breach of the executory contract. It is not avoidance, rescission, or termination."); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 59 U. COLO. L. REV. 845, 916 (1988) ("[R]ejection is not a rescission of the license or franchise, but merely that estate's determination not to assume it.").

48. 476 F.3d at 1306.

49. *Id.* (finding no authority requiring that the parties be put back in the positions they occupied before the contract was formed).

50. *Id.* (citing *In re* Drexel Burnham Lambert Grp., Inc., 138 B.R. 687, 703 (Bankr. S.D. Fla. 2000)).

51. *See* Andrew, *supra* note 47, at 848–49 (suggesting rejection is nothing more than the label for the decision not to assume).

52. *Id.* at 932 ("The confusion surrounding rejection has led, though, to the mistaken view that rejection of an 'executory' contract somehow abates or alters contract liabilities, thereby diminishing the non-debtor's rights.").

B. Codification of the Intellectual Property Licenses in Bankruptcy Act: 11 U.S.C. § 365(n)

In 1988, Congress passed the Intellectual Property Licenses in Bankruptcy Act to prevent debtor-licensors from abusing judicial rejection to strip licensees of contractual, bargained-for rights.[53] The IPLBA directly responded to the Fourth Circuit's ruling in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, which prioritized a debtor-licensor's rejection rights over a licensee's intellectual property rights and chilled intellectual property development.[54] Under *Lubrizol*, licensees of intellectual property lost their rights to use the intellectual property after the debtor-licensor rejected the executory contract in bankruptcy.[55] After *Lubrizol,* almost any license could be invalidated by the licensor's decision to file for bankruptcy.[56]

Intellectual property, high technology, and investor communities fiercely denounced the *Lubrizol* framework.[57] The U.S. Department of Commerce concluded that *Lubrizol* would preclude significant investment in technologies that required licensing.[58] Answering the outcry, Congress enacted IPLBA to prevent bankrupt licensors from depriving licensees of irreplaceable intellectual property rights.[59] Codified at 11 U.S.C. § 365(n), IPLBA strengthened the rights of intellectual property licensees.[60]

Section 365(n) provides intellectual property licensees with additional rights when a bankruptcy trustee or debtor-in-possession

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53. John P. Musone, *Crystallizing the Intellectual Property Licenses in Bankruptcy Act: A Proposed Solution to Achieve Congress' Intent*, 13 BANKR. DEV. J. 509, 509–10 (1997).

54. Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) ("Nor can it be doubted that allowing rejection in this and comparable cases could have a general chilling effect upon the willingness of such parties to contract at all with businesses in possible financial difficulty."); Musone, *supra* note 53, at 512 (detailing how Congress passed IPLBA with the express intent of reversing *Lubrizol*).

55. *Lubrizol*, 756 F.2d at 1048.

56. Jay L. Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 307 (1989).

57. Menell, *supra* note 39, at 770.

58. *Id.*

59. S. 1626, 100th Cong., 133 CONG. REC. S11, 654–55 (1987); *see* Andrew, *supra* note 47, at 919 (providing details of IPLBA, introduced by Senator Dennis DeConcini with the expressed purpose of "deny[ing] bankrupt licensors the ability to deprive licensees of irreplaceable intellectual property . . . by providing protections similar to those offered in real estate sales agreements and leases"); *see also* H.R. REP. No. 100-1012, at 6 (1988) (noting that *Lubrizol* had "a chilling effect on licenses of intellectual property and that businesses are becoming reluctant to rely on licensed technology knowing that the license could be taken away if the licensor files bankruptcy. Licensees sometimes use the licensed technology as the basis for an entire business.").

60. 11 U.S.C. § 365(n) (2012).

rejects the license agreement.[61] The key provision of § 365(n) is the right of the "licensee under such contract to . . . retain its rights . . . to such intellectual property . . . as such rights existed immediately before the case commenced."[62] These rights include continued use of the intellectual property for the duration of the license agreement, extending any applicable period under nonbankruptcy law.[63] Additionally, the licensee is given the ability to enforce exclusivity provisions against the debtor-licensor.[64]

However, under § 365(n) a licensee does not retain all of his or her original rights under the license.[65] Rather, the debtor and his or her successors obtain reprieve from some continuing obligations under the license.[66] Although the license's "affirmative performance" obligations no longer bind the debtor, passive obligations, such as not licensing the technology to others if the original license contained an exclusivity clause, still constrain the debtor's choices.[67]

C. Obstacles to Trademark Protection Under § 365: The Statutory Definition of "Intellectual Property" Under the Bankruptcy Code

As it is used in 11 U.S.C. § 365(n), the term "intellectual property" does not include trademarks and related forms of protection (i.e., trade dress).[68] Section 101(35A) of the Bankruptcy Code defines "intellectual property":

> (35A) "intellectual property" means –
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> (A) trade secret;
> (B) invention, process, design, or plant protected under title 35;
> (C) patent application;
> (D) plant variety;

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61. Menell, *supra* note 39, at 772.

62. 11 U.S.C. § 365(n)(1)(B).

63. Gilhuly et al., *supra* note 28, at 35.

64. *Id.*

65. *See* Menell, *supra* note 39, at 772 ("Congress did not, however, simply override the licensor's power to reject IP licensing agreements. Rather, it carefully crafted the mechanics and rights structure under section 365(n) to satisfy . . . intellectual property licensees . . . while shielding debtor-licensors from any additional burdens associated with the license.").

66. *Id.*

67. *See id.* (detailing the affirmative and negative duties debtors face upon rejection); *see also* S. REP. NO. 100-505, at 9 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3206–07; Gilhuly et al., *supra* note 26, at 38 ("Congress distinguished between the debtor-licensor's 'passive obligations' and 'affirmative performance.' ").

68. 11 U.S.C. § 101(35A) (2012).

> (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 nonbankruptcy law.[69]

Legislative history indicates that Congress intentionally omitted trademarks from "intellectual property" when it enacted § 365(n).[70] Congress found that such contracts were "beyond the scope of [the] legislation. . . . [T]rademark . . . relationships depend to a large extent on control of the quality of the products or services sold by the licensee . . . . [I]t was determined to postpone congressional action in this area and to allow the development of equitable treatment . . . by bankruptcy courts."[71]

Differences between the nature of trademark laws and that of patent and copyright laws may support differential treatment by Congress and explain the absence of trademark rights in 11 U.S.C. § 101(35A).[72] First, trademarks indicate the source of goods and services and cannot be sold or assigned apart from the goods they symbolize.[73] Second, while patents and copyrights are property rights of limited duration, trademarks derive from marketplace use, evolve over time, and can last indefinitely.[74] The durational differences between copyrights, patents, and trademarks may justify differential treatment.[75] Finally, the underlying goals of the protections are different. Patent and copyright protection focuses on promoting innovation[76] while trademark protection derives from the "need to ensure the integrity of the marketplace, and to prevent consumer confusion as to the source of goods."[77]

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69. *Id.*

70. S. REP NO. 100-505, at 5, *reprinted in* 1988 U.S.C.C.A.N., at 3204; Gilhuly et al., *supra* note 28, at 45 ("The exclusion of trademarks from the Bankruptcy Code's definition of IP appears to be intentional.").

71. *Id.*

72. 11 U.S.C. § 101(35A); *see* Gilhuly et al., *supra* note 28, at 32 (explaining differences between patent, copyright, and trademark laws).

73. Gilhuly et al., *supra* note 28, at 32.

74. James M. Wilton & Andrew G. Devore, *Trademark Licensing in the Shadow of Bankruptcy*, 68 BUS. LAW. 739, 757 (2013) (discussing the fundamental differences between the nature of trademark, patent, and copyright rights).

75. *See id.* (providing an example of how the long-term nature of many trademark licenses leads to difficulties in amending the contracts in anticipation of contract renewal, thus posing constraints on licensors in ways that can harm a licensor's business's viability).

76. Gilhuly et al., *supra* note 28, at 32.

77. *Id.*

D. Treating Rejection of an Executory Contract as a Breach of Contract: 11 U.S.C. § 365(g)

The Code also provides § 365(g) to assist the court in determining the rights of both licensees and debtors upon the rejection of an executory contract.[78] The essential language within this section states, "[T]he rejection of an executory contract or unexpired lease of the debtor constitutes a *breach* of such contract or lease."[79] In applying § 365(g) to trademark licensees and assigning trademark rights after rejection, courts consider law on breach from both bankruptcy and other areas of law.[80] If one party breaches a contract, the nonbreaching party's rights do not change.[81] In *Thompkins v. Lil' Joe Records, Inc.,* the plaintiff argued that rejection under § 365(g) required contract dissolution that would return the parties to their precontract positions.[82] In denying the plaintiff's argument for contract rescission, the court decided that rejection under § 365(g) had "no effect upon the contract's continued existence . . . rejection merely frees the estate from the obligation to perform."[83] Under § 365(g), the trustee's rejection operates as the debtor's estate breaching the contract; the licensee's right to continued use of the intellectual property is unaffected.[84]

III. ANALYSIS: THE CIRCUIT SPLIT BETWEEN THE FOURTH CIRCUIT AND THE SEVENTH AND THIRD CIRCUITS

Because the Bankruptcy Code definition of "intellectual property" does not include trademarks, courts disagree over whether protections for intellectual property licensees under § 365(n) should nevertheless extend to trademark licensees.[85] This disagreement has created a circuit split between the Fourth Circuit on the one hand and

78. 11 U.S.C. § 365(g) (2012).

79. *Id.* (emphasis added); *see* 2 NORTON, *supra* note 6, § 46:57 ("The Bankruptcy Code instructs us that rejection is a breach of the executory contract. It is not avoidance, rescission, or termination.").

80. *See e.g.*, Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 377 (7th Cir. 2012) ("[W]hat § 365(g) does by classifying rejection as breach is establish that in bankruptcy, as outside of it, the other party's rights remain in place.").

81. *Id.*

82. Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294, 1306 (11th Cir. 2007).

83. *Id.*

84. *See id.* Although *Thompkins* did not deal with trademarks, the reasoning of 11 U.S.C. § 365(g) can be applied to trademark license agreements.

85. *See supra* notes 11–13 and accompanying text.

the Seventh and Third Circuits on the other.[86] Under the Fourth Circuit's approach in *Lubrizol,* a trademark licensee cannot continue to use the trademark license once the debtor-licensor's trustee rejects the license in bankruptcy.[87] This directly opposes the Seventh and Third Circuits' approach in *Sunbeam* and *In re Exide*.[88] Under this approach, the trustee's rejection of the executory contract constitutes a breach of contract.[89] As a result, the nonbreaching party, here the licensee, is entitled to his or her rights under the contract as they existed immediately before the breach, which may include the right to the continued use of the trademark.[90]

A. Fourth Circuit Approach in Lubrizol Enterprises v. Richmond Metal Finishers: *No Postrejection Use of the Trademark by the Licensee*

The Fourth Circuit first articulated its position in *Lubrizol Enterprises v. Richmond Metal Finishers*, a case involving a patent license.[91] In 1982, Richmond Metal Finishers ("RMF") and Lubrizol entered into a contract that granted Lubrizol a nonexclusive license to use a metal coating process developed and owned by RMF.[92] The court determined that the agreement was an executory contract.[93] In exchange for the license, Lubrizol owed RMF royalties for use of the process, while RMF had the continuing duty to notify Lubrizol of any patent infringement suits. RMF also agreed to consider renegotiating royalty rates if new licenses were granted to other parties at lower rates.[94] RMF filed for Chapter 11 a year later and sought to reject the contract under § 365(a).[95] The bankruptcy court approved the rejection, finding that it did not violate the business judgment rule.[96] By accepting the bankruptcy court's application of the business judgment test, the Fourth Circuit denied Lubrizol the right to retain its contractual right

86. *Id.*

87. *See generally* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985) (providing the basis for most district court opinions terminating the rights of licensees to use trademark rights upon rejection by the debtor's trustee).

88. *See supra* note 19 (providing the holding from *Sunbeam*).

89. *Id.*

90. *Id.*

91. *See supra* note 54 and accompanying text.

92. *Lubrizol*, 756 F.2d at 1045.

93. *Id.*

94. *Id.*

95. 11 U.S.C. § 365(a) (2012); *Lubrizol,* 756 F.2d at 1045.

96. *Lubrizol,* 756 F.2d at 1047.

to use the technology and limited Lubrizol's claim to damages for the rejection.[97]

Several lower courts have adopted *Lubrizol's* reasoning and provided further justifications for denying trademark licensees the continued right to use the trademark postrejection.[98] For example, one bankruptcy court demonstrated a strict textualist interpretation of § 365 in an analysis that closely mirrored *Lubrizol*. When determining trademark rights in a software dispute, the court in *In re Centura* determined that the plain language of 11 U.S.C. § 365(n) excluded trademarks from the definition of "intellectual property." Because it was "inappropriate to resort to legislative history when the statute is clear," the court denied the licensee continuing rights.[99] Other cases have supported the Fourth Circuit's finding that damages are the only remedy authorized under § 365(g)(1) for licensees after rejection.[100] This effectively denies licensees a specific performance remedy that would allow postrejection use of the trademark.[101]

Some lower courts have applied *Lubrizol* to deny licensees continued trademark rights under the license but have granted a "phase out period."[102] During the "phase out," or transition period, the licensee is temporarily granted the right to continued use of the trademark for a defined period. Although there is no statutory authority for transition periods, courts have granted them in at least two instances.[103] However, the length of the phase out periods varied

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97. *Id.* at 1048:

> Lubrizol would be entitled to treat rejection as a breach and seek a money damages remedy; however, it 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. . . . [T]he purpose of [365(g)] is to provide only a damages remedy for the non-bankrupt party.

98. *See, e.g.*, *In re* Old Carco LLC, 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009) (suggesting that trademarks are not "intellectual property" under the Bankruptcy Code and, therefore, rejection by a licensor deprives a licensee of the right to use a trademark); *In re* HQ Global Holdings, Inc., 290 B.R. 507, 513 (Bankr. D. Del. 2003) ("[U]pon the rejection of a trademark license, *Lubrizol's* harsh holding controls, and the licensee is left with only a claim for breach."); *see also In re* Blackstone Potato Chip Co., 109 B.R. 557, 562 (Bankr. D.R.I 1990) (holding that the license and/or trade name is transferred back to the debtor post-rejection).

99. 281 B.R. 660 (Bankr. N.D. Cal. 2002). The statute is clear in that 11 U.S.C. § 365(n) and 11 U.S.C. § 101(35A) have no textual reference to trademark rights.

100. *See, e.g.*, *In re* Chipwich, Inc., 54 B.R. 427, 431 (Bankr. S.D.N.Y. 1985) (limiting the licensee to a damages claim resulting from the debtor's breach of contract under 11 U.S.C. § 365(g)(1)).

101. *See id.* (providing no mention of a claim for allowing a licensee continued use of the trademark).

102. *See HQ Global Holdings*, 290 B.R. at 514 (providing licensees with a phase out period during which they must remove all of the debtor's trademarks).

103. *See In re* Exide Techs., 340 B.R. 222, 250 (Bankr. D. Del. 2006) (providing a two-year transition period); *HQ Global Holdings*, 290 B.R. at 514 (providing a thirty-day transition period).

widely; in one case, the court granted the licensee thirty days, while another court granted the licensee two years.[104] Although a phase out period may seem to be a viable solution to the circuit split, without any statutory authorization of phase out periods, widespread adoption is unlikely.[105]

The Fourth Circuit's approach has several benefits. First, the Fourth Circuit's approach maximizes the ability of trustees and debtors-in-possession to "collect and reduce to money the property of the estate for which such trustee serves, as expeditiously as is compatible."[106] In some cases, the bankruptcy trustee will attempt to reject the trademark license for the express purpose of liquidizing the trademark through an auction or sale.[107] By denying trademark licensees continued use of the trademark after rejection, the Fourth Circuit's approach emphasizes finality between licensor and licensee.[108] Additionally, it aids the expeditious liquidation of an estate's trademark assets by creating certainty in the rights of both parties and the value of the trademark rights to be sold.[109]

Second, the Fourth Circuit's approach better maintains the integrity of trademark rights.[110] Rejection relieves the debtor of all future obligations, including the continuing obligation to monitor and assure quality control over the trademarked goods.[111] Granting trademark licensees continued use of the trademark without quality control by the debtor-licensor jeopardizes the quality of the trademark.[112] Without oversight by the licensor, the licensee can

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104. *In re Exide,* 340 B.R. at 250; *HQ Global Holdings*, 290 B.R. at 514.

105. Gilhuly et al., *supra* note 28, at 48.

106. 11 U.S.C. § 704(a)(1) (2012); Petition for Writ of Certiorari, *supra* note 20, at *13–14.

107. *See* Petition for Writ of Certiorari, *supra* note 20, at *13–14 (detailing circumstances in which a bankruptcy trustee may need to sell intellectual property for the benefit of the estate and creditors, and discussing the difficulty of doing so under the Seventh Circuit's approach).

108. *See id.* (describing how, under the Fourth Circuit's ruling, the value of the trademark will be certain for bidders at an auction).

109. *Id.* ("[T]he inter-circuit conflict creates substantial uncertainty regarding what rights a purchaser in bankruptcy is acquiring from the bankruptcy estate.").

110. *See id.* at 12–13 ("[The Seventh Circuit's opinion] threatens to undermine the integrity of trademark rights. . . . As a result, a licensee can subsequently affix the trademark to products without fear of liability, thus weakening the inherent value of the trademark and harming consumers who rely on the trademark.").

111. *See* Menell, *supra* note 39, at 772 (suggesting that affirmative obligations requiring action from the debtor's estate are discharged after rejection); *see also* S. REP. NO. 100-505, at 9 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3206–07; Gilhuly et al., *supra* note 28, at 38 ("Congress distinguished between the debtor-licensor's 'passive obligations' and 'affirmative performance.' "); Richard Lieb, *The Interrelationship of Trademark Law and Bankruptcy Law*, 64 AM. BANKR. L.J. 1, 36–37 (1990) ("Rejection does not itself operate to rescind the executory contract *ab initio*, but merely serves to terminate it with respect to the debtor's obligations for future performance.").

112. Petition for Writ of Certiorari, *supra* note 20, at 12–13.

"subsequently affix the trademark to products without fear of liability, thus weakening the inherent value of the trademark and harming consumers who rely on the trademark."[113] Some scholars suggest that allowing licensees continued use of the trademark postrejection would be equivalent to the abandonment of the trademark and lead to the destruction of the brand.[114]

On the other hand, the Fourth Circuit's approach also evinces several weaknesses. First, as the *Lubriz*ol court noted, terminating a licensee's continuing rights to postrejection trademark use could chill the willingness of parties to contract with businesses during times of financial difficulty.[115] Congress responded to *Lubrizol*'s harsh holding by passing § 365(n) but failed to solve this essential problem with respect to businesses using trademark licenses. By omitting trademarks from the 11 U.S.C. § 101(35A) definition of intellectual property, the general chilling effect still applies to businesses that use trademark licenses.[116]

Second, the Fourth Circuit's approach conflicts with the fundamental rights of parties under contract law. *Lubrizol* allows licensors to revoke trademarked rights that were once the subject of negotiated agreements between the licensor and licensee.[117] This allows debtor-licensors to use the bankruptcy process as a "sword . . . [not] a shield, putting them in a catbird seat they often do not deserve."[118] The *In re Matusalem* court recognized this danger when the licensor explicitly used a Chapter 11 filing to reject a trademark license agreement.[119] The court denied the licensor the right to reject the license agreement, citing a violation of the business judgment rule and

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113. *Id.*

114. Wilton & Devore, *supra* note 74, at 774:

> [W]hat would be the result? In the Chapter 11 case of franchisor-licensor of a national brand . . . 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?"

115. Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) ("Nor can it be doubted that allowing rejection in this and comparable cases could have a general chilling effect upon the willingness of such parties to contract at all with businesses in possible financial difficulty.").

116. 11 U.S.C. § 365(n) (2012); *id.* § 101(35A); *Lubrizol*, 756 F.2d at 1048.

117. *In re* Exide Techs., 607 F.3d 957, 967 (3rd Cir. 2010) (Ambro, J., concurring) ("They should not—as occurred in this case—use it to let a licensor take back trademark rights it bargained away.").

118. *Id.* at 967–68; *see* Xuan-Thao N. Nguyen, *Bankrupting Trademarks*, 37 U.C. DAVIS L. REV. 1267, 1302 (2004) (suggesting that a franchisor or licensor could use the threat of rejection to force the licensee into a new license agreement containing terms more favorable to the franchisor or licensor).

119. *In re* Matusalem, 158 B.R. 514, 520 (Bankr. S.D. Fla. 1993).

determining that "this is not an effort at reorganization but a vendetta."[120] Specifically, the court equated the use of Chapter 11 filings whose sole purpose is to rescind a trademark license with a bad faith effort akin to "taking another bite at [the] apple."[121]

Another weakness emerges when modern business practices are examined. In *In re Centura*, the court determined that the licensee could not affix the licensor's trademark to the brand-name product postrejection; however, the licensee's other intellectual property rights to continue to sell and manufacture the product—here, software—were still protected under § 365(n).[122] This example illustrates how trademark rights can be closely related to other protected intellectual property rights—such as copyright or patent rights—under § 365(n). In many instances it makes little sense to sever the interrelationship between licensed intellectual property rights of different varieties.[123] Modern business practice frequently relies on the simultaneous use and licensing of multiple forms of intellectual property.[124] The right to sell and use a copyrighted product may be of little value if that product cannot be sold under an established trademark. Thus, it may make little practical sense to exclude trademarks yet protect other intellectual property rights.[125] Thus, § 365 stands in tension with modern business practices.[126]

B. The Seventh and Third Circuits' Approach: Sunbeam Products *and* In re Exide

The Seventh and Third Circuits' approach originated in *Sunbeam Products Inc. v. Chicago American Manufacturing, LLC* and

120. *Id.* at 522 ("[I]f the Debtor's conception of § 365(n) were implemented, the proposed rejection would utterly destroy the business of Inc. and with it the livelihood of Inc.'s principals and employees.").

121. *Id.* ("The debtor hopes to accomplish under the Bankruptcy Code what the District Court, Court of Appeals and the State Court would not permit.").

122. *In re* Centura Software Corp., 281 B.R. 660, 669 (Bankr. N.D. Cal. 2002) (finding it undisputed that Raima UK still retained its § 365(n) rights to sell and market the Raima Software).

123. Nguyen, *supra* note 118, at 1309–10.

124. *Id.*

125. *See generally* Gideon Parchomovsky & Peter Siegelman, *Towards an Integrated Theory of Intellectual Property*, 88 VA. L. REV. 1455 (2002) (suggesting that the Supreme Court's approach towards intellectual property has been based on an "insular view" of intellectual property whereby IP is divided into three subfields, trademarks, patents and copyrights, whereas, by contrast, real-world businesses combine these three different subfields to increase their competitive advantage over rivals).

126. *See id.* It makes little sense to protect licensees of patents, copyrights, and trademarks, but to cut off those protections for trademarks, when all three are commonly used in combination.

In re Exide respectively.[127] In *Sunbeam*, Lakewood Engineering (Lakewood) contracted with Chicago American Manufacturing ("CAM") to produce box fans.[128] Under the license agreement, CAM had the right to place the Lakewood trademarks on completed box fans.[129] Due to financial difficulties, several of Lakewood's creditors brought an involuntary bankruptcy petition against Lakewood in 2009, a year after CAM made the agreement.[130] Lakewood's trustee determined that the best course of action was to sell the business, and, in furtherance of that goal, the trustee rejected the license with CAM.[131] Sunbeam Products ("Sunbeam") purchased Lakewood's assets, including Lakewood's patents and trademarks.[132] When CAM continued to sell Lakewood-branded fans directly in competition with Sunbeam,[133] Sunbeam filed suit seeking the determination that CAM could no longer sell Lakewood-branded fans postrejection.[134] The bankruptcy court found in favor of CAM, holding that § 365(n) extends to trademarks "on equitable grounds."[135]

The Seventh Circuit affirmed the bankruptcy court's holding on a different legal theory.[136] Rather than affirming on equitable grounds, the Seventh Circuit focused on 11 U.S.C. § 365(g),[137] which specifically refers to rejection of an executory contract as a "breach" of such contract.[138] Based on this language, the Seventh Circuit determined that in and outside of bankruptcy law, upon a breach, the nonbreaching party's rights remain in place.[139] Under the Seventh Circuit's reasoning, rejecting an executory contract is not equivalent to a "rescission" by

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127. Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 377 (7th Cir. 2012); *In re* Exide Techs., 607 F.3d 957, 963–64 (3rd Cir. 2010).

128. *Sunbeam*, 686 F.3d at 374.

129. *Id.*

130. *Id.* A trustee's ability to reject license agreements or unexpired leases under 11 U.S.C. § 365(a) does not depend on whether the bankruptcy proceeding was voluntary or involuntary. Courts will use the business judgment test in either situation.

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.* at 375.

135. *Id.*

136. *Id.* (finding that "what the Bankruptcy Code provides, a judge cannot override by declaring the enforcement would be 'inequitable' . . . there are hundreds of bankruptcy judges, who have many different ideas about what is equitable in any given situation").

137. 11 U.S.C. § 365(g) (2012); *see Sunbeam*, 686 F.3d at 376 ("[R]ejection . . . constitutes a breach of such contract.").

138. § 365(g).

139. *Sunbeam*, 686 F.3d at 376 ("What § 365(g) does by classifying rejection as a breach is establish that in bankruptcy, as outside of it, the other party's rights remain in place.").

which the parties are placed back in their precontract positions.[140] This treatment is similar to that of lessors and lessees of real property. If a lessor enters bankruptcy, the lessor cannot end a tenant's right to possession, even if the lessor rejects the lease.[141] Thus, under the Seventh Circuit's approach, trademark licensees receive continued use of the trademark postrejection because their prepetition rights to use the trademark survive rejection.[142]

Judge Ambro's concurrence in *In re Exide* embodies the Third Circuit's similar position.[143] *In re Exide* involved a battery company ("Exide") that licensed the "Exide" trademark to EnerSys, another company in the industrial battery business.[144] The license was perpetual, exclusive, and royalty-free, reflecting Exide's desire to exit the battery business.[145] However, a few years later, Exide wanted to return to the North American battery market and sought to regain the trademark from EnerSys.[146] Exide filed for Chapter 11 and attempted to regain the trademark by rejecting the licensing agreement. The Bankruptcy Court held in favor of Exide and denied EnerSys the continued use of the trademark.[147] The Third Circuit reversed, finding that because EnerSys had no continuing obligations, the contract was not of an executory nature and could not be rejected under § 365(a).[148]

Although the Third Circuit focused on the "executoriness" of the contract under 11 U.S.C. § 365(a) and did not reference a licensee's rights under § 365(n), Judge Ambrose's concurrence addressed postrejection trademark rights.[149] Because rejection was not the functional equivalent of rescission, it did not require that parties be returned to the positions they occupied before contracting.[150] Judge Ambrose determined that the legislative history of § 365(n) supported use of the court's equitable powers to grant continued use over "fairly procured trademark rights."[151] Allowing licensees continued rights

140. Andrew, *supra* note 47, at 916.

141. *Sunbeam,* 686 F.3d at 377 (providing an analogy to landlord-tenant law).

142. *See id.* (suggesting that if rights remain with the licensee, these rights may include trademark rights).

143. *In re* Exide Techs., 607 F.3d 957, 964–68 (3rd Cir. 2010) (Ambro., J., concurring).

144. *Id.* at 961.

145. *Id.*

146. *Id.*

147. *Id.* ("The Bankruptcy Court entered an order granting Exide's motion to reject the Agreement.") (citing *In re* Exide Techs., 340 B.R. 222, 250 (Bankr. D. Del. 2006)).

148. 11 U.S.C. § 365(a) (2012); *Exide*, 607 F.3d at 964.

149. § 365(a), (n); *Exide*, 607 F.3d at 964–67.

150. *See supra* text accompanying notes 39–40 (providing case law and scholarly opinions as to the fundamental meaning of "rejection" under the Bankruptcy Code).

151. § 365(n); *Exide*, 607 F.3d at 967.

postrejection would prevent a licensor from "tak[ing] back trademark rights it bargained away."[152]

In re Matusalem utilized an analysis resembling the Seventh and Third Circuits' approach despite predating *Sunbeam* by nineteen years. The *Matusalem* court determined that termination of the franchisee-licensee's continued right to use the trademark would "utterly destroy the business of [the licensee] and with it the livelihood of [the licensee]'s principals and employees."[153] Though the court denied the licensor's request to reject the agreement after finding that the decision failed the business judgment test, the court still determined that rejection under 11 U.S.C. § 365(n) would "not deprive [the licensee] of its rights under the franchise agreement."[154]

The Seventh and Third Circuits' approach offers several advantages. First, it provides the most protection for licensees who fairly bargain for the right to use the licensors' trademarks.[155] License agreements are frequently the product of economic compromises between parties. In exchange for royalty payments, licensees typically examine the relevant territorial market, the probability of success, and the need for stipulations such as exclusivity.[156] Licensees consider all such relevant factors and pursue a trademark license that, as a result of such negotiation, enhances the wealth of both the licensor and licensee. In many instances, at the time of the licensors' bankruptcy filings, licensees have made substantial investments in reliance on the continued licensing of intellectual property rights.[157] Because many licensees' businesses are premised on the licensors' trademarks, termination of the licensees' bargained-for rights risks destroying those businesses.[158] The Seventh and Third Circuits' approach addresses this risk by protecting licensees from bankrupt debtors seeking to use rejection as a sword to reacquire rights that they bargained away.[159]

Second, allowing trademark licensees continued use of the license postrejection prevents the chilling effect on the willingness of parties to contract with businesses in tenuous financial

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152. *Exide*, 607 F.3d at 967.

153. *In re* Matusalem, 158 B.R. 514, 522 (Bankr. S.D. Fla. 1993).

154. *Id.*

155. *Exide*, 607 F.3d at 967.

156. *See* Menell, *supra* note 39, at 768 (describing negotiations between licensees and licensors).

157. *Id.*

158. *See, e.g.*, *In re* Matusalem, 158 B.R. 514, 517 (Bankr. S.D. Fla. 1993) (finding that termination of the licensee's right to use the trademark would destroy the business).

159. See, *supra* note 118 and accompanying text for a discussion on the concept of using bankruptcy as a "sword."

circumstances.[160] Licensees are more likely to enter license agreements if they know that their rights to continue using the trademarks are protected in a way akin to the protections granted to copyright and patent licensees under 11 U.S.C. § 365(n). The legislative history of § 365(n) leaves the protection of trademark licensees an open question.[161] Specifically, it suggests that Congress did not include trademarks in the Code's definition of intellectual property because more extensive study was needed.[162] Therefore, while it is true that Congress explicitly omitted trademarks from the Code's definition of intellectual property, it left open the possibility of future inclusion after further research. Section 365(n) should likely include trademarks to fully achieve Congress's intent in passage of the Intellectual Property Licenses in Bankruptcy Act and the codification of 11 U.S.C. § 365(n).[163]

A natural criticism of the Seventh and Third Circuits' approach is that it is judicial legislating. In enacting § 365(n), Congress explicitly omitted trademarks, thus the inclusion of trademarks in the Bankruptcy Code's definition of intellectual property goes against the express will of Congress.[164] There is no ambiguity in the term "intellectual property" in § 365(n).[165] Likewise, there is no ambiguity in the definition of intellectual property in 11 U.S.C. § 101(35A).[166] Section 101(35A) does not include the modifier "including but not limited to" nor any language that would suggest that the list is not exhaustive.[167] Under a strict textualist approach, omission in this instance may require courts to apply *Lubrizol*; if protections for trademark licensees should exist at all, it is Congress, not the courts, that must provide them.[168]

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160. *See* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) ("Nor can it be doubted that allowing rejection in this and comparable cases could have a general chilling effect upon the willingness of such parties to contract at all with businesses in possible financial difficulty.").

161. S. REP. NO. 100-505, at 5 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3204.

162. *Id.*

163. Gilhuly et al., *supra* note 28, at 45 ("The exclusion of trademarks from the Bankruptcy Code's definition of IP appears to be intentional."); Musone, *supra* note 53, at 512 (detailing how Congress passed IPLBA with the express intent of reversing *Lubrizol*).

164. S. REP. NO. 100-505, at 5, *reprinted in* 1988 U.S.C.C.A.N. at 3204; *see In re* Centura Software Corp., 281 B.R. 660, 670 (Bankr. N.D. Cal. 2002) (suggesting that courts should not resort to legislative history when the statute is unambiguous).

165. 11 U.S.C. § 365(n) (2012).

166. *See id.* § 101(35A) (providing a list of "intellectual property").

167. *See id.*

168. *See supra* note 99 and accompanying text (explaining that the court in *In re Centura* used a strict textualist argument).

Yet, an analysis of the legislative history of § 365(n) counters this criticism.[169] Although Congress explicitly omitted trademarks, it did so only to provide for more "extensive study."[170] A sufficient period of study has likely passed, and trademark licensees deserve the same protections granted to copyright and patent licensees.[171]

Another criticism of this approach is that it harms the integrity of trademarks rights.[172] Trademarks differ from other forms of intellectual property because the trademark itself is inseparable from the goodwill of the business.[173] Some scholars have argued that trademark licenses fundamentally differ from other intellectual property licenses because the licensor must continually preserve the quality of the goods or services utilizing the licensor's mark.[174] Such maintenance of the brand's integrity ensures that the public is not misled.[175] Thus, some scholars believe that the Seventh Circuit wrongfully characterized a trademark license as merely a conveyance of a property right, in which the licensor receives a reversionary interest to redeem upon expiration or termination of the license.[176] These scholars view a trademark license as an active relationship between the licensor and licensee that is necessary to maintain the validity of the trademark.[177] Rejection of the license in bankruptcy severs the relationship between licensor and licensee, and the licensor no longer has the obligation nor the ability to ensure quality control over the mark.[178] The quality of the trademarked product is no longer subject to quality regulations because specific performance by the debtor-licensor

169. S. REP. NO. 100-505, at 5, *reprinted in* 1988 U.S.C.C.A.N. at 3204.

170. *Id.*

171. For example, *Sunbeam* provides a reasoned analysis for why excluding trademark licensees protections while granting those same protections to patent and copyright licensees makes little sense. *Infra* Part IV.B.

172. *See generally* Wilton & Devore, *supra* note 74 (suggesting that the Seventh Circuit's concept of a trademark right as a property conveyance with a reversionary interest jeopardizes the integrity of trademark rights).

173. *See id.* at 774 (asserting that goodwill and the company's trademark symbol are inseparable).

174. *Id.* at 773 ("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.").

175. *Id.*

176. *See id.* at 772.

177. *Id.* at 780.

178. *See id.* at 774 (suggesting that the *Sunbeam* decision "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").

is prohibited under the Bankruptcy Code.[179] Under the Seventh Circuit's approach, licensees would be free to use a brand denoted by a mark without any quality control by the franchisor, potentially leading to the diminution of the trademark's integrity.[180]

However, slippery slope arguments over trademark integrity may be exaggerated. Because the vitality of a licensee's business often hinges on the continued quality of the trademark, licensees have little incentive to diverge from quality control guidelines set by the licensor. A licensee will likely maintain the integrity of the trademarked goods or services to avoid alienating its consumer base.[181] Licensors also seek to avoid naked licenses because failure to ensure quality control may support a court's finding that the trademark owner has abandoned the trademark.[182] If a court determines that the licensor has abandoned the trademark, the licensor may no longer assert rights to the mark.[183]

Other scholars criticize the Seventh Circuit's analogy to real property as an invalid comparison under § 365.[184] To support its holding in *Sunbeam,* the court analogized a trademark license to a real property lease, suggesting that rejection would not abrogate the lease of real property and therefore should not abrogate a license to intellectual property.[185] However, this analogy falters upon closer look. Congress explicitly addressed the rights of lessees upon rejection of a real property lease by a lessor in 11 U.S.C. § 365(h).[186] This demonstrates

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179. *Id.* at 780 ("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.").

180. *Id.* at 774.

181. In the event of a licensor's bankruptcy, a licensee whose business depends on the licensor's trademark will likely not suddenly diminish the quality of its products. Natural incentives exist for the licensee to continue production of goods with the same quality or risk alienating the licensee's consumer base. Oftentimes a licensee's business hinges on the same clients as the licensor's business. What hurts one likely hurts the other.

182. Gordon, *supra* note 31, at 837.

183. *Id.*

184. *See generally* Wilton & Devore, *supra* note 74, at 746 (suggesting throughout that the analogy used by the Seventh Circuit is inapt and reflects a mistaken reading of § 365).

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

> [A] lessee that enters bankruptcy may reject the lease and pay damages for abandoning the premises, but rejection does not abrogate the lease (which would absolve the debtor of the need to pay damages). Similarly 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.

186. 11 U.S.C. § 365(h) (2012) (providing for instances in which a trustee rejects an unexpired lease of real property, suggesting that the lessee may retain its rights under such a lease, including rights of possession, quiet enjoyment, etc., to the extent that such rights are enforceable under applicable nonbankruptcy law).

that Congress likely intended to distinguish between real property and intellectual property rights postrejection, granting additional protections only to the former.[187] By applying the § 365(h) exception for real property lessees, the Bankruptcy Code suggests that unstated exceptions should not be implied under a theory of *expressio unius est exclusio alterius*.[188]

IV. SOLUTION: APPLYING THE SEVENTH AND THIRD CIRCUITS' APPROACH WITH THE ADDED STIPULATION THAT LICENSEES MAINTAIN QUALITY CONTROL STANDARDS AFTER REJECTION

In deciding how to resolve the circuit split, the Supreme Court should adopt the approach taken by the Seventh and Third Circuits with the additional requirement that trademark licensees postrejection must maintain the quality control requirements inherent in the trademark license.

A. Trademarks Are Intellectual Property and Should Be Included Under the Definition of Intellectual Property in 11 U.S.C. § 101(35A)

The overwhelming weight of scholarship suggests that trademark rights belong in the protected class of intellectual property described in 11 U.S.C. § 365(n).[189] Because Congress did not fully address the issue, leaving it open for experimentation, the time is ripe for the definitive inclusion of trademark rights under § 365(n).[190] Trademarks are a natural subgroup of intellectual property.[191] Trademarks, patents, and copyrights are the principal three subgroups of intellectual property law.[192] Intellectual property is defined in academic scholarship as "a category of intangible rights protecting commercially valuable products of the human intellect."[193] Trademarks meet this criterion for classification as intellectual property. Although

187. Wilton & Devore, *supra* note 74, at 774 ("Statutory protections for tenants under real estate leases have been in place for seventy-five years . . . while no similar protections have ever existed for trademark licensees.").

188. *Id.*

189. *See generally* Agin, *supra* note 44 (suggesting that trademark licensees should be protected under 11 U.S.C. § 365(n)); Lieb, *supra* note 111 (describing the three key components of intellectual property law, patents, trademarks, and copyrights); Nguyen, *supra* note 118 (suggesting that trademarks are a fundamental part of intellectual property).

190. *See supra* text accompanying note 59–64 (suggesting that the legislative history of § 365(n) leaves the door open for inclusion of trademark rights in the future).

191. Parchomovsky & Siegelman, *supra* note 125, at 1458.

192. *Id.*

193. BLACK'S LAW DICTIONARY 824 (9th ed. 2009).

the economic foundations for patent and copyright protections differ from that of trademark law, all three protect investments in research and development and product quality.[194] Thus, the adoption of the Seventh and Third Circuits' approach conforms to generally accepted notions of "intellectual property" by extending 11 U.S.C. § 365(n)'s protections to trademark licensees. Ultimately, pressure should be placed on Congress to amend 11 U.S.C. § 101(35A) of the Bankruptcy Code to include trademarks in the definition of intellectual property.

B. Quality Control: Attaining the Benefits of the Seventh and Third Circuits' Approach Without the Weaknesses

This solution has the same benefits as adopting the Seventh and Third Circuits' approach without some of the weaknesses. Granting licensees continued use of trademarks postrejection protects licensees from debtor-licensors who attempt to use rejection as a sword to unfairly take back trademark rights that they freely bargained away.[195] Further, under this approach, potential trademark licensees no longer experience the chilling effect and can confidently enter into license agreements with licensors in tenuous financial circumstances.[196]

The primary argument against the Seventh and Third Circuits' approach is that allowing trademark licensees to continue to use trademarks postrejection jeopardizes the integrity of trademark licenses.[197] The fear is that under this approach the trademark license becomes a naked license, free from the quality control stipulations enforced by the licensor.[198] Because quality control protects the average consumer from confusion and deceit, the Seventh and Third Circuits' approach may harm consumers.[199]

This solution proposes retention of quality control standards, which alleviates the concern that losing quality control requirements could diminish the quality of goods produced. However, licensees have natural incentives to maintain quality standards even without a

194. Parchomovsky & Siegelman, *supra* note 125, at 1059 ("Despite the different economic and legal theories underlying them, however, we contend that both patents and trademarks allow firms to appropriate the benefits of investment in Research and Development ("R&D") and product quality.").

195. *See generally* cases and authorities cited *supra* note 111 (discussing the weaknesses of the *Sunbeam* approach).

196. *See generally* cases and authorities cited *supra* note 59 (describing the chilling effect that *Lubrizol* had on the willingness of parties to contract).

197. *See supra* text accompanying notes 172–80.

198. Nguyen, *supra* note 118, at 1311–12 (suggesting that a trademark license often requires a licensor's quality control provision in order to avoid a naked license).

199. *Id.* at 1314.

judicially created obligation. In many instances, a licensee has spent substantial resources building the goodwill of the trademark in the assigned territory or location.[200] Because the licensee's success depends on the integrity of the trademark, the licensee is unlikely to destroy the goodwill of the trademark by selling goods or products of materially different quality.[201]

While these natural incentives do allay some fears about the total collapse of quality control after the rejection of a trademark license agreement in bankruptcy, they are not sufficient to protect consumers and the integrity of the mark. This Note's proposed solution resolves the issue of diminished trademark integrity by formally requiring licensees to take the specific actions that they should be economically motivated to pursue in the first place. By affirmatively requiring licensees to maintain the quality control standards stated in the original licensing agreement for the duration of the license's life, this approach actively prevents degradation of trademark integrity.[202]

By pushing courts to require that postrejection trademark licensees maintain the trademark's integrity, this solution mitigates fears that the *Sunbeam* approach will lead to naked licenses and result in consumer harm. Moreover, implementing this solution would not be unduly burdensome; most trademark licenses include the licensor's quality control requirements in a "quality standard provision."[203] Because licensors rarely visit a licensee's business location to verify the quality of products or services, they rely on licensees to abide by the contract's quality assurance terms.[204] The quality standard provision is now the norm in trademark licensing because of its low cost to both licensors and licensees. Judicial enforcement of this provision is also a low-cost remedy, since the Bankruptcy Code prevents requiring the debtor-licensor to continue quality control duties.[205] Rather than forcing individual licensors to affirmatively ensure the continued quality of products associated with their licensed marks—a costly endeavor—the duty would flow naturally from the rejection of a trademark licensing

200. *Id.* at 1310.

201. *Id.*

202. *See id.* at 1314. Nguyen postulates that the imposition of quality-control standards upon licensees will protect the consumer by maintaining the quality control standard for the goods under the licensed trademarks, even if the licensor rejects the trademark license agreement. *Id.* Consequently, the goodwill of the trademark will not be destroyed as the licensee continues to adhere to the existing quality control obligation. *Id.*

203. *Id.* at 1311.

204. *Id.*

205. *See id.* (suggesting that the license provides the structure for maintaining the agreed upon level of quality).

agreement in bankruptcy. This solution acts as an incentive for licensors to include quality control standards within the original agreement and further protects the public from divergences in the quality of goods produced by different licensees. In this regard, consumers, licensors, and additional licensees will be protected from deviations in the quality of goods or services that might jeopardize the integrity of the trademark once a trademark license is rejected in bankruptcy.

V. CONCLUSION

Legal scholarship classifies trademarks as a form of intellectual property. However, trademark law differs from copyright and patent law in a few respects. While patent and copyright law aim to encourage innovation and creativity through rewarding exclusivity, trademark law functions to preserve goodwill and reputation among consumers. The differences between these subcategories of intellectual property may have influenced Congress's decision to initially omit trademarks from the definition of intellectual property in 11 U.S.C. § 101(35A).

As a result, courts have split over whether trademarks should be included in spite of the omission. The recent *Sunbeam* decision relies upon theoretical interpretations of the meaning of rejection under an executory contract in bankruptcy, finding that rejection is not the equivalent to a rescission of the license. The overwhelming weight of scholarship supports this interpretation of rejection under the Bankruptcy Code. When a debtor-licensor rejects a contract, the licensor breaches the license agreement. However, because one party's breach does not diminish the other party's contractual rights, a trademark licensee's continued rights to use the trademark persist after rejection.

The greatest drawback of granting licensees continued use of trademarks postrejection is the potential sacrifice of trademark integrity if licensors stop enforcing quality control. A licensee's natural incentives to maintain quality control alleviate a portion of these fears, even if the court does not impose an affirmative duty to sustain quality. In many instances, a licensee's livelihood depends on the continued viability of the license, and a reduction in the quality of the products or services bearing the licensed mark is just as detrimental to the licensee's business as it is to the licensor's business. Supplementing these natural incentives, the proposed solution remedies those fears by affirmatively requiring that licensees maintain the quality control specifications contained in their license agreements before the licenses were rejected in bankruptcy. This solution addresses the criticism of the

Seventh and Third Circuits' approach while maintaining all of its benefits. Regardless, Congress should directly address the circuit split through updating the legislation to include trademark licensees in the protections provided by 11 U.S.C. § 365(n).

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* B.A. Duke University. J.D. Candidate, Vanderbilt University Law School. This note is dedicated to my editors on the *Vanderbilt Law Review*, Kimberly Ingram, Courtney Mitchell, Scott Singer, Terrence McKelvey, Andrea Bilbija, and all who helped out and provided suggestions for improvement. Special thanks to Professor Bill Norton for his guidance and input, and a hat tip to my good friend Patrick Tricker for the initial topic idea.