UT LAW CLE | THE UNIVERSITY OF TEXAS SCHOOL OF LAW

PRESENTED AT

34th Annual Jay L. Westbrook
Bankruptcy Conference

November 12-13, 2015
Austin, Texas

Intellectual Property Issues in Bankruptcy and the Exclusion of Trademark Licenses from the Definition of Intellectual Property

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I. INTRODUCTION

The Bankruptcy Code divides intellectual property into distinct categories depending upon the particular type of intellectual property. Issues with respect to intellectual property can be of utmost importance in bankruptcy, as a debtor attempts to weave its way through its bankruptcy case by, perhaps, attempting to assume and assign agreements that may implicate a non-debtor's rights in intellectual property, or through selling assets. In addition, issues concerning the perfection of security interests in intellectual property pop up in bankruptcy proceedings as the filing of a bankruptcy case arms either the debtor-in-possession or the trustee with the power to avoid certain unperfected interests. In the modern landscape of corporate bankruptcies, these basic aspects of the treatment of intellectual property often dictate how and where an IP-heavy debtor reorganizes.

II. THE IP DECISION MATRIX

A. Non-Assignability

Numerous cases hold that because a non-exclusive license cannot be assigned under Federal copyright and patent laws, the debtor cannot assign them to a purchaser under section 365(c).[1] *In re Golden Books Family Entertainment, Inc.*, 269 B.R. 300 (Bankr. D. Del. 2001) (non-exclusive licenses cannot be assigned under Federal Copyright Law). A similar logic applies to non-exclusive patent licenses. *Perlman v. Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.)*, 165 F.3d 747 (9th Cir. 1999) (determining that assignment of non-exclusive patent license was prohibited by patent law and hypothetical interpretation of section 365(d)(1)); *In re CFLC, Inc.*, 89 F.3d 673 (9th Cir. 1996) (non-exclusive patent license non-assignable under Federal Patent Law and 365(c)). *In re Trump Entm't Resorts, Inc*., 526 B.R. 116 (Bankr. D. Del. 2015), holds that trademark licenses are not assignable in the absence of some express authorization from the licensor, such as a clause in the license agreement itself." *Id.*(citing *In re XMH Corp.*, 647 F.3d 690, 695 (7th Cir. 2011) ("as far as we've been able to determine, the universal rule is that trademark licenses are not assignable in the absence of a clause expressly authorizing assignment"); *Miller v. Glenn Miller Prods., Inc.*, 454 F.3d 975, 988, 992-93 (9th Cir. 2006); *N.C.P. Mktg. Group, Inc. v. Billy Blanks (In re N.C.P. Mktg. Group, Inc.)*, 337 B.R. 230, 235-37 (D. Nev. 2005); *3 McCarthy on Trademarks* § 18:43 (4th ed. 2010).

If you cannot sell it, you cannot monetize it, and the entire bankruptcy estate suffers as a result. One major exception to this non-assignability obtains when the license itself contains a consent, such as a consent to assignment upon the sale of substantially all of the assets. *Murray v. Franke-Misal Technologies Group, LLC (In re Supernatural Foods, LLC)*, 268 B.R. 759 (Bankr. M.D. La. 2001) (license permitting assignment in connection with "sale of substantially all assets" amounted to requisite consent to transfer under section 365(c)). The second major exception to non-assignability is that applicable copyright and patent law holds that exclusive patent and copyright licenses are transferable, making section 365(c) inapposite. *In re Golden Books Family Entertainment, Inc.*, 269 B.R. 311 (Bankr. D. Del. 2001) (exclusive copyright license assignable under Copyright Law), *citing In re Patient Educ. Media, Inc*., 210 B.R. 237

[1] All citations are to the Bankruptcy Code, unless otherwise notated.

(Bankr. S.D.N.Y. 1997). *See also Supernatural Foods,* 268 B.R. at 800-801 (distinguishing cases regarding exclusive license in concluding that partial license with exclusive features was not assignable).

However, trademarks license agreements, as we will see throughout this paper, are different from patents and copyrights and are non-assignable regardless of the exclusive or non-exclusive features of the license.

> Often the owner of a trademark will find that the most efficient way to exploit it is to license the production of the trademarked good to another company, which may have lower costs of production or other advantages over the trademark's owner. Normally the owner who does this will not want the licensee to be allowed to assign the license (that is, sublicense the trademark) without the owner's consent, because while the owner will have picked his licensee because of confidence that he will not degrade the quality of the trademarked product he can have no similar assurance with respect to some unknown future sublicensee. "The purpose of a trademark, after all, is to identify a good or service to the consumer, and identity implies consistency and a correlative duty to make sure that the good or service really is of consistent quality, i.e., really is the same good or service." Id. at 695. Accord 4 MCCARTHY ON TRADEMARKS § 25:33 (4th ed. 2010) ("Since the licensor-trademark owner has the duty to control the quality of goods sold under its mark, it must have the right to pass upon the abilities of new potential licensees.").

In re Trump Entm't Resorts, Inc., 526 B.R. 116, 123-124 (Bankr. D. Del. 2015), *quoting XML*, 647 F.3d at 696.

B. Hypothetical Versus Actual

If the non-exclusive IP license (which most are) and trademark license cannot be assigned, can it still be assumed by the reorganized debtor? The non-assignability under applicable non-bankruptcy law creates huge hurdles to value maximization for the IP dependent debtor. Results vary among the various circuits as to whether the meaning of section 365(c) and 365(f) can be harmonized. So, it is very important to consider where to file an IP dependent restructuring case. The circuit split can be distilled into a "hypothetical" versus an "actual" test. Under the hypothetical rubric, the chapter 11 debtor cannot even assume a non-assignable IP license even though it is the same corporation with whom the licensor did business with pre-petition. Courts surmise that 365(c) means that the counterparty to the agreement could refuse to accept performance from a *hypothetical* third party, even though the debtor never intends to assign the agreement. *In re West Elecs., Inc.,* 852 F.2d 79, 83 (3d Cir. 1988). Delaware bankruptcy courts, therefore, follow the "hypothetical" test yielding value-decimating results. *E.g., In Re Access Beyond Technologies, Inc.*, 237 B.R. 32 (Bankr. D. Del. 1999) (on motion to sell assets, court determined that non-exclusive patent license is non-assumable and non-assignable.).

Under the "actual" test, assumption by the debtor is permitted because the assumption does not "actually" assign the license. Without delving into semantics, the wording of section 365(c) leaves much to be desired as applied to assumption without assignment. If there is assumption without assignment, the "actual" test argues, there is no reason to analyze whether the non-debtor party should accept performance from someone other than the debtor in possession. *See, e.g. Institut Pasteur v. Cambridge Biotech Corp.,* 104 F.3d 489, 493 (1st Cir. 1997). Under the actual test, the disjunctive "or" in § 365(c) is construed as the conjunctive "and." Courts applying the actual test make a case-by-base inquiry into whether the non-debtor party would be compelled to accept performance from someone other than the party with whom it had originally contracted, and a debtor would not be precluded from assuming a contract unless it *actually* intended to assign the contact to a third party. *See Summit Invest. & Dev. Corp. v. Leroux,* 69 F.3d 608, 612 (1st Cir. 1995).[2]

The Ninth Circuit adopted the hypothetical test in *In re Catapult Entertainment, Inc.,* 165 F.3d 747 (9th Cir. 1999). In *Catapult Entertainment,* Perlman had licensed certain patents to Catapult Entertainment, which later filed a bankruptcy petition. *Id.* at 748-49. In its bankruptcy case, Catapult obtained confirmation of its reorganization plan and approval of its request to assume the licenses from Perlman, over Perlman's objection. *Id.* On appeal, Catapult argued that § 365(c)(1) should be read to permit a debtor to assume any executory contract as long as no actual assignment was also proposed, consistent with the actual test approach. *Id.* The Ninth Circuit disagreed. It held that the plain language of § 365(c)(1) precluded Catalpult from assuming the Perlman licenses because federal patent law made patent licenses personal and nondelegable, thus satisfying § 365(c)(1)(A), and Perlman did not consent to the assumption, thus satisfying § 365(c)(1)(B).

The Fourth Circuit adopted the actual test in *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp),*361 F.3d 257 (4th Cir. 2004). In *Sunterra,* the bankruptcy court permitted the debtor to assume a nonexclusive license of copyrighted software over the licensor's objection. *Id.* at 260. RCI operated a software development company for the resort and hospitality industry and developed software products for the industry. *Id.* Sunterra was a resort management business, and entered into a software license agreement with RCI. *Id.* Under their software license agreement, RCI granted Sunterra a nonexclusive, world-wide, perpetual, irrevocable, royalty-free license to use, copy, modify, and distribute the software. *Id.* RCI's software was a copyrighted computer program. *Id.* at n. 4.

In Sunterra's bankruptcy case, RCI filed a motion to have the bankruptcy court deem the agreement rejected, arguing that Sunterra was precluded by § 365(c) from assuming the agreement without RCI's consent. *Id.* at 261. Sunterra argued that § 365(c) did not mandate rejection because Sunterra did not intend to assign the agreement. *Id.* at 262. To resolve the dispute, the Fourth Circuit examined both the hypothetical and actual tests. *See id.* If the

[2] Put another way, under the actual test, a debtor could be permitted to assume an executory contract as long as the debtor did not attempt to assign the executory contract because the statute is read to prohibit assumption and assignment, rather than assumption or assignment. *See In re Catapult Entertainment, Inc.,* 165 F.3d 747,751 (9th Cir. 1999).

hypothetical test applied, Sunterra could not assume the agreement because RCI would be excused pursuant to applicable copyright law from accepting performance from a hypothetical third party. *See id.* at 263. But, if the actual test applied, Sunterra could assume the agreement because it did not intend to assign the agreement to a third party, meaning that RCI was not actually being forced to accept performance from a different party. *See id.*

The *Sunterra* court adopted the actual test, and in so doing, examined Sunterra's argument that because RCI had agreed not to prohibit Sunterra from transferring the license to a successor in interest if the transfer included substantially all of Sunterra's assets, RCI had effectively consented to assumption of the license sufficient for § 365(c). RCI, in turn, argued that § 365(c)(1)(A) provides that it applies notwithstanding "whether or not such contract . . . prohibits or restricts assignments of rights." *Id.* The *Sunterra* court rejected RCI's argument because the agreement in fact permitted the transfer under certain circumstances. *Id.* The Fourth Circuit agreed, however, with RCI's argument that the license only permitted assignments, not assumptions, and concluded that the "terms assumption and assignment describe 'two conceptually distinct events." *Id.* at 267 (citing *Perlman v. Catapult Entertainment (In re Catapult Entertainment),* 165 F.3d 747, 752 (9th Cir. 1999)).

Fortunately for us, the Fifth Circuit also adopted the actual test. In *In the Matter of Mirant Corporation,* 440 F.3d 238 (5th Cir. 2006), Mirant Corporation filed a bankruptcy petition, inciting a disagreement with Bonneville Power Administration ("BPA") concerning whether BPA could terminate an executory contract for the future purchase of electric power by Mirant. *Id.* at 240. The Fifth Circuit, although examining § 365(e)(2)(A)[3] looked to analysis of § 365(c), noting that resolution of the dispute depended upon adoption of the actual or hypothetical approach. *Id.* at 247. After reviewing the history of the adoption of the actual and hypothetical approaches, the Fifth Circuit adopted the actual approach. *Id.* at 249. In so concluding, the Fifth Circuit reasoned that the plain text of § 365(e)(2)(A) requires an actual test for determining whether a law is applicable under the exception, because the statute provides that "applicable law" must be the law that "excuses a party," not just any law. *Id.* According to the Fifth Circuit, the applicability of the law under § 365(e)(2)(A) "is determined not in the abstract but on the record at hand." *Id.* (citing *Cajun Elect. Members Comm. v. Mabey (In re Cajun Elec. Power Cooperative, Inc.,* 230 B.R. 693, 705 (5th Cir. 1999).

Although the Second Circuit has yet to weigh in on this split, the court *In re Adelphia Communications Corp.,* 359 B.R. 65 (Bankr. S.D.N.Y. 2007) adopted the actual test. There, the debtors requested authority to assign certain cable franchise agreements without having the consent of all local franchising authorities ("LFAs") to effectuate a transfer of their cable operations. Relevant cable ordinances prohibited assignment without LFA consent. *Id.* at 74. The court emphasized that where an assumption is done by a debtor-in-possession (as opposed to a bankruptcy trustee), the right to object to assumption does not, without more, affect the right to assume. *Id.* at 72. In so doing, the court stressed that an executory contract must first be assumed before it is assigned, and thus if § 365(c)(1) precludes a debtor-in-possession from assuming a contract to be assigned, there would be no purpose behind having a § 365(c)(1)

[3] Section 365(e)(2)(A) provides an exception to the rule that an executory contract may not be terminated if applicable law excuses the nondebtor party to a contract from accepting performance and such nondebtor party does not consent to such assumption or assignment.

exception in § 365(f). *See id.* The court also examined what constitutes "applicable law" noting that the term was not defined in the Bankruptcy Code, to determine whether the LFA's ordinances were "applicable law." *Id.* at 73. The court distinguished between ordinances that constitute "little more than a glorified contract," and those that regulate particular matters in the community generally, enacted via authority from states. *Id.*

III. ARE LICENSES OF INTELLECTUAL PROPERTY EXECUTORY?

Whether a license of intellectual property qualifies as "executory" has consequences in a bankruptcy case because of the debtor's power to assume and assign, or reject, executory contracts. The vast majority of bankruptcy courts have defined an executory contract as "a contract under which the obligation of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." *In re Exide Technologies*, 607 F.3d 957 (3rd Cir. 2010) (citing Countryman, *Executory Contracts in Bankruptcy: Part I,* 57 Minn. L. Rev. 439 (1973)). To determine whether the obligations of the debtor and the counterparty to the contract are underperformed sufficient to constitute a material breach, bankruptcy courts look to applicable state law. *See id.* (citing *In re Columbia Gas*, 50 F.3d 233, 240 (3rd Cir. 1995)).[4]

In *In re Exide Technologies,* the Third Circuit examined whether a trademark agreement amongst and larger overall sale transaction constituted an executory contract. Exide Technologies and EnerSys had entered into four agreements at the time that Exide sold to EnerSys most of its battery business. *See id*. at 960. One of the agreements included a trademark and trade name license agreement, but the bankruptcy court held that the four agreements constituted a single, integrated agreement. *Id.* Under the agreement, Exide granted EnerSys a perpetual, exclusive, royalty-free license in the Exide trademark to EnerSys for use in the industrial battery business because it wanted to continue to use the trademark outside of the industrial battery business. *Id.*

Ten years later, Exide contemplated returning to the industrial battery market, but EnerSys refused to relinquish the trademark. *Id.* at 961. When Exide filed its Chapter 11 bankruptcy case, it sought to seize the opportunity to regain the trademark for the industrial battery market, and thus sought to reject the agreement.[5] *Id.* On appeal, the Third Circuit held that the bankruptcy court did not properly measure whether either party had substantially performed in its analysis of the executoriness of the agreement, but that the record demonstrated that EnerSys had indeed substantially performed. *See id.* at 963. The Third Circuit concluded that EnerSys had substantially performed because its performance rendered outweighed its performance remaining; EnerSys had paid the full purchase price and had been operating under the agreement for ten years. *See id.* Notably, the Third Circuit rejected Exide's argument that EnerSys's obligation to not use the trademark outside the industrial battery business was material and still outstanding, characterizing it instead as a condition subsequent, not a material

[4] One feature of the exclusive patent or copyright license is that it functions more like a fully-vested transfer of the intellectual property in exchange for money. Analogously, the exclusive license connotes fewer ongoing performance obligations than the non-exclusive license.

[5] Section 365 permits a debtor-in-possession, subject to the court's approval, to assume or reject any executory contract or unexpired lease of the debtor.

obligation. *Id.* The Third Circuit also rejected Exide's argument that EnerSys's obligation to observe a quality standards provision was an outstanding obligation demonstrating the contract was executory, concluding that such obligation was minor and did not relate to the transfer of the industrial battery business. *Id.* Similar decisions concluding that IP licenses included in other, larger transactions are not themselves "executory" contracts include *In re Interstate Bakeries Corp.*, 751 F.3d 955 (8th Cir. 2014) (trademark license integrated into asset purchase agreement was not "executory") and *In In re Matusalem*, 158 B.R. 514, 521-22 (Bankr. S.D. Fla. 1993) (section 365(n) did not terminate trademark license where trademark was integrally linked to other intellectual property).

IV. THE MEANING OF REJECTION

If determined to be executory, rejection of IP licenses is particularly harsh if the debtor is the licensor. Given the importance of IP licenses to various businesses, significant mischief potentially accompanies the IP rejection decisions – the licensor has been paid by the pre-petition counterparty to use the license often up-front, the licensor can simply reject and relicense the technology to another licensee post-petition leaving the original licensee with catastrophic damages that cannot be paid. To understand the back and forth of IP rejection decisions, one must first grapple with the meaning of rejection. In the Fifth Circuit, the law clearly holds that rejection equals repudiation of the estate's ongoing obligations to perform.

> Section 365 derives from § 70(b) of the former Bankruptcy Act, a provision that broadly codified the common law doctrine that allowed the trustee either to assume and perform the debtor's leases or executory contracts or to "reject" them if they were economically burdensome to the estate. *See generally* Michael T. Andrew, *Executory Contracts in Bankruptcy; Understanding "Rejection,"* 59 U of Colo.L.Rev. 845, 874-81 and n. 136 (1988). This court has held that the deemed rejection of a lease under § 70(b) did not terminate the lease but merely placed the trustee's obligation to perform under the leasehold outside of the bankruptcy administration without destroying the leasehold estate. *In re Garfinkle,* 577 F.2d 901, 904 (5th Cir.1978).

Eastover Bank for Savings v. Sowashee Venture (In re Austin Dev. Co.), 19 F.3d 1077 (5th Cir. Miss. 1994). The debtor may reject its obligations under the contract, but the contract continues to exist as to all non-debtor parties. *Id.* This fundamental tenet leads inexorably to the conclusion that bankruptcy jurisprudence embarked on a wayward path in 1985.

The opinion in *In re Lubrizol Enterprises, Inc.,* (*Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.)*, 756 F.2d 1043 (4th Cir. 1985) is the trailhead of the wayward path. Prior to the petition date, Richmond Metal Finishers ("RMF") entered into a contract with Lubrizol that granted Lubrizol a nonexclusive license to use a metal coating process technology. *Id.* at 1045. Under the contract, RMF owed several obligations to Lubrizol, including the following: (1) notify Lubrizol of any patent infringement suit and defend against such suit; (2) notify Lubrizol of any other use or licensing of the process; (3) reduce royalty payments if a lower royalty rate agreement was reached with another licensee; and (4) indemnify Lubrizol for losses arising out misrepresentation or breach of warranty. *See id.* at 1045-46. RMF later filed a bankruptcy petition. *Id.* In its proposed Chapter 11 plan, RMF proposed to reject the technology license agreement with Lubrizol to facilitate the sale or licensing of the technology, without the roadblocks of such provisions in the agreement. *Id.*

The Fourth Circuit agreed with the bankruptcy court's finding that the technology license agreement was executory. *Id.* In so doing, it concluded that RMF owed Lubrizol continuing duties, which included the duty to notify Lubrizol of further licensing of the process and also of reducing Lubrizol's royalty rate to meet any more favorable rates granted to subsequent licensees. *Id.* at 1045. The court noted that such obligations of the debtor continued over the life of the agreement and were unperformed, making the contract executory as to RMF. *Id.* The court also pointed to RMF's duties to notify Lubrizol and defend infringement suits, reasoning that a contingent obligation does not preclude a finding of executoriness. *Id.* at 1046. The court further found that the agreement was executory as to Lubrizol because Lubrizol owed RMF the duty of accounting for and paying royalties for the life of the agreement. *Id.* Although a duty to make monetary payments to another party is insufficient alone to support a finding of executoriness, the court found that Lubrizol had also promised to deliver written quarterly sales reports and maintain books of account. *See id.* Rather, according to the Fourth Circuit, licensing agreements are similar to leases because of the limited nature of the interest conveyed, and noted further that leases are expressly subject to rejection under § 365.

Notably, in *Lubrizol*, the Fourth Circuit also reversed the district court's holding that by rejecting the agreement, RMF could deprive Lubrizol of its rights. Citing to legislative history, the Fourth Circuit emphasized that § 365(g) provided that Lubrizol was entitled to treat the rejection as a breach and seek money damages, but following rejection, could not retain its contract rights in the technology by specific performance, notwithstanding whether specific performance would be an available remedy upon breach. *Id.* The Fourth Circuit stressed that although the Bankruptcy Code provides special treatment for certain types of agreements, including for example, collective bargaining agreements, it affords no special treatment for technology licensees of copyrights and patents, meaning they "share the general hazards created by § 365 for all business entities dealing with potential bankrupts." *Id*. On this point, other courts and commentators have criticized Lubrizol.

After *Lubrizol,* Congress enacted section 365(n) of the Bankruptcy Code, "to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to section 365 in the event of the licensor's bankruptcy." S. Rep. No. 100-505 at 1 (1988), *reprinted in* 1988 U.S.C.C.A.N. at 3204. Section 365(n)(1) provides that if a trustee or debtor in possession rejects "an executory contract under which the debtor is a licensor of a right to intellectual property," the licensee under the contract may elect:

> (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) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), 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.

and the licensee is deemed to waive "any right of setoff it may have with respect to such contract" and any administrative claim arising from the performance of the contract. *Id.* at § 365(n)(2)(C). However, section 365(n) leaves unaffected the licensee's rights under section 365(g), so that a general claim for damages, if any, from rejection can be asserted by the licensee." S. Rep. No. 100-505, at 10 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3207. A savvy practioner will assert recoupment notwithstanding these restrictions.

Section 365(n) applies only to contracts under which the debtor is a licensor of "intellectual property," defined under 11 U.S.C. § 101(35)(A) as copyrights and patents. Trademarks were excluded from the definition and therefore not protected under section 365(n). The question is why?

The Senate Report on the amendment explains:

> Finally, the 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, *see, e.g., In re Chipwich, Inc.*, 54 Bankr. Rep. 427 (Bankr. S.D.N.Y. 1985), 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.

S. Rep. No. 100-505, at 5 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3204. *See In re Old Carco LLC,* 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009) ("365(n) entitles the licesee to retain their rights with respect to the Chrysler trademarks and continue using them post-rejection without merit. Section 365(n) only allows such retention of rights and continued usage if the executory contract is one under which 'the debtor is a licensor of a right to intellectual property.' Trademarks are not 'intellectual property' under the Bankruptcy Code.") (citation omitted); *In re HQ Global Holdings, Inc.,* 290 B.R. 507, 512-13 (Bankr. D. Del. 2003) (finding that trademarks and other proprietary marks" are not "intellectual property" under the Bankruptcy Code, and are not protected by section 365(n)).

The issue of rejecting a license agreement that granted the counter-party a license to use both "intellectual property," as defined in section 101(35)(A), and certain trademarks was revisited in *Raimi UK Ltd. v. Centura Software Corp.* (*In re Centura Software Corp.),* 281 B.R.

660 (Bankr. N.D. Cal. 2002). In *Centura,* the debtor licensor rejected a license agreement which afforded the non-debtor licensee the right to use the debtor's software and to use the debtor's trademarks to market and sell the debtor's software. *Id.* at 662. An adversary proceeding was later commenced to determine whether the non-debtor licensee, under Bankruptcy Code section 365(n), could continue using the debtor's trademark. *Id.* at 663-64. The court held that the plain language of section 365(n) did not apply to trademarks, and that once the debtor's license has been rejected, the counter-party could not continue to use the trademarks. *Id.* at 669-71. In so holding, the court distinguished the holding in *Matusalem*,[6] emphasizing that "*Matusalem* considered section 365(n) in a pre-rejection context, not—as here—post-rejection." *Id.* at 671. The court in *Centura* continued as follows:

> [B]ecause [section] 365(n) governs intellectual property rights post-rejection and it explicitly excludes trademarks, in order to protect their entire bundle of rights, licensees [to both intellectual property and trademarks] . . . must assert their rights early in the case, before the [licensor] . . . receives court approval of its rejection decision. *The licensees must at that time persuade the bankruptcy court to weigh the equities and not to reject the agreement because its trademarks are integrally linked to other intellectual property.*

Id. at 671-72 (emphasis added) (internal citations omitted).[7]

So the handful of cases addressing rejection of trademark licenses by the debtor-licensor continue to struggle with the inequities visited upon non-debtor licensees and the potential for abuse that remained unaddressed by the addition of section 365(n). In 2012, the wayward trail launched by *Lubrizol*, has come full circle. Simply put, *Lubrizol* was wrongly decided because it failed to distinguish between rejection and termination of an executory contract. That wrong decision begat legislation to fix it, but inexplicably omitting trademarks. Fortunately, the Seventh Circuit figured it all out and put us back on the right track.

In *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC,* 686 F.3d 372 (7th Cir. 2012), the Seventh Circuit cited to Judge Ambro's *Exide* concurrence in rejecting *Lubrizol's* holding that a licensor debtor's rejection of an intellectual property license terminated the licensee's rights. At issue in *Sunbeam* was whether a manufacturer of box fans, which had been granted the right to use the debtor's trademarks, could continue employing the marks after rejection of the underlying license agreement. The bankruptcy court had allowed the licensee to

[6] The court in *Centura* also questioned whether the court in *Matusalem* actually "extend[ed] [section] 365(n) protection to trademarks," disagreeing with at least one commentator's interpretation of that decision. *Centura Software Corp.*, 281 B.R. at 672-73 & n.21.

[7] Under *Matusalem* and *Centura*, a non-debtor licensee under an agreement involving both trademark licenses and "intellectual property" as defined under section 101(35)(A), may have a hope of retaining its right to use of the trademark license by arguing that permitting rejection of its contract would violate the "business judgment test" under which motions to reject executory contracts are tested. Specifically, if the non-debtor licensee retained the "intellectual property" license, the debtor's ability to license the trademark to a third party without the associated "intellectual property" might be of dubious value; and the bifurcation of the trademark license from the associated "intellectual property" license may produce nothing for the debtor and a large claim against the debtor.

continue using the trademarks, on the "equitable grounds" that the licensee had invested substantial resources that would otherwise be lost. *Id.* at 375.

The Seventh Circuit affirmed the bankruptcy court's decision, but not its "equitable grounds" reasoning. In doing so, the Seventh Circuit rejected *Lubrizol* based on a reading of section 365(g), which provides that rejection constitutes a breach of contract.[8] *See id.* at 376. Specifically, it recognized that "[w]hat [section] 365(g) does by classifying rejection as breach is establish that in bankruptcy, as outside of it, the other party's rights remain in place." *Id.* at 377. Thus, while rejection "frees the estate from the obligation to perform," it has "absolutely no effect upon the contract's continued existence," or presumably the non-debtor's rights under such contract. *See id.* at 377.

In holding that the non-debtor's rights to employ the debtor's trademark continued post-rejection, the Seventh Circuit was unpersuaded by the fact that "trademark" was not specifically included in the Bankruptcy Code's definition of "intellectual property." *Id.* at 375. In fact, it noted that "[s]ome bankruptcy judges have inferred from the omission [of trademarks from the Bankruptcy Code's definition of "intellectual property"] that Congress codified *Lubrizol* with respect to trademarks, but an omission is just an omission." *Id.*

While affirming the bankruptcy court's holding, the Seventh Circuit criticized the lower court's use of its equitable powers to allow the licensee to continue using the marks. The Seventh Circuit emphasized that "[w]hat the Bankruptcy Code provides, a judge cannot override by declaring that enforcement would be 'inequitable.'" *Id.* The Seventh Circuit stated that § 365(g) only says that rejection constitutes a breach. The court observed that a licensor's breach did not terminate a licensee's right to use intellectual property outside of bankruptcy. *Id.* The court held that, by classifying rejection as a breach, § 365(g) provided that the other party's rights remain, except that the debtor was not subject to specific performance. *Id.* The court emphasized that nothing about the bankruptcy process of treating the rejection as a breach and converting the debtor's unperformed obligations into a claim for damages by the licensee, which might be written down in common with other debts of the same class, meant that rejection vaporized a licensee's rights. *Id.* The court compared licensing agreements with leases, pointing out that a lessor cannot dispossess a lessee by rejecting a lease and then lease the property for a higher price. *Id.*

In short, the Seventh Circuit held that rejection does not terminate the license or the licensing agreement, and does not rescind the agreement. Rejection is not "the functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions they occupied before the contract was formed." *Thompkins v. Lil' Joe Records, Inc.*, 476 F.3d 1294, 1306 (11th Cir. 2007).[9] The court continued

[8] In rejecting *Lubrizol,* the Seventh Circuit was aware that it was creating a circuit split. *In re Sunbeam Prods.,* 686 F.3d at 378. Nonetheless, the Supreme Court denied a petition for certiorari. *Sunbeam Prods., Inc. v. Chicago Am. Mfg., LLC,* 133 S. Ct. 790 (Dec. 10, 2012)

[9] See also *Eastover Bank for Savings v. Sowashee Venture (In re Austin Dev. Co.),* 19 F.3d 1077, 1082 (5th Cir.1994) (holding that rejection under § 365(g) "does not mean that the executory contract . . . has been terminated, but only that a breach has been deemed to occur"); *Cohen v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.),* 138 B.R. 687 (Bankr.S.D.N.Y.1992) (rejection "does not embody the contract-

> Scholars uniformly criticize *Lubrizol,* concluding that it confuses rejection with the use of an avoiding power. See, e.g., Douglas G. Baird, *Elements of Bankruptcy* 130–40 & n.10 (4th ed.2006); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection",* 59 U. Colo. L.Rev. 845, 916–19 (1988); Jay Lawrence Westbrook, *The Commission's Recommendations Concerning the Treatment of Bankruptcy Contracts,* 5 Am. Bankr.Inst. L.Rev. 463, 470–72 (1997). *Lubrizol* itself devoted scant attention to the question whether rejection cancels a contract, worrying instead about the right way to identify executory contracts to which the rejection power applies.

Sunbeam at 377.

In the *Exide Technologies* concurrence, Judge Ambro recognized that, because trademarks are not included in section 101(35)(A)'s definition of "intellectual property," trademark licenses are not explicitly covered by section 365(n). *Exide Technologies,* 607 F.3d 957, 966-67 (3d Cir. 2010).

> In light of these direct congressional statements of intent, it is simply more freight than negative inference will bear to read rejection of a trademark license to effect the same result as termination of that license. The purpose of [section] 365 is not to be the functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions they occupied before the contract was formed. It merely frees the estate from the obligation to perform, and has absolutely no effect upon the contract's continued existence.

Exide 607 F.3d at 967 (citations and quotations omitted).

The bankruptcy court in *In re Crumbs Bake Shop, Inc.,* 2014 Bankr. LEXIS 4568, No. 522 B.R. 766 (Bankr. D. N.J. 2014), examined the effect of a bankruptcy sale on the rights of trademark licensees. The bankruptcy court had authorized the sale of substantially all of Crumbs' assets under § 363(f). *Id.* at *2. Subsequently, issues arose concerning the effect of the sale on the rights of trademark licensees, when Crumbs filed a motion to reject certain executory contracts and unexpired leases, including several license agreements. *Id.* Prior to the petition date, Crumbs had specialized in the retail sale of cupcakes, baked goods, and beverages, and had entered into licensing agreements with third parties. *Id.* at *3. Such licensing agreements allowed third parties to utilize the Crumbs trademark and trade secrets. *Id.* A licensee objected to Crumbs' post-sale motion to reject, asserting that § 365(n) provided that it maintained its rights under its respective license agreement. *Id.*

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vaporizing properties so commonly ascribed to it . . . . Rejection merely frees the estate from the obligation to perform; it does not make the contract disappear." *Id.* at 703 and "[r]ejection has absolutely no effect upon the contract's continued existence; the contract is not cancelled, repudiated, rescinded, or in any other fashion terminated." *Id*. at 708 (quotations omitted).

The *Crumbs* court first tackled the issue of whether § 365(n) applies to trademarks at all, because although § 365(n) plainly applies to intellectual property licenses, the definition of "intellectual property" in the Bankruptcy Code does not include trademarks.[10] The *Crumbs Bake Shop* court held that § 365(n) applies to trademarks, rejecting the argument that equitable considerations should mandate a different result, commenting that "[b]ankruptcy estates, whether reorganizing or liquidating, benefit already from the ability to assume or reject executory agreements. There is no reason to augment such benefits at the expense of third parties and licensing system which Congress sought to protect by means of preserving certain rights under § 365(n)."[11]

The *Crumbs* court then held that the sale of Crumbs' assets did not extinguish the rights of the third party licensees absent consent. In so doing, the court rejected the purchaser's argument that the licensees had impliedly consented by failing to object to the sale motion, finding that improper notice of the intended effect of the sale on the licensees' rights.[12] The court further ruled that § 365(n), as the more specific provision, governed over § 363(f). Thus, the court rejected the argument that the sale (pursuant to § 363(f)) operated to cut off the licensees' rights in the agreements. *Id.* at *31.

V. IS THERE A LIEN ON THE INTELLECTUAL PROPERTY?

Several courts have wrestled with issues concerning the proper method of perfection of security interests in various forms of intellectual property. Indeed, various methods exist depending upon the type of intellectual property involved. Consequences for failing to follow the correct method can be drastic if a bankruptcy case is involved, as certain provisions of the Bankruptcy Code may empower a trustee or debtor-in-possession to avoid unperfected security interests.

The bankruptcy trustee in *Braunstein v. Gateway Mgmt. Servs. (In re Coldwave Systems, LLC),* 368 B.R. 91 (Bankr. D. Mass. 2007) successfully avoided an unperfected security interest in a patent. Prior to its bankruptcy petition, debtor Coldwave Systems had been engaged in the design, development, manufacture, licensing, and sale of shipping, freezing, and storage systems, and owned the patent. *Id.* at 92. Gateway leased shipping containers to Coldwave, and Gateway and Coldwave entered into an agreement in which Coldwave granted to Gateway a security interest in collateral, to include the patent. *Id.* at 93. The agreement provided that it was governed by California law. *Id.*

To perfect the security interest in the patent, Gateway filed a Recordation Form Cover Sheet with the United States Patent and Trademark Office ("USPTO"). *Id.* It then filed UCC-1 Financing Statements describing the patent in Massachusetts and Washington, D.C. *Id.* Over a year later, Gateway attempted to effect a partial strict foreclosure of the patent, notifying

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[10] *See* § 101(35A).

[11] The court went on further to state that in bankruptcy cases involving sales, "monetary recoveries primarily benefit the pre-petition and post-petition lenders and administrative claimants. Minimal distributions to general unsecured creditors are the norm. It is questionable that Congress intended to sacrifice the rights of licensees for the benefit of the lending community."

[12] The court flatly stated that had the licensees had sufficient notice and objected to the sale motion, the court would have ruled that § 365(n) applied to leave their rights untouched by the sale.

Coldwave that it was exercising its rights under the agreement. *Id.* It then filed a Transfer Statement with the USPTO that indicated the ownership of the patent had been transferred from Coldwave to Gateway. *Id.*

The Trustee argued that Gateway's filing with the USPTO was ineffective to perfect a security interest in the patent, and because perfection of a security interest in a patent is governed by state law, Gateway's security interest was not perfected until it filed a UCC-1 financing statement. The court began its analysis by examining the U.C.C. as adopted by California as provided by the parties' agreement. *Id.* at 95-96. The court observed first that the general rule for perfection of a security interest in a general intangible (such as a patent) is by filing. *Id.* (citing CAL. COMM. CODE § 9310(a)). An exception exists for "property subject to a statute, regulation, or treaty described in § 9311." *Id. I* Section 9311, in turn, provides that no filing is necessary to perfect a security interest in property subject to a statute, regulation or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt section 9310." *Id.* Looking to the applicable federal patent law, the court observed that it only addressed assignments, grants, or conveyances. The court looked to the Ninth Circuit's analysis of that same language in *Moldo v. Matsco, Inc. (In re Cybernetic Services, Inc.),* 252 F.3d 1039 (9th Cir. 2001). There, the Ninth Circuit concluded that the Patent Act requires parties to record with the USPTO only ownership interests in patents and does not preempt the U.C.C. as to the perfection of security interests. *Id.*[13] The court agreed with the Ninth Circuit's ruling, and held that Gateway did not have a perfected security interest until it filed its UCC-1. *Id.*

As a last-ditch effort, Gateway argued that it obtained perfection by possession of the patent, and asserted that its possession of the patent was proven by the transfer statement it filed with the USPTO. The court readily rejected Gateway's argument, remarking that "a patent right is incorporeal property, not susceptible of actual delivery or possession." (citing *Waterman v. Mackenzie,* 138 U.S. 252, 260, 11 S.Ct. 334, 34 L. Ed. 923 (1891)). The court further remarked

[13] In *In re Cybernetic Services, Inc.*, 252 F.3d 1039 (9th Cir. 2001) examined whether the Patent Act or the UCC (as adopted in California) required the holder of a security interest in a patent to record the interest with the USPTO to perfect the interest as against other creditors. Prior to the petition date, Matsco, Inc. and Matsco Financial Corporation (collectively, "Matsco") held a security interest in a patent developed by Cybernetic Services for a data recorded that captured data from a video signal regardless of the horizontal line in which the data is located. Matsco had filed its security interest consistent with the California U.C.C. Cybernetic Services later filed a Chapter 7 bankruptcy petition. Matsco sought relief from the automatic stay to foreclose on its interest in the patent, but the bankruptcy trustee opposed, arguing that Matsco's interest in the patent was not perfected. On appeal, the Trustee argued that the Patent Act preempted the filing requirements of Article 9 of the U.C.C. and that Article 9 itself mandates that a security interest in a patent can only be perfected by filing it with the USPTO. The Ninth Circuit distinguished the Copyright Act by noting that it specifically covered security interests, in contrast to the Patent Act.13 The court also rejected the trustee's argument based upon the step-back provision of the U.C.C., which required a creditor file notice of a secured transaction with the USPTO to perfect a security interest.13 The court found that the Patent Act is not a statute that provides for a national recording system of security interests and thus is outside the scope of the step-back provision of the UCC.13 Accordingly, the interest could not be avoided by the Chapter 7 trustee because it had been properly perfected pursuant to the U.C.C.

that no exception in the UCC excepted general intangibles from the general rule requiring filing for perfection.[14]

Turning to trademarks, in *Trimarchi v. Together Development Corp.,* 255 B.R. 606 (D. Mass. 2000), the district court considered an appeal from a bankruptcy court's order holding that an individual's security interest in a trademark was not perfected because the trademark registration requirements of the Lanham Act did not preempt the U.C.C. Prior to the petition date, Trimarchi and Together Development Corp. ("TDC") entered into a stock repurchase agreement, pursuant to which TDC executed two promissory notes evidencing its obligations to Trimarchi, which were secured in part by a trademark. *Id.* at 607. Trimarchi filed a UCC-1 with the USPTO, but did not file it anywhere else. *Id.* Later, TDC filed a bankruptcy petition and sold substantially all of its assets, including the trademark. *Id.* Trimarchi objected to the sale, but the bankruptcy court overruled his objection on the basis that his security interest was unperfected because he did not file the UCC-1 in the required state and local offices. *Id.* On appeal, the court rejected the argument that the filing of the UCC-1 with the USPTO was sufficient for perfection of the security interest because the Lanham Act is an exemption to state and local filing requirements. *Id.* Instead, the court held that the Lanham Act does not preempt the UCC's filing requirements, and perfection of a security interest in a trademark is governed by Article 9 of the UCC. *Id.*

Failure to correctly perfect a security interest in certain patents and trademarks resulted in the avoidance of the security interest in *In re Pasteurized Eggs Corporation,* 296 B.R. 283 (Bankr. D. N.H. 2003). In *Pasteurized Eggs,* the debtor filed suit against Bon Dente Joint Venture ("BDJV") seeking a declaration that certain patents and trademarks were property of the bankruptcy estate and that BDJV's asserted security interest in them could be avoided pursuant to § 544 of the Bankruptcy Code. *Id.* at 285. The bankruptcy court emphasized that whether a security interest is perfected is a matter of state law, even when the property is a patent. *Id.* at 290 (citing *Cybernetic,* 252 F.3d at 1043). The *Pasteurized Eggs* court held that BDJV's act of filing the patent purchase agreement with the USPTO was not sufficient to perfect a security interest, and BDJV should have instead filed a UCC-1 in accordance with the Illinois Uniform Commercial Code. *See also Gasser Chair Company, Inc.,* 2006 U.S. Dist. LEXIS 13402, No. 88 CV 3931 (E.D.N.Y. Feb. 8, 2006) (granting a motion to sell a patent upon finding that a security interest in a patent should be perfected in accordance with state law, not by filing record in the USPTO).

The court in *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (C.D. Cal. 1990), tackled the same issue but with respect to the perfection of security interests in copyrights. National Peregrine, Inc. ("NPI")'s assets included copyrights, distribution rights, and licenses to 145 films. *Id.* at 197. Capital Federal Savings ("Cap Fed") had loaned money to NPI's predecessor, secured by NPI's film library. *Id.* Cap Fed filed its UCC-1 financing statements in California, Colorado, and Utah, but did not record its security interest in the United States Copyright Office ("USCO"). *Id.* at 198. Later, NPI filed a bankruptcy petition, and shortly thereafter, commenced a lawsuit against Cap Fed, asserting that Cap Fed's security interest in the copyrights to the films

[14] The court in *Cybernetic Services, Inc.*, 252 F.3d 1039 (9th Cir. 2001) held that the Patent Act did not preempt state law regarding secured transactions.

was unperfected because it had failed to file with the USCO, enabling it to avoid the security interest for the benefit of its bankruptcy estate. *Id.*

The court began by examining the Copyright Act's mandate that "any transfer of copyright ownership or other document pertaining to a copyright" may be recorded in the Copyright Office. *Id.* at 198-99. The court further found that the "comprehensive scope" of the Copyright Act's recording provisions supported preemption of state methods of perfecting security interests in copyrights, stressing that such copyright laws "ensure 'predictability and certainty of copyright ownership, promote national uniformity, and avoid the practical difficulties of determining and enforcing an author's rights under the differing laws and in the separate courts of the various states." *Id.* at 199(citing *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989)).

Further, the court found that the Copyright Act and Article 9 create different priority schemes, so if filing under the U.C.C. were sufficient, such would undermine the priority scheme established at the federal level with respect to copyright, weighing in favor of preemption. *Id.* at 201 (citing *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed 2d 118 (1989)). The court remarked that "[t]of the extent interested parties are confused as to which system is being employed, this increases the level of uncertainty and multiplies the risk of error, exposing creditors to the possibility that they might get caught with their pants down." *Id.* Accordingly, the court found that Cap Fed's security interest in the film library was not perfected. *Id.*

With respect to a security interest in an unregistered copyright, the court in *Aerocon Eng'g, Inc. v. Silicon Valley Bank (In re World Auxiliary Power Company)*, 303 F.3d 1120 (9th Cir. 2001) held that perfection with the Copyright Office was not sufficient. Distinguishing its holding from the court's opinion in *Peregrine Entertainment*, the court noted that the Copyright Act provides that registration with the Copyright Office is permissive, not mandatory, and is not a condition for copyright protection. *Id.* at 1126. The court also observed that a copyrighted work only receives a registration number that would be revealed via its search if it registered, but an unregistered work has no such registration number that would be revealed by a search. *Id.* This meant that a secured creditor could not preserve priority in an unregistered copyright by recording in the Copyright Office. *Id.*

The court then examined relevant "step-back" provisions of the U.C.C. that functioned to avoid conflict with federal law, noting that § 9104(a) exempts from U.C.C. filing requirements security interests in property "subject to . . .[a] statute . . . of the United States which provides for filing of the security interest." *Id.* at 1127. The court concluded that such provision demonstrated that if a copyright has been registered, a security interest can be perfected only by recording the transfer in the Copyright Office. *Id.* With respect to unregistered copyrights, the court concluded, however, that the U.C.C. did not defer to the Copyright Act because the Copyright Act does not provide for the rights of secured parties to unregistered copyrights. *Id.* Thus, the court held that the U.C.C. governs the perfection and priority of security interests in unregistered copyrights, and perfection of security interests in unregistered copyrights proceeds under the applicable U.C.C.

The bankruptcy court's holding in *Transportation Design & Technology* has been followed in subsequent cases. In *Moldo v. Matsco, Inc. (In re Cybernetic Services, Inc.),* 239 B.R. 917 (B.A.P. 9th Cir. 1999), *aff'd,* 252 F.3d 1039 (9th Cir. 2001), the bankruptcy trustee sought to avoid a security interest in a patent that was not recorded in the Patent and Trademark Office pursuant to 35 U.S.C. § 261. Rejecting this claim, the court held that the proper way to record a security interest in a patent was to file a U.C.C. financing statement with the secretary of state. *Id.* at 923; *see also Elec. Constructors, LLP v. Tower Tech, Inc. (In re Tower Tech, Inc.)*, 67 Fed. App'x. 521, 524 (10th Cir. 2003) (citing *Cybernetic;* finding that debtor's status as a hypothetical lien creditor was superior to party that filed its security interest in the Patent and Trademark Office, but failed to perfect its security interest under the U.C.C.); *City Bank & Trust Co. v. Otto Fabric, Inc.*, 83 B.R. 780, 784 (D. Kan. 1988) (filing in the Patent and Trademark Office was unnecessary to perfect security interest in patent as against the trustee in bankruptcy).