

June 18, 2018

Connecticut Bankruptcy Court Holds That Trademark Licensee Does Not Automatically Lose the Right to Use Trademarks When Debtor-Licensors Rejects License, Siding with Seventh Circuit in Circuit Split

The United States Bankruptcy Court for the District of Connecticut recently examined a question at the heart of an existing circuit split regarding the consequences of trademark license rejection in bankruptcy: can a trademark licensee retain the use of a licensed trademark post-rejection? *In re SIMA International, Inc.*, 2018 WL 2293705 (Bankr. D. Conn. May 17, 2018). In *SIMA*, the Court held that rejection of a trademark license constitutes a breach of contract under section 365(g) of the Bankruptcy Code and will not necessarily terminate a licensee's right to use a licensed trademark post-rejection.

Background

In 1996, SIMA International, Inc. ("SIMAI") and Marlys Hanson, Inc. ("MHI") entered into a license agreement (the "Agreement") that, among other things, granted MHI an exclusive right to use all copyrights, trademarks, and other intellectual property associated with SIMAI's System for Identifying Motivated Abilities ("SIMA") – a system that analyzes an individual's behavior and life/work accomplishments to provide insights relating to that individual's career path and job performance – for purposes of developing "adaptations." MHI later developed a software program known as CAPS, which drastically reduced the amount of time necessary to perform the SIMA analysis.

In November 2017, SIMAI commenced a voluntary chapter 7 bankruptcy case; a few weeks later, the Chapter 7 Trustee moved to reject the Agreement pursuant to section 365(a) of the Bankruptcy Code. MHI objected to the Trustee's motion and notified the Court of its election to retain its rights under the Agreement pursuant to section 365(n). The parties agreed that (1) the Agreement was an executory contract, (2) the Trustee had authority under section 365 to seek rejection, and (3) MHI had the option to retain its rights to any "intellectual property" under section 365(n). The issue in dispute was whether MHI's section 365(n) election (1) covered, and thus entitled MHI to continue to use, the SIMA trademark and (2) preserved MHI's exclusive rights under the Agreement.

Scope of Section 365(n) and Circuit Split Regarding Consequences of Rejection

Under section 365(n) of the Bankruptcy Code, when a debtor-licensor rejects an "intellectual property" license, the non-debtor licensee has the option to retain its rights to "intellectual property" under the license as such rights existed before the bankruptcy filing, subject to certain limitations. The retained rights include enforcing exclusivity provisions in the license but exclude all other rights to specific performance of the

license. If a licensee elects to retain its rights under the license, the licensee must, among other things, continue to pay the royalties due under the agreement.

As noted in our previous client alerts, trademarks are not included in the Bankruptcy Code's definition of "intellectual property," and a circuit split exists regarding the legal consequences of trademark license rejection. While the Seventh Circuit has held that section 365(g) provides that rejection of a trademark license constitutes a breach of contract that does not "vaporize" a licensee's rights to continue to use the trademark, *see Sunbeam Products, Inc. v. Chicago American Manufacturing*, 686 F.3d 372 (7th Cir. 2012), the First Circuit recently held that section 365(n) does not apply to trademarks and that a licensee's right to use a licensed trademark terminates upon rejection of the underlying license agreement, *see In re Tempnology, LLC*, 879 F.3d 389 (1st Cir. Jan. 12, 2018).

Analysis

Before turning to the issues in dispute, the Court first considered and granted the Trustee's motion to reject the Agreement and determined that MHI had properly elected to retain its rights under section 365(n).

The Court then considered whether section 365(n) protects MHI's rights to use the trademark under the rejected Agreement. The Court held that MHI retained the right to use the trademark post-rejection but grounded its decision on the "plain language" of section 365(g) – a provision which provides that rejection of an executory contract generally constitutes a breach – rather than an expansive reading of section 365(n) or the Bankruptcy Code's definition of intellectual property. In so ruling, the Court declined to follow *Tempnology* and instead adopted *Sunbeam's* interpretation of the relationship between sections 365(g) and 365(n). Further, the Court critiqued the First Circuit's conclusion that the omission of trademarks from section 365(n) leaves licensees unprotected in the event of rejection, noting that it "overlooks that a licensee could retain use of the debtor's trademark under Section 365(g) because rejection is deemed a breach and, therefore, rejection does not necessarily eliminate the rights provided under the contract."

The Court found that state law determines the parties' rights under the Agreement, including after a breach, and under Connecticut law, SMAI's rejection breach was not material because MHI's section 365(n) election indisputably preserved MHI's rights to the non-trademark intellectual property covered by the Agreement. The Court concluded that "the core of the bargain and substantial purpose of the [Agreement] had been preserved" and that "[n]either Section 365(g) applying state law, nor Section 365(n), provide a basis to terminate the licensee's equally central and bargained-for rights in the SIMA® trademark."

The Court also found that (1) the SIMA "trademark was not only ancillary to the use of the [protected] intellectual property, it is directly embedded within, supplemental to, and integral to the intellectual property license," and (2) the Agreement was clear and unambiguous on this point. The Court concluded that upsetting MHI's expectations with respect to the use of the trademark would "fly in the face of the carefully drafted provisions."

Finally, the Court rejected the Trustee's argument that MHI's election did not preserve its right under the Agreement to prevent the development of competing products. Instead, the Court held that MHI's election preserved its exclusive right under the Agreement, noting that the plain language of section 365(n) "leaves little room for an alternative interpretation."

Conclusion

The United States Bankruptcy Court for the District of Connecticut has sided with the Seventh Circuit in the circuit split regarding the consequences of trademark license rejection. Whether the Second Circuit weighs in on this split remains to be seen. Additionally, *Tempnology* is subject to a pending petition for a writ of certiorari with the Supreme Court, which (if granted) may provide additional guidance.

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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:

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