

Sunbeam Products: New Case Law for Trademarks in Bankruptcy TeleBriefing

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Lubrizol Enterprises, Inc. v. Richmond Mutual Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985)

- **Facts:**

Debtor Richmond Metal Finishers, Inc. (“RMF”) granted non-exclusive patent license to Lubrizol Enterprises

- RMF filed motion to reject license in order to sell assets free of licensee’s rights to use licensed technology

- **Held:**

- Patent license was an executory contract with performance due on both sides
- On rejection, licensee is left with a pre-petition remedy for money damages but has no remedy of specific performance and thereafter licensee returned no right to continue to use this licensed technology
- Although result “could have a chilling effect upon the willingness of parties to contract at all with business in possible financial difficulty,” only Congress and not the courts can provide a remedy.

§ 365(n) of Bankruptcy Code

- Section 365(n)
 - A section of the Bankruptcy Code that protects licensees of “intellectual property”
 - U.S. Patents
 - U.S. Copyrights
 - Trade Secrets
 - Not Trademarks
 - Essentially allows a licensee to continue to enjoy certain licensed intellectual property rights under a rejected contract, provided licensee continues to pay royalties and gives up rights of set off for the Debtor’s non-performance
- If the licensor rejects the license, the licensee has the option to either:
 - (a) treat the contract as terminated and assert a pre-petition damages claim, or
 - (b) retain its right to use the licensed IP for term of license, and continue to pay royalties without right of setoff for damages from the licensor’s non-performance

Advantages of § 365(n)

- Provides strong protection for licensees of mature technology or technology to be further developed by licensee
- Licensee able to continue to exploit IP even if license is rejected
- Allows enforcement of exclusivity provisions even if license is rejected
- Allows specific enforcement of contract rights to obtain “embodiments” of intellectual property (such as computer source code, prototypes, patented cell lines) and to enforce rights under “supplementary agreements”
- Strong incentive not to reject

Limitations of § 365(n)

- Rights Limited to U.S. Patents, Copyrights, and Trade Secrets
 - Only statutory “intellectual property”
 - Not trademarks
 - No explicit protection for foreign intellectual property
- Rights only apply in a U.S. bankruptcy (no foreign equivalent to § 365(n))

Limitations of § 365(n) (cont.)

- Rights under § 365(n) only apply to license rights in existence and licensed on the petition date (potential problems with options to acquire rights later on or license that omits key elements necessary to independently exploit technology)
- Must continue to pay royalties without right of setoff for Licensor's non-performance
- No ability to force Licensor to perform
 - In-licenses (what if in-licenses are rejected?)
 - Development (what happens if key employees are laid off?)
 - Supply (are alternative sources available?)
- Risk that Events in the Bankruptcy Case will Adversely Affect § 365(n) protection
 - Licensee must protect rights if Licensor attempts to sell IP
 - Precision Industries, Inc. v. Qualitech Steel SBQ, LLC, (7th Cir. 2003)

§ 365(n) Drafting Tips for Licensees (Patent and Copyright Licenses)

- Refer to § 365(n) in license
- Specify “embodiments” (computer source code, prototypes, cell lines, etc.)
- Refer to “supplementary” contracts
 - Escrow agreement
 - Regulatory agreement
 - Other agreements relating to licensed IP
- Differentiate royalty vs. other payments
- Obtain a complete set of licensed rights (i.e. a right to sell is not much good without a right to manufacture)
- Make licenses current at signing
- For cross-licenses, make part of a single integrated contract or cross default
- Run searches for liens against licensed intellectual property and obtain non-disturbance agreements from secured parties

Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC., 686 F.3d 372 (7th Cir. 2012)

- **Facts:**

Debtor Lakewood Engineering & Mfg. Co. (“Lakewood”) entered into a one year supply contract with Chicago American Manufacturing LLC (“CAM”). In the event Lakewood failed to meet sales projections, the contract granted CAM a non-exclusive license to sell trademarked Lakewood products directly into the market to allow CAM to recoup start up costs. Creditor forced Lakewood into Chapter 7 bankruptcy and the Chapter 7 Trustee rejected the contract and sought to enjoin CAM from selling the trademarked products.

- **Held:**

- Rejection of a trademark license does not abrogate a licensee’s contractual rights or divest a licensee of its right to use licensed trademarks.
- Conflict among the circuits based on Lubrizol case is acknowledged.

Trademark Licenses in Bankruptcy – Questions for Consideration

- Does a trademark license create a property right in the licensee that can be separated from a licensee's contractual obligations to maintain brand standards and quality control?
- If the Sunbeam holding is correct and licensees are permitted to continue use of trademarks following license rejection, what happens if a debtor/licensor of a national restaurant brand (McDonalds, Denny's, etc.) files for bankruptcy and rejects hundreds of franchise agreements with dozens of franchisees?
- Is the situation different with exclusive trademark licenses? What if the exclusive license is for single product niche in a narrow territory (Heinz branded single portion packets for restaurants in Illinois)?
- Does it make a difference if the debtor licensor does not enforce brand standards because it has sold an entire business unit and granted a prepaid, exclusive, perpetual license?
- For royalty bearing licenses, under Sunbeam, must the licensee continue to pay royalties to the licensor?

In re Interstate Bakeries Corporation (8th Cir. August 30, 2012)

- **Facts:**

Debtor Interstate Bakeries Corporation (“IBC”) sold assets in Chicago and Central Illinois related to “Butternut Bread” and “Sunshine Bread” trademarks to Lewis Brothers Bakeries (“LBB”). The sale included grant of a prepaid, perpetual, exclusive license to the trademarks.

- IBC filed Chapter 11 Bankruptcy and reserved rights in its reorganization plan to reject the LBB License.
- LBB filed an adversary proceeding seeking a declaration that the LBB License was part of a completed transaction and not executory.

- **Held:**

- Because covenants to maintain quality of goods were material, LBB License is an executory contract subject to rejection.
- Implication under Lubrizol rule is that an exclusive, prepaid trademark license can be rejected and licensee can lose rights to licensed mark.

Drafting Tips for Licensees of Prepaid, Exclusive Trademark Licenses

- Assess credit risk of licensor as part of due diligence
- Consider sale/licenseback of trademarks
- Consider use of bankruptcy remote special purpose intellectual property holding company
- Consider waiver of monetary damages for licensor breach to preserve ability to enforce right of specific performance in licensor bankruptcy
- Consider steps to enhance arguments that license is not an executory contract subject to rejection
 - Make license an integrated contract with Asset Purchase Agreement and its successor and assigns.
 - Expressly provide for licensee and its successors and assigns to have an irrevocable right to use licensed trademarks.
 - Provide for licensee to have right of specific performance to maintain quality control, but no right to terminate license for licensee's breach.

Discussion

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Q&A

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