

July 17, 2012

Trademark Licensee's Rights Survive Rejection of License in Bankruptcy in *Sunbeam* Decision

In reaction to a decision by the U.S. Court of Appeals for the Fourth Circuit, *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), in which the court held that a licensee of patents, copyrights and trademarks loses its rights if the trustee or debtor in possession rejects a license under the Bankruptcy Code under which the debtor was the licensor, Congress enacted section 365(n) of the Bankruptcy Code (11 U.S.C. § 365(n)). Section 365(n) provides that if the debtor was the licensor under a patent or copyright license that is rejected in bankruptcy, the licensee has the option either to retain its rights as they existed on the bankruptcy petition date and continue its performance, or to treat the license as terminated. Section 365(n) does not apply to trademarks, an omission by Congress that was intentional.

Taking issue with *Lubrizol*, the U.S. Court of Appeals for the Seventh Circuit, on a direct appeal from the bankruptcy court, held that the rejection of a trademark license by a trustee or debtor in possession does not strip the licensee of its right to continue to use the trademark. In *Sunbeam Products, Inc. v. Chicago American Mfg., LLC*, 2012 WL 2687939 (7th Cir. July 9, 2012), the court held that Congress's omission of trademarks from the scope of section 365(n) did not mean that Congress intended to adopt the rule of *Lubrizol* where trademark licenses were involved.

The Seventh Circuit believed that the *Lubrizol* court incorrectly read section 365(g) of the Bankruptcy Code. Section 365(g) provides in relevant part that the rejection of an executory contract such as an intellectual property license constitutes a breach of the contract. The court reasoned that, outside of bankruptcy, a breach of the contract by the trademark licensor would not strip the licensee of all of its rights. In bankruptcy, the court held, the result is no different. While the court acknowledged that the trustee or debtor in possession cannot be compelled to specifically perform after the contract is rejected and breached in bankruptcy and that such non-performance would therefore, at most, give rise to a claim for damages, it does not follow that the licensee loses its other contractual rights.

Although the bankruptcy court also decided in favor of the licensee, it did so on equitable grounds because of the substantial investment of the licensee in exploiting the trademark. The Seventh Circuit rejected the bankruptcy court's use of equitable considerations as a rationale and reasoned that if the Bankruptcy Code's language mandated the loss of the licensee's rights, equitable concerns could not overcome that result. Noting that the *Lubrizol* decision has been criticized, however, the court found that section 365(g) did not mandate the loss of all of a non-debtor counterparty's rights upon rejection, concluding that section 365(n) neither codifies nor disapproves *Lubrizol* as applied to trademarks. The Seventh Circuit acknowledged that its decision now creates a split in the circuit courts that may lead to future consideration of the issue by the Supreme Court.

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7/17/12