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First Circuit's Rejection of *Sunbeam* Sheds a Different Light on § 365(n)

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Statutory interpretation tenets tell us that when it comes to the Bankruptcy Code, one need not look any further than the "plain" meaning of Congress's chosen term or phrase to elicit meaning.[1] These principles are challenging, however, when Congress is silent or indicates that the omission is due to indecisiveness, and the "plain meaning" definition is contrary to common usage. Interpretation of § 365(n) in this situation has caused a circuit split, one that leaves licensees of one type of intellectual property treated differently depending on where their licensor files its bankruptcy case.

Considered without reference to a corresponding definition, § 365(n) seems clear. If the trustee or debtor in possession, as a licensor, rejects an executory intellectual property (IP) license, the licensee may elect to treat that contract as terminated or retain the rights granted to it in the contract for its duration. While the meaning of "intellectual property" seems almost self-evident, Congress's chosen definition in § 101(35) had one crucial omission — including patents, trade secrets and copyrights, but not trademarks — when § 365(n) was codified.

For courts within the Seventh Circuit, that omission is of little import, as trademark licensees have the option to continue using licensed trademarks despite rejection. However, based on the First Circuit's recent interpretation of § 365(n), a debtor/licensor's rejection of an outbound trademark license leaves the trademark licensee with only a damages claim in a case within that circuit.

To fully appreciate the current state of § 365(n) and what it means for trademark licensees, a reference to that provision's history is helpful. In 1985, the Fourth Circuit Court of Appeals was tasked with determining the impact of the rejection of a patent license in *Lubrizol Enters. Inc. v. Richmond Metal Finishers Inc.*[2] With § 365(g) providing that "rejection of an executory contract ... constitutes a breach" as of the petition date, the Fourth Circuit held that rejection effectively terminated the IP license because the licensee was only entitled to a pre-petition claim for money damages, and not specific performance. The *Lubrizol* court acknowledged that its interpretation "could have a general chilling effect upon the willingness of ... parties to contract at all with businesses in possible financial difficulty." Nonetheless, it noted that its holding was required because "under bankruptcy law, such equitable considerations may not be indulged by courts in respect of the type of contract here in issue."[3]

Congress reacted relatively swiftly and purposefully, introducing § 365(n) to the Bankruptcy Code in 1988 in order to ensure that the "rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off" upon rejection of a license.[4] As enacted, § 365(n) reads:

> If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect —
>
> (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or
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> (B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) ... as such rights existed immediately before the case commenced, for (i) the duration of such contract; and (ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.

Additional related provisions are contained in § 365(n)(2) and (3). In essence, § 365(n) allows licensees to continue using licensed IP after rejection, on certain conditions.

Congress then defined "intellectual property" within § 354(n)'s purview as meaning (1) a trade secret; (2) an invention, process, design or plant;

1 *See Merit Mgmt. Grp. LP v. FTI Consulting Inc.*, 583 U.S. __, __ S. Ct. __ (2018) ("Our analysis begins with the text of [the statute] and we look to both the language itself [and] the specific context in which that language is used.") (quotation omitted); *RadLAX Gateway Hotel LLC v. Amalgamated Bank*, 566 U.S. 639, 648, 132 S. Ct. 2065; *U.S. v. Ron Pair Enters.*, 489 U.S. 235, 109 S. Ct. 106 (1989) (citation omitted) ("[W]here, as here, the statute's language is plain, the sole function of the courts is to enforce it according to its terms.").

2 756 F.2d 1043 (4th Cir. 1985).

3 *Id.* at 1045-48.

4 *See* S. Rep. No. 100-505.

continued on page 54

(3) a patent application; (4) a plant variety; (5) a work of authorship; or (5) a mask work — all to the extent protected by applicable nonbankruptcy law.[5] In so doing, Congress established that patent and copyright licenses are within § 365(n)'s scope, and the text indicates that trademarks are not. A review of § 365(n)'s legislative history reveals that Congress's decision to exclude trademarks from protected "intellectual property" was based on a need for further deliberation rather than a conclusive determination, stating:

> [T]he bill does not address the rejection of executory trademark, trade name or service mark licenses by debtor-licensors. While such rejection is of concern because of the interpretation of section 365 by the *Lubrizol* court and others ... such contracts raise issues beyond the scope of this legislation. In particular, trademark, trade name and service mark licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee. Since these matters could not be addressed without more extensive study, it was determined to postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts.[6]

The subject then seems to have fallen off the legislative agenda. Due to the fact that Congress did not expressly protect trademark licensees under § 365(n), some courts have reasoned by negative inference[7] that the *Lubrizol* holding continued to govern, thus cutting off a trademark licensee's rights upon rejection of its license.[8] Other courts have held that rights granted to licensees under trademark licenses are not automatically extinguished through rejection, stating a view that contract rejection is merely a breach, not a termination, and that based on the provision's legislative history, bankruptcy courts should use their equitable powers[9] to decide, in each instance, whether trademark licensees may retain their license-granted rights following rejection.[10]

The Seventh Circuit was one of the first appellate courts[11] to have had the opportunity to weigh in on this divided issue in *Sunbeam Products Inc. v. Chicago Am. Mfg. LLC*.[12] In *Sunbeam*, a licensee bargained for the right to manufacture and sell products using the debtor's patents, and relatedly, to use the debtor's tradename. After sale of the debtor's IP, the purchaser sued the licensee in order to enjoin the licensee's sales of the patented product and its use of the trademark. Diverging from *Lubrizol*, the Seventh Circuit held that the Bankruptcy Code does not provide that "any rights of the other contracting party have been vaporized" through rejection. Accordingly, the trademark licensee's bargained-for rights remained in place despite a rejection and sale of the subject IP.[13]

Congress's deferral of the inclusion of trademark licenses as involving "intellectual property" has left courts with an interpretive challenge.

Meanwhile, the U.S. House of Representatives drafted a bill to include "trademarks" within the definition of "intellectual property," and to state that "in the case of a trademark ... the trustee shall not be relieved of a contractual obligation to monitor and control the quality of a licensed product or service."[14] That bill did not gain traction.

This brings us to the present. Some five years after the issuance of the *Sunbeam* holding, the First Circuit was presented in *Mission Product Holdings Inc. v. Tempnology LLC (In re Tempnology LLC)* ("*Mission Product*")[15] with an appeal involving rejection by a debtor/licensor of certain IP licenses that required the court to assess the interplay between § 365(n) and (g). In *Mission Products*, the debtor, Tempnology LLC, developed technology that enabled fabric to stay cool during exercise. Tempnology entered into a "co-marketing and distribution agreement" with Mission Product Technology (the licensee) through which Tempnology granted the licensee (1) non-exclusive, irrevocable, royalty-free, fully paid-up, perpetual, transferable license to exploit Tempnology's patents; (2) exclusive rights to distribute and sell products manufactured by Tempnology; and (3) a related license to use Tempnology's trademarks (the "license agreement").

Tempnology filed a chapter 11 petition with the U.S. Bankruptcy Court for the District of New Hampshire and promptly moved to reject the license agreement. After rejection, Tempnology moved for determination of the remaining rights of the licensee under § 365(n). While conceding that the licensee held the option to retain rights associated with the patent license, Tempnology asserted that the licensee's distribution rights and trademark license were not protected "intellectual property" under § 365(n). The licensee contended that its exclusive distribution rights were expressly protected "exclusivity provisions" associated with the patent license, and asked the bankruptcy court to use its equitable powers to enable it to retain use of the licensed trademark post-rejection.

The bankruptcy court agreed with Tempnology and held that the licensee did not retain exclusive distribu-

5 *See* 11 U.S.C. § 101(35)(A).
6 S. Rep. No. 100-505, at 5, *reprinted in* 1988 U.S.C.C.A.N. at 3204.
7 This is in accord with the canon of *expressio unius est exclusio alterius. See United States v. Landmesser*, 378 F.3d 308, 313 n.8 (3d Cir. 2004).
8 *See, e.g., In re Old Carco LLC*, 406 B.R. 180 (Bankr. S.D.N.Y. 2009); *In re HQ Global Holdings Inc.*, 290 B.R. 507, 513 (Bankr. D. Del. 2003); *In re Centura Software Corp.*, 281 B.R. 660, 674-75 (Bankr. N.D. Cal. 2002).
9 These courts view the Bankruptcy Code as "silent" and find it appropriate to review the legislative history. *See DiGiovanni v. Traylor Bros. Inc.*, 75 F.3d 748, 755 (1st Cir. 1996) (citation omitted).
10 *See Exide Techns.*, 607 F.3d 957, 965 (3d Cir. 2010) (Ambro, J., concurring) (use of § 365 to reclaim trademark rights that debtor bargained away "makes bankruptcy more a sword than a shield, putting debtor-licensors in a catbird seat they often do not deserve"); *In re Crumbs Bakeshop Inc.*, 522 B.R. 766 (Bankr. D.N.J. 2014).
11 *In Exide Techns.*, *supra* (license was determined to be non-executory).
12 686 F.3d 372 (7th Cir. 2012).
13 According to the *Sunbeam* court, § 365(n)'s legislative history indicates that the "omission [of trademarks] was designed to allow more time for study, not to approve *Lubrizol*." *Id.* at 377.
14 *See* Innovation Act of 2013, H.R. 3309, 113th Cong. § 6(d) (2013).
15 879 F.3d 389 (1st Cir. 2018).

tion rights nor the trademark license after rejection. With regard to the latter, the court also held that "the omission of trademarks from the definition of intellectual property in Section 101(35A) indicates that Congress did not intend for them to be treated the same as the six identified categories."[16] On appeal, the First Circuit Bankruptcy Appellate Panel (BAP) agreed with the bankruptcy court that the right to distribute the debtor's product did not involve "intellectual property," but reversed with regard to the trademark licenses, following the holding in *Sunbeam*, *supra*.[17]

An appeal to the First Circuit followed. Like the BAP, the First Circuit concluded, after a careful analysis of the text of § 365 and the terms used therein, that even though the licensee may have held certain "exclusive" rights to distribute the debtor's product, since those rights were not "intellectual property," they did not qualify as an "exclusivity provision" that could be enforced following rejection of the corresponding agreement for purposes of § 365(n)(1)(B). Relatedly, and importantly, a divided panel of the court declined to follow the Seventh Circuit's approach in *Sunbeam* given that "trademarks" were not included in the Bankruptcy Code's "intellectual property" definition, and that the statute does not "contain any catch-all or residual clause from which one might infer the inclusion of properties beyond those expressly listed."

The First Circuit also did not find appropriate circumstances to vary from application of Congress's chosen words, noting that following the holding in *Sunbeam* would hamper a debtor's attempt to use rejection to "release the debtor's estate from burdensome obligations," given the nature of trademarks under nonbankruptcy law.[18] The majority found justification for the congressional differentiation among IP types, stating that "the effective licensing of a trademark requires that the trademark owner — here Debtor, followed by any purchaser of its assets — monitor and exercise control over the quality of the goods sold to the public under cover of the trademark."[19] Failure to monitor and exercise this control jeopardizes the continued validity of the owner's own trademark rights.[20]

As a result, the First Circuit was concerned that the Seventh Circuit's holding effectively forced a debtor "to choose between performing executory obligations arising from continuance of the license or risking the permanent loss of its trademarks," resulting in an improper restriction on a debtor's ability to use § 365 to free itself from executory obligations. Equity could not be invoked in favor of the licensee, the First Circuit explained, since Congress did not provide courts with the ability to craft exceptions to § 365(n)'s text, as it had done elsewhere in the Code.[21] Instead, the First Circuit indicated its favor for "the categorical approach of leaving trademark licenses unprotected from court-approved rejection, unless and until Congress should decide otherwise."[22] The First Circuit agreed with the bankruptcy court that rejection left the licensee with only a pre-petition damages claim, while Tempnology had no further obligations. In this regard, the First Circuit indicated that it was applying a "plain meaning" approach to consideration of the issues, precluding judicial statutory alteration due to concern for the consequences to the licensee.[23] The implication of the First Circuit's ruling appears to be that following rejection of the Tempnology agreement, the licensee would continue to hold the ability to exploit Tempnology's patents for manufacture, yet it could not market those products under Tempnology's well-known brand names.

Congress's deferral of the inclusion of trademark licenses as involving "intellectual property" has left courts with an interpretive challenge. Judicial attempts to sort through the "plain meaning" of § 365(n), common usage and equities of the situation left by this legislative uncertainty could mean that the rights of trademark licensees will be diametrically different depending on whether the licensor files its bankruptcy case in Massachusetts or Illinois. This situation undeniably makes "bankruptcy more a sword than a shield," at least within the First Circuit, placing the onus on trademark licensees to negotiate and plan accordingly.[24] abi

16 541 B.R. 1, 7-8 (Bankr. D.N.H. 2015).
17 559 B.R. 809 (B.A.P. 1st Cir. 2016).
18 *In re Mission Prods.*, 879 F.3d at 402 (quoting *Bildisco & Bildisco*, 465 U.S. 513, 528 (1984)).
19 *Id.* (citation omitted).
20 *Id.* (citations omitted).
21 The First Circuit gave as examples §§ 365(d)(5) and 552(b)(1).
22 *Mission Prods.* at 403-04 (citation omitted).
23 Hon. Juan R. Torruella, writing for the minority, disagreed "with the majority's bright-line rule" and urged that since § 365(a) was silent as to trademark licenses, "resort to review of the legislative history was proper." *Mission Prods.* at 405-06 (Torrueala, J., concurring in part, dissenting in part).
24 *In re Exide Techs.*, 607 F.3d at 967-68 (Ambro, J., concurring).

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