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Effects of Licensors' Duty to Maintain Control Over a Trademark on Licensees' Ability to Assert Rights Provided Under Section 365 of the Bankruptcy Code

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INTRODUCTION

Under title 11 of the United States Code (the "Bankruptcy Code"), a debtor may reject or assume an executory contract, including a license for intellectual property.¹ The definition of intellectual property does not include the term "trademark." Consequently, it is not clear whether a non-debtor licensee can continue using a trademark if the debtor-licensor rejects it. Moreover, there appears to be a consensus forming among courts in that a debtor-licensee cannot assign a license to a third-party without the consent of the licensor. Regardless of which party initiates bankruptcy proceedings, there is a special consideration contemplated by courts— the licensor's duty under federal trademark law to ensure that the goods and/or services being used in connection with the licensed trademark are of appropriate quality. This memorandum will examine this duty imposed on the licensor under federal trademark law and the effects it has on licensees in enacting rights and protections provided under section 365 of the Bankruptcy Code in a three-fold approach. Part I describes the function of federal trademark law, and the rights of licensors and licensees. Part II examines the significance of the absence of trademark from the

¹ 11 U.S.C. § 365(a) (2012).

Bankruptcy Code's definition of intellectual property, and how this effects the applicability of section 365(n), which provides protections for intellectual property licensees. Part III analyzes the extent to which trademark licenses can be assigned by debtor-licensees under section 365(a) of the Bankruptcy Code.

I. PROTECTING CONSUMERS IN THE MARKETPLACE: THE PURPOSE OF FEDERAL TRADEMARK LAW

The fundamental purpose of trademark law is to ensure consumer protection in the marketplace. A trademark is a word, phrase, symbol, or design which is used to signal to consumers a certain quality, reputation and/or trustworthiness produced by a particular source.² Simply put, trademarks act as source-identifiers as to the origin of a particular good or service, and provide consumers with a means of association.³

Federal trademark law provides the opportunity for trademark owners to license out their trademarks to licensees. Trademark licensing enables trademark owners to maximize the complete potential of their trademarks, while also expanding consumer recognition in the marketplace. The benefits of trademark licensing include territorial and market expansion, utilizing new capacities such as manufacturing, distribution or advertising capabilities, and preventing trademarks from falling out of use.⁴ These benefits lead to an increased consumer recognition of the trademark as signaling a particular quality or reputation of the goods/services being purchased. Moreover, trademark licenses play a role in mitigating infringement suits, as often times, owners will license out their marks in order to avoid costly litigation fees.⁵

² *Trademark, Patent, or Copyright?*, USPTO.GOV, <https://www.uspto.gov/trademarks-getting-started/trademark-basics/trademark-patent-or-copyright> (last visited Apr. 22, 2018).

³ *Id.*

⁴ *See Module 12: Trademark Licensing*, WIPO.INT, http://www.wipo.int/export/sites/www/sme/en/documents/pdf/ip_panorama_12_learning_points.pdf (last visited Mar 25, 2018).

⁵ *Id.*

In trademark licensing, the licensor plays the more important role, as it has the ultimate say over who it licenses the trademark to and the subsequent rights under which the licensee will operate. The licensor *must* ensure that its licensees are providing uniformity in the quality of goods/services being represented under the trademark or face severe penalties, including losing all rights to its trademark.⁶ In order to ensure such uniformity, licensors must have the final say over all quality control elements of the goods and/or services which bear the licensed trademark. Consequently, the licensor must have unilateral control of who operates the terms of the licenses. This means including terms within the trademark licenses which ensure that the licensor can maintain oversight over production or execution of goods/services bearing the trademark. Additionally, this may mean ensuring that a licensee can never assign the license to a third party, without at least the consent of the licensor. It is important to ensure that trademark licensors are able to maintain such control, in order to meet this mandated duty, even in non-trademark law.

II. THE RIGHTS OF LICENSEES IN DEBTOR-LICENSOR BANKRUPTCY CASES: APPLICABILITY OF PROTECTIONS OFFERED BY SECTION 365(n) TO TRADEMARK LICENSEES

The most important right of a licensor, in any context, is maintaining control over the use of its trademark in connection with particular goods and/or services. In the context of bankruptcy cases, this right of the licensor must be upheld no matter which party is filing for bankruptcy. Section 365(a) of the Bankruptcy Code allows a debtor-licensor to reject any executory contract that is not beneficial to the company.⁷ This is consistent with enabling the licensor to maintain final say over use of the trademark, by allowing the licensor to terminate licenses when they are doing more harm than good. For example, in a situation where the licensor can no longer ensure that a licensee is producing goods/services in the manner the trademark indicates, allowing a

⁶ See 15 U.S.C. § 1060 (“A registered mark or a mark for which an application to register has been filed *shall* be assignable *with the good will* of the business in which the mark is used.”) (emphasis added).

⁷ Mission Prod. Holdings, Inc. v. Tempnology LLC (*In re Tempnology, LLC*), 879 F.3d 389, 394 (1st Cir. 2018).

licensee to continue operating under that license would be detrimental to the trademark's function as a source-identifier. Thus, allowing the licensor the ability to terminate such licenses to preserve the goodwill of the trademark is consistent with federal trademark law. In response to such rejections by trademark licensors, licensees have attempted to invoke protections offered to intellectual property licensees under section 365(n) of the Bankruptcy Code.

Upon a licensor-debtor's rejection of a license under section 365(a) of the Bankruptcy Code, trademark licensees have looked to section 365(n) for remedies. Section 365(n) provides intellectual property licensees with two potential remedies in the event a debtor-licensor rejects its license: (1) to treat the license as terminated and seek pre-petition damages; or (2) to retain its rights under the license for the remaining duration of the license.⁸ However, the absence of "trademark" from the definition of "intellectual property" in the Bankruptcy Code leaves uncertainty as to whether trademark licensees can invoke the protections offered by section 365(n).⁹ Some courts argue that the absence of "trademark" is significant and indicates that Congress meant trademarks to be excluded from this section, especially since other types of intellectual property such as copyright, trade secrets and patents are listed in the Bankruptcy Code's definition.¹⁰ On the other hand, some courts have found that the absence of the term "trademark" from the definition of intellectual property to be much less significant, and therefore allow section 365(n) to be invoked by trademark licensees.¹¹

Where courts have taken a narrow, textual view of the definition of intellectual property, the invocation of section 365(n) by licensees has been found inapplicable. In *In re Tempnology, LLC*, the debtor-licensor attempted to terminate its licenses with the licensee. In response, the

⁸ 11 U.S.C. § 365(n).

⁹ See 11 U.S.C. § 101(35A).

¹⁰ See *In re Tempnology, LLC*, 879 F.3d at 396-97.

¹¹ See *In re Crumbs Bake Shop, Inc.*, 522 B.R. 766, 768-69 (Bankr. D.N.J. 2014).

licensee attempted to invoke section 365(n), arguing that it should be able to retain its rights to the license for the remaining duration of the license.¹² There, the Court of Appeals for the First Circuit found that though section 365(n) was enacted to better balance the rights of intellectual property licensees, the absence of trademark from the definition of intellectual property in the Bankruptcy Code was significant and intentional on the part of Congress.¹³ The court concluded that this absence rendered section 365(n) inapplicable to trademark licensees, and therefore, its protections could not be invoked.¹⁴ Other courts have also discussed this narrow view of the applicability of section 365(n), explaining that the absence of trademark from the definition in the Bankruptcy Code indicated that Congress wanted courts to follow *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.* in trademark licensee cases.¹⁵ *Lubrizol* was decided prior to the enactment of section 365(n), and stood for the proposition that upon rejection by an intellectual property licensor of the license, the licensee can no longer use any of the licensed intellectual property.¹⁶ Courts have justified this narrow view by emphasizing the importance in ensuring trademark licensors can uphold their duty under federal trademark law to maintain control over the quality of the goods/services which bear the trademark.¹⁷

Not all courts have found the absence of trademark from the definition of intellectual property in the Bankruptcy Code to be as significant in determining the applicability of section 365(n). The Bankruptcy Court for the District of New Jersey took this approach in the case of *In re Crumbs Bake Shop, Inc.*, and rather than focusing on the definition of intellectual property, the court engaged in an equity analysis.¹⁸ The court there concluded that preventing the trademark

¹² *In re Tempnology, LLC*, 879 F.3d at 401.

¹³ *Id.* at 394-95.

¹⁴ *Id.* at 404.

¹⁵ 686 F.3d at 375.

¹⁶ *Id.*; *See also* *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985).

¹⁷ *See In re Tempnology*, 879 F.3d at 402-03.

¹⁸ *In re Crumbs Bake Shop, Inc.*, 522 B.R. at 768-69.

licensees in the case from asserting section 365(n) would be inequitable, and thus held that its provisions applied to trademark licenses.¹⁹ Other courts have taken similar views, and have found the omission of trademarks from the definition of intellectual property insignificant when determining the applicability of section 365 of the Bankruptcy Code.²⁰

III. THE RIGHTS OF DEBTOR-LICENSEE IN BANKRUPTCY CASES: ASSIGNABILITY OF TRADEMARK LICENSES BY LICENSEES UNDER SECTION 365(a)

The licensor's right to maintain control over its trademark has also been a primary consideration in the context of debtor-licensee bankruptcy cases. Under section 365(a) a debtor-licensee may assume or reject an executory contract as long as the debtor provides adequate assurance of performance by the third-party assignee.²¹ Using this provision, some trademark licensees have attempted to assign their licenses, usually in a sale of their assets to third-parties, without the consent of the licensor.²² However, section 365(c)(1) of the Bankruptcy Code emphasizes such assignment will not stand if it is prohibited by the relevant non-bankruptcy law, here the relevant non-bankruptcy law being federal trademark law.²³ The general consensus among courts concerning assignment of trademark licenses is that federal trademark law prevents assignment without the consent of the licensor, unless otherwise provided in the license. Nevertheless, as with all rules, courts have engaged in different interpretations of the ability of a trademark licensee to assign a license.

One such court that required consent was the United States Bankruptcy Court for the District of Delaware, which held that a trademark licensee could not assign its license as part of a

¹⁹ *Id.* at 770-72.

²⁰ *See Sunbeam Products, Inc. v. Chicago American Mfg., LLC*, 686 F.3d 372 (7th Cir. 2012) (“[T]he limited definition in § 101(35A) means that § 365(n) does not affect trademarks one way or the other.”).

²¹ 11 U.S.C. § 365(a).

²² ²² *See In re Rupari Holding Corp.*, 573 B.R. 111, 114-15 (Bankr. D. Del. 2017).

²³ 11 U.S.C. § 365(c)(1).

sale of substantially all of its assets without consent of the licensor.²⁴ The court focused on section 365(c)(1) of the Bankruptcy Code in its reasoning and applied federal trademark law as the relevant non-bankruptcy law.²⁵ The court relied on its previous decision in *In re Trump Entertainment Resorts, Inc.*, in which it held that federal trademark law generally bans assignment of trademark licenses without the licensors approval.²⁶ In *In re Trump Entertainment Resorts*, the court reasoned that consent was necessary in order to ensure that a trademark licensor could uphold its duty to provide uniform quality of the products bearing the licensor's trademark.²⁷ Though there is an exception to this rule, in which parties may "contract around" the general disallowance by including otherwise in the license itself, in this case no such thing had occurred.²⁸ Therefore, the court found in favor of the licensors, holding section 365(c)(1) applicable and preventing the debtor-licensees from assigning the license to the third-party buyer of its assets.²⁹ The Seventh Circuit made similar observations regarding the sensibility in having a default rule requiring consent of the licensor in the assignment of trademark licenses, even in bankruptcy.³⁰ The court reasoned that the duty of the licensor to maintain control as to the quality of the goods/services bearing the trademark and the role of trademarks in protecting consumers made such a rule justifiable.³¹

There have been limited instances in which assignments without the consent of the licensor have been upheld. This occurred when a court declined to use federal trademark law as the relevant non-bankruptcy law, and instead used a different non-bankruptcy law. For example, the United States Bankruptcy Court for the Eastern District of Pennsylvania found consent was

²⁴ *In re Rupari Holding Corp.*, 573 B.R. at 120.

²⁵ *Id.* at 117.

²⁶ *Id.*; see *In re Trump Entertainment Resorts, Inc.*, 526 B.R. 116 (Bankr. D. Del. 2015).

²⁷ *In re Trump Entertainment Resorts*, 526 B.R. at 123–24.

²⁸ *In re Rupari Holding Corp.*, 573 B.R. at 117-18.

²⁹ *Id.* at 118-19.

³⁰ *In re XMH Corp.*, 647 F.3d 690, 696 (7th Cir. 2011).

³¹ *Id.*

not needed in an assignment, but did so using a personal services law of the state of Pennsylvania as opposed to federal trademark law.³² This result has been called into question by other courts, primarily the court's failure to assess the assignment under federal trademark law.³³

CONCLUSION

Trademark licensees can run into obstacles in asserting the rights and protections offered under section 365 of the Bankruptcy Code. The reasoning for this, as many courts explain, is due to the licensor's responsibility under federal trademark law to maintain oversight over the quality of the goods and/or services which bear the licensed mark. Due to the uncertainty caused by the absence of trademark under the definition of intellectual property in the Bankruptcy Code, courts have taken varying positions as to whether the protections offered to intellectual property licensees under section 365(n) apply to trademark licensees. Though there is more certainty regarding the need for licensor consent in the event that a licensee wants to assign its license under section 365(a), this too has not been set in stone. As of now, without the inclusion of trademarks as part of the definition of intellectual property, licensees must be proactive in protecting their rights, rather than relying solely on section 365 of the Bankruptcy Code. This should be done through inserting provisions into the licenses at the time they are executed, with such provisions explicitly dealing with issues of potential rejections by a debtor-licensors and assignability of the licenses by debtor-licensees. On the other hand, licensors can likely find safety in the Bankruptcy Code, as it is often interpreted in a manner which enables licensors to maintain their duties of quality control imposed by federal trademark law.

³² *In re Rooster, Inc.*, 100 B.R. 228 (Bankr. E.D. Pa. 1989).

³³ *See In re Trump Entertainment Resorts, Inc.*, 526 B.R. at 126.