

August 16, 2012

Seventh Circuit Holds That Trademark Licensee Does Not Lose Right to Use Licensed Trademarks When Debtor-Licensors Rejects License

In a decision authored by Chief Judge Easterbrook, the United States Court of Appeals for the Seventh Circuit recently held that a trademark licensee does not necessarily lose the right to use licensed marks upon rejection of the license agreement by a debtor-licensor. (*Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, Docket No. 11-3920 (7th Cir. July 9, 2012.)) In so holding, the Court expressly rejected the contrary decision issued by the Fourth Circuit in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985) almost thirty years ago. The decision is grounded on the Court's understanding of the consequence of rejection under the Bankruptcy Code rather than the nature of the particular contract at issue and, thus, may also have implications for other types of contracts. And, while the decision clarifies the treatment of trademark licenses in bankruptcy (at least in the Seventh Circuit), the extent of the rights retained remains somewhat unclear.

Background:

In 2008, Lakewood Engineering & Manufacturing Co. ("Lakewood") and Chicago American Manufacturing ("CAM") entered into a contract relating to the manufacture of Lakewood's box fans. The contract authorized CAM to use Lakewood's patents to manufacture the box fans and to place Lakewood's trademarks on the completed products. Lakewood would take orders for the box fan from retailers and direct CAM to ship the box fans to the retailers. CAM was reluctant to incur the costs associated with preparing for production and to manufacture the 1.2 million box fans that Lakewood estimated it would require during the 2009 season without assurances of payment. To address this concern, Lakewood authorized CAM to sell the 2009 run of box fans for its own account if Lakewood did not purchase them.

Three months into the contract, several of Lakewood's creditors filed an involuntary petition against it. The court appointed a trustee, who ultimately sold Lakewood's assets (including its patents and trademarks) to Sunbeam Products doing business as Jarden Consumer Solutions ("Jarden"). Jarden did not want to purchase CAM's inventory of Lakewood-branded fans nor did it want CAM to sell those fans in competition with Jarden's box fans. Lakewood's trustee rejected the executory portion of the CAM contract under section 365(a) of the Bankruptcy Code. CAM continued to make and sell Lakewood-branded fans, leading Jarden to file an adversary proceeding in the bankruptcy court.

The bankruptcy court determined that CAM was entitled to make – and sell – as many Lakewood-branded fans as Lakewood had estimated it would need for the 2009 season. The bankruptcy court determined that section 365(n) of the Bankruptcy Code allowed CAM to practice Lakewood's patents when making the fans for the 2009 season. However, trademarks are not one of the enumerated categories of "intellectual property" covered by

section 365(n) of the Bankruptcy Code. Without deciding whether rejection of a contract under section 365(a) of the Bankruptcy Code terminates the licensee's right to use the marks, the bankruptcy court permitted CAM, which had invested substantial resources in manufacturing the Lakewood-branded box fans, to continue to use Lakewood's marks "on equitable grounds."

Analysis:

The Seventh Circuit affirmed the bankruptcy court's decision that CAM retained the right to use Lakewood's marks post-rejection but found the bankruptcy court's reasoning untenable, noting that "[w]hat the Bankruptcy Code provides, a judge cannot override by declaring that the enforcement would be 'inequitable.'" *Id.* at 4 (citations omitted). The Court instead grounded its decision on its analysis of section 365(g) of the Bankruptcy Code. Section 365(g) specifies the consequences of rejection under section 365(a) of the Bankruptcy Code and expressly provides that "the rejection of an executory contract . . . constitutes a breach of such contract"

The Court noted that a licensor's breach of a license would not terminate a licensee's right to use intellectual property outside of bankruptcy; the Court held that section 365(g) of the Bankruptcy Code ensures that a licensee's rights remain in place in bankruptcy by classifying rejection as a breach. The Court observed that, post-rejection, a debtor can no longer be subject to an order for specific performance with respect to the contract and its unfulfilled obligations must instead be addressed through a claim for damages. It emphasized, however, that nothing about the rejection implies that any of the rights of the licensee have been "vaporized."

While the Bankruptcy Code does permit a debtor or trustee to eliminate contract rights under certain circumstances (*e.g.*, through the exercise of the avoidance powers), the Court was not persuaded that this can be accomplished through rejection. The Court noted that rejection is "not the functional equivalent of rescission," *id.* at 8 – "it merely frees the estate from the obligation to perform" and "has absolutely no effect upon the contract's continued existence." *Id.* at 9 (*quoting Thompkins v. Lil' Joe Records, Inc.*, 476 F.3d 1294, 1306 (11th Cir. 2007)). Based on the foregoing, the Court concluded that the trustee's rejection of the CAM agreement did not abrogate CAM's contractual rights to continue to exploit Lakewood's marks.

Conclusion:

Sunbeam makes clear, at least in the Seventh Circuit, that a trademark licensee will not necessarily lose its rights to use a licensed mark if its licensor rejects its license in bankruptcy. However, the scope of the retained rights remains to be seen.

* * * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Kelley A. Cornish 212-373-3493 kcornish@paulweiss.com	Douglas R. Davis 212-373-3130 ddavis@paulweiss.com	Alice Belisle Eaton 212-373-3125 aeaton@paulweiss.com
Brian S. Hermann 212-373-3545 bhermann@paulweiss.com	Alan W. Kornberg 212-373-3209 akornberg@paulweiss.com	Elizabeth R. McColm 212-373-3524 emccolm@paulweiss.com
Andrew N. Rosenberg 212-373-3158 arosenberg@paulweiss.com	Jeffrey D. Saferstein 212-373-3347 jsaferstein@paulweiss.com	Stephen J. Shimshak 212-373-3133 sshimshak@paulweiss.com

Erica G. Weinberger contributed to this client alert.

NEW YORK

1285 Avenue of the Americas
New York, NY 10019-6064
+1-212-373-3000

BEIJING

Unit 3601, Fortune Plaza Office
Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
+86-10-5828-6300

HONG KONG

12th Fl., Hong Kong Club Building
3A Chater Road
Central Hong Kong
+852-2846-0300

LONDON

Alder Castle, 10 Noble Street
London EC2V 7JU
United Kingdom
+44-20-7367-1600

TOKYO

Fukoku Seimei Building, 2nd Floor
2-2, Uchisaiwaicho 2-chome
Chiyoda-ku, Tokyo 100-0011
Japan
+81-3-3597-8101

TORONTO

Toronto-Dominion Centre
77 King Street West, Suite 3100
P.O. Box 226
Toronto, ON M5K 1J3
Canada
+1-416-504-0520

WASHINGTON, D.C.

2001 K Street NW
Washington, DC 20006-1047
+1-202-223-7300

WILMINGTON

500 Delaware Avenue, Suite 200
Post Office Box 32
Wilmington, DE 19899-0032
+1-302-655-4410