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A SOLUTION-BASED APPROACH TO REJECTING TRADEMARK LICENSES IN BANKRUPTCY

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ABSTRACT

The Seventh Circuit created a circuit split in bankruptcy law regarding the rejection of trademark licenses in its 2011 decision in *Sunbeam Prods., Inc. v. Chi. Am. Mfg. LLC*. All other courts have held that when a trademark license is rejected under 11 U.S.C. § 365 in a Chapter 11 bankruptcy proceeding, the licensee may no longer use the licensed trademark. All other forms of intellectual property are subject to § 365(n), which prevents automatic termination of the licensee's rights. In *Sunbeam*, the court held that the rejection of a trademark license under § 365 does not automatically terminate the licensee's rights. The court held that Congress' omission of trademarks from § 365(n) did not automatically mean that trademark licensee rights were exhausted after a rejection. An analysis of the history of the rejection of trademark licenses during bankruptcy proceedings reveals that the underlying reason for the circuit split arises from a larger circuit split regarding interpretation of the term "rejection" in § 365(g) of the Bankruptcy Code. This split has been around for at least twenty-eight years and a 1997 committee report requested that Congress clarify the term through an amendment. Congress has not yet clarified the term and the Supreme Court has not granted any *writs of certiorari* on the matter. This article therefore proposes the employment of a multi-factor test when a contract is rejected that takes into consideration the concerns of each side of the split. This article proposes further factors for consideration when the contract is a trademark license, which addresses the quality control concerns that led Congress to omit trademarks from § 365(n) in the first place. The employment of a multi-factor test allows a more equitable solution to be reached without waiting for Congress or the Supreme Court to take action.

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I. INTRODUCTION

With the downturn in the economy and living costs skyrocketing, more people have turned to cheaper alternatives for vacationing. Imagine that STARBUCKS™ and an up-and-coming camping gear manufacturer ("UCM") have decided to capitalize on the situation. The two companies teamed up to create a STARBUCKS™ line of coffee equipment, tea equipment, and drink wares suitable for camping. After negotiations, STARBUCKS™ and the UCM entered into a trademark licensing agreement. The licensing agreement contained several provisions including extensive quality control measures on the STARBUCKS™ logos that would go on the wares and for the quality of the wares themselves. The UCM negotiated the agreement to be five years instead of the two years that STARBUCKS™ wanted, because the UCM expected profits only after the end of the second year. To ensure it would reach those profits, the UCM included a provision in the agreement that prevented STARBUCKS™ from entering into another agreement with a competitor during the term of the agreement.

Two years into the agreement, STARBUCKS™ found itself in great financial difficulties because the economy had continued to decline and its consumers were opting to make coffee from home with generic coffee beans to save money. STARBUCKS™ had no option but to file for bankruptcy. By this time, the UCM had just recouped its investment and was about to start making a profit from the STARBUCKS™ line of camping wares.

During the Chapter 11 bankruptcy proceedings for reorganization, STARBUCKS™ decided that it could make more money from royalties by terminating the licensing agreement with the UCM and creating a license agreement with a larger manufacturer instead. Therefore, STARBUCKS™ rejected the UCM's license agreement, which terminated the UCM's right to use any STARBUCKS™ trademarks. The UCM had no recourse because it had just recouped its investment on the project. It also had no capital to start a new project because it had spent all of its capital on the STARBUCKS™ line. To make matters worse, the UCM had already made tens of thousands of wares that were stocked and ready to be sold. It could no longer sell them because of the rejection. To avoid huge losses, the UCM did not create any more of the STARBUCKS™ products, but continued to sell what was in stock. Within the next several weeks, the UCM received a complaint alleging trademark infringement.

This bankruptcy situation does not happen with other forms of intellectual property licenses because of specific provisions within the Bankruptcy Code.[1] With

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[1] 11 U.S.C. §§ 101(35A), 365(n)(1)(B)(i) (2012). Bankruptcy proceedings are subject to Title 11 of the United States Code, termed the "Bankruptcy Code." Bankruptcy, 11 U.S.C. §§ 101–1532

patents, trade secrets, and copyrights, the debtor may reject the licensing contract,[2] but the rejection has no automatic termination effect on the rights given by the license.[3] With trademarks, all jurisdictions except the Seventh Circuit treat a trademark licensee's right to use a trademark as automatically terminated when a debtor-licensor rejects the contract during bankruptcy.[4] This article focuses on why trademark licenses are treated differently within bankruptcy proceedings and proposes a more equitable solution. Part II of the article discusses the peculiar history leading up to the trademark license discrepancy and the recent case that caused a circuit split on the issue. Part III analyzes the trademark discrepancy in bankruptcy proceedings and determines the root cause of it. Part IV proposes the incorporation of a "rejection" test for executory contracts involving property, or something with characteristics of property, as an alternative to waiting for an amendment by Congress or opinion from the Supreme Court.

II. BACKGROUND

The STARBUCKS™ situation comes from a unique intersection of three separate areas of law: (1) trademarks, (2) licenses, and (3) bankruptcy. Each of these areas of law is complex in and of itself, creating a complex problem when all three are forced to merge in an area of law such as bankruptcy proceedings with intellectual property licenses.[5] Section II.A will give a brief explanation of how these areas of law tie together and will help illustrate the underlying problem trademark licensees currently face when a licensor proceeds through the bankruptcy process. Section I.B will then discuss the cases giving rise to the current circuit split on whether a trademark licensee rights are automatically terminated after a debtor rejects the license.

(2012). 11 U.S.C. § 101 defines the term "Intellectual Property" to include patents, copyrights, and trade secrets, but not trademarks. 11 U.S.C. § 101(35A) (2012). 11 U.S.C. § 365(n) prevents intellectual property licenses (except for trademark licenses) from being automatically terminated when an executory contract is rejected by a debtor or trustee. 11 U.S.C. § 365(n).

[2] 11 U.S.C. §§ 365(a), 1107(a). With intellectual property licenses, a "debtor" refers to either an appointed trustee, or a debtor-in-possession with the same rights during bankruptcy proceedings as a trustee. 11 U.S.C. §§ 101(13), 1101(1).

[3] 11 U.S.C. § 365(n) (2012). With patent, copyright, and trade secret licenses, if the licensee prefers to retain the license for the remainder of the term, it may do so. 11 U.S.C. § 365(n)(1)(B)(i). *See* Peter M. Gilhuly, Kimberly A. Posin, & Ted A. Dillman, *Intellectually Bankrupt?: The Comprehensive Guide to Navigating IP Issues in Chapter 11*, 21 AM. BANKR. INST. L. REV. 1, 34 (2013) ("[W]hen a debtor-licensor seeks to reject a license of patents, copyrights or trade secrets, the licensee has the right to keep the license in place.").

[4] *See* Gilhuly, Posin, & Dillman *supra* note 3, at 47.

[5] *See* ERIC E. BENSEN, COLLIER GUIDE TO CHAPTER 11: KEY TOPICS AND SELECTED INDUSTRIES ¶ 10.04[1] (Alan N. Resnick & Henry J. Sommer eds. 2013) [hereinafter COLLIER GUIDE] ("The most difficult questions concerning intellectual property matters to arise in bankruptcy do so in the context of the intellectual property license.").

A. The Intersection of Bankruptcy, Contract, and Trademark Laws

As indicated by its statutory definition, a trademark is something used with a good to identify or distinguish the good and to indicate its source.[6] While a trademark can be "any word, name, symbol, or device, or any combination thereof,"[7] it may alternatively be many other things such as a color,[8] a sound,[9] or packaging.[10] A trademark's function is to "induce[] a purchaser" to choose a particular good or product based on its source.[11] Trademarks became a legally recognized form of intellectual property through the Lanham Act of 1946,[12] and as with all forms of intellectual property, a trademark owner's rights include licensing of the property to a third party.[13]

A trademark license is a form of contract between two parties in which the licensor grants the licensee the right to manufacture, use, distribute, and sell products with the licensor's mark, typically in return for royalties from the licensee.[14] Licensing can be a "win-win" situation for both the licensor and the licensee,[15] but

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[6] 15 U.S.C. § 1127 (2012).

[7] *Id.*

[8] 1 ANNE GILSON LALONDE, GILSON ON TRADEMARKS § 2.11[2][a] (Matthew Bender, rev. ed. 2013) [hereinafter GILSON ON TRADEMARKS]; Qualitex Co. v. Jacobson Prods. Co., Inc., 514 U.S. 159, 161 (1995) (holding that a color alone could satisfy both ordinary requirements for trademark registration and use under the statutory definition).

[9] 1 GILSON ON TRADEMARKS, *supra* note 8, § 2.11[6]; Oliveira v. Frito-Lay, Inc., 251 F.3d 56, 61 (2d Cir. 2001) ("We can see no reason why a musical composition should be ineligible to serve as a symbol or device to identify a person's goods or services.").

[10] 1 GILSON ON TRADEMARKS, *supra* note 8, § 1.02[1][a] (Product packaging is protected as a trade dress, a type of nontraditional trademark.).

[11] *See* Mishawaka Rubber & Woolen Mfg. Co. v. S. S. Kresge, 316 U.S. 203, 205 (1942) ("A trade-mark is a merchandising short-cut which induces a purchaser to select what he wants, or what he has been led to believe he wants.").

[12] The Lanham Act, 15 U.S.C. §§ 1051–1141 (2012). The Lanham Act contains the federal statues for trademark law. *Id.*

[13] *See* Xuan-Thao N. Nguyen, *Bankrupting Trademarks*, 37 U.C. DAVIS L. REV. 1267, 1274 n.30 (2004); Beech-Nut Packing Co. v. P. Lorillard Co., 273 U.S. 629, 632 (1927) ("[T]he mark is property, protected and alienable, although as with other property its outline is shown only by the law of torts, of which the right is a prophetic summary.").

[14] *See* Irene Calboli, *The Sunset of "Quality Control" in Modern Trademark Licensing*, 57 AM. UNIV. L. REV. 341, 343 (2007) ("[Trademark licensing is] where trademark owners authorize third parties to produce and distribute products under their marks, usually in exchange for royalties"). Trademark licenses can be either exclusive or nonexclusive. ROGER MILGRIM & ERIC BENSEN, 2 MILGRAM ON LICENSING § 11.03 (Matthew Bender rev. ed. 2013) [hereinafter MILGRIM ON LICENSING] ("[a]s is true in any other type of license, a trademark license can be exclusive or nonexclusive"); Gilhuly, Posin, & Dillman, *supra* note 3, at 6 (discussing that intellectual property licenses can be exclusive or nonexclusive). In many commercial uses, the licenses are non-exclusive because trademark owners use the licenses to expand into new markets without incurring the costs of producing the goods themselves. JAY DRATLER, JR., LICENSING OF INTELLECTUAL PROPERTY § 1.03[1]-[9] (Law Journal Press 2013) [hereinafter LICENSING OF IP] (discussing reasons for licensing intellectual property).

[15] Calboli, *supra* note 14, at 343 ("Without exaggeration, licensing today interests most products, represents a significant source of revenue for many trademark owners, and continues to grow in importance due to the changes in product manufacturing, the internationalization of trade, and the shift toward a service economy.") (internal citation omitted).

can quickly become a "win-lose" situation when one party encounters financial difficulties and files for bankruptcy.[16]

When a business enters bankruptcy, it is typically commenced as a final effort to avoid going out of business completely.[17] Two options exist when a business is in financial failure; it can file for either chapter 7 or chapter 11 bankruptcy.[18] Chapter 7 bankruptcies involve liquidation of assets to pay creditors,[19] and are not available to banks or insurance companies.[20] Chapter 11 bankruptcies involve mechanisms for reorganization of the business with the goal of the business emerging from financial failure.[21] It is within the chapter 11 bankruptcy proceedings that the issue with trademark licenses, a type of contract, is found.

Part of the chapter 11 bankruptcy proceedings is for the debtor to file information about any executory contracts the debtor has.[22] No definition for an executory contract exists in the title 11 Code,[23] but it is widely accepted that an executory contract is one where both parties still have some performance due.[24] Although this may seem straightforward, there is contention over the level of underperformance required for the contract to be considered executory.[25] Many courts have held that a material breach is required for a contract to be considered

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[16] *In re* Matusalem, 158 B.R. 514, 522 (Bankr. S.D. Fla. 1993) (noting that the effect of a licensor going bankrupt could "utterly destroy" a licensee's business when a trademark license is at issue).

[17] ELIZABETH WARREN, CHAPTER 11: REORGANIZING AMERICAN BUSINESSES xiii (Vicki Been et al. eds., Aspen Publishers 2008) ("Failing businesses can file a petition in bankruptcy, give themselves some breathing room, and take a final chance to save their businesses."). The federal laws found in title 11 of the United States Code govern both types of bankruptcy for businesses, Chapter 11 and Chapter 7. The Bankruptcy Act, 11 U.S.C. §§ 101–1532 (2012).

[18] COLLIER GUIDE, *supra* note 5, ¶ 109.03[1] (stating that corporations and partnerships are eligible for liquidation, known as Chapter 7 bankruptcy); *id.* ¶ 109.05 (stating that Chapter 7 partnerships and corporations are alternatively eligible for reorganization, known as Chapter 11 bankruptcy).

[19] *Id.* ¶ 700.01 (stating that Chapter 7 of the Bankruptcy Code handles the sales of a debtor's property to pay creditors "a form of relief afforded by the bankruptcy laws that involves the collection, liquidation and distribution of the nonexempt property of the debtor").

[20] 11 U.S.C. § 109(b) (2012) (excluding railroads, banks, and insurance companies from being debtors under Chapter 7 bankruptcy).

[21] COLLIER GUIDE, *supra* note 5, ¶ 1.02[1] (explaining that rehabilitating a business is preferred over termination, because businesses are tied to the economy and termination will impact many people and entities including employees, stockholders, creditors, and customers).

[22] 11 U.S.C. § 1007(b)(1)(C) (stating that a debtor under Chapter 11 proceedings must file information related to "schedules, statements, and other documents" for "executory contracts and unexpired leases").

[23] Peter S. Menell, *Bankruptcy Treatment of Intellectual Property Assets: An Economic Analysis*, 22 BERKELEY TECH. L.J. 733, 755 (2007) (stating that the term "executory contract" is "not specifically defined in the [Bankruptcy] Code"); Madlyn G. Primoff & Erica G. Weinberger, *E-Commerce and Dot-Com Bankruptcies: Assumption, Assignment, and Rejection of Executory Contracts, Including Intellectual Property Agreements and Related Issues Under Sections 365(c), 365(e), and 365(n) of the Bankruptcy Code*, 8 AM. BANKR. INST. L. REV. 307, 310 (2000) ("[T]he term 'executory contract' is not defined in the Bankruptcy Code.").

[24] Menell, *supra* note 23, at 755 (commenting that most courts follow the notion that an executory contract is one where both parties still have performance due).

[25] *Id.* at 755–56 (discussing that courts use different tests to determine whether a contract is executory depending on the jurisdiction).

executory (the "Countryman" test).[26] For example, the Ninth Circuit follows the Countryman test, holding that a contract is executory when "the obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other."[27] Other courts have held that a contract is executory if making it executory is in the best interest of the debtor and there is some performance due beyond payment of money (the "functional" test).[28]

Whether or not the contract is considered executory is of great importance to both the debtor and the other party to the contract. Under the Bankruptcy Code, executory contracts and non-executory contracts have different procedures the debtor must follow.[29] The primary difference is that when the contract is executory the debtor has the option to reject it, but when the contract is non-executory the debtor may not reject it.[30] Rejection of a contract has significant legal effect because the debtor is relieved of remaining obligations, and the non-debtor's remedy becomes a breach of contract claim beginning at the time the bankruptcy action was initiated.[31] The practical effect of this with a trademark license, when the licensor is the debtor, is that the licensee must stop using the trademark immediately and any claims must be brought as a pre-bankruptcy breach of contract claim.[32] This breach of contract claim is treated as a general unsecured claim,[33] meaning that the licensee must prove any damages,[34] and even if it can prove damages, it may receive little, if any, recovery.[35] To make matters even grimmer for a licensee, once the debtor rejects a

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[26] *Id.* at 755; *see also* Vern Countryman, *Executory Contracts in Bankruptcy Law: Part I*, 57 MINN. L. REV. 439, 460 (1973).

[27] *See, e.g.*, *In re* Wegner, 839 F.2d 533, 536 (9th Cir. 1988).

[28] Sipes v. Atl. Gulf Cmtys. Corp. (*In re* Gen. Dev. Corp.), 84 F.3d 1364, 1375 (11th Cir. 1996) (holding that the Eleventh Circuit prefers the "functional approach" over the "Countryman approach"); *In re* Jolly, 574 F.2d 349, 351 (6th Cir. 1978) (deciding that whether a contract is executory depends on the purpose of rejecting the contract); *In re* Arrow Air, Inc., 60 B.R. 117, 122 (Bankr. S.D. Fla. 1986) (holding that a contract is allowed to be "executory under the functional approach if its assumption or rejection would ultimately benefit the estate and its creditors").

[29] 11 U.S.C. § 365(a) (2012) (stating a trustee or debtor may "assume or reject any executory contract"); 11 U.S.C. § 365(n) (expressing that a debtor may assume or reject an intellectual property license, but if the debtor rejects it, the licensee may choose to continue the license or allow the rejection); Gilhuly, Posin, & Dillman, *supra* note 3, at 2 (2013) (noting that the Bankruptcy Code treats executory contracts differently from ones that are nonexecutory).

[30] Gilhuly, Posin, & Dillman, *supra* note 3, at 2–3.

[31] 11 U.S.C. § 365(g)(1) (2012) ("the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease . . . [taking place] immediately before the date of the filing of the petition"); Aslan v. Sycamore Inv. Co., 909 F.2d 367, 371 (9th Cir. 1990) (discussing that when an executory contract is rejected, § 365(g)(1) from the Bankruptcy Code applies, creating a breach of contract beginning on the day before the petition for bankruptcy was filed).

[32] *See* Menell, *supra* note 23, at 767 (noting that when an executory contract is rejected, the effect is that "section 365(g) of the Code provides that the debtor is deemed to have breached the agreement, giving rise to a pre-petition damages claim for breach of contract").

[33] NLRB v. Bildisco & Bildisco, 465 U.S. 513, 531 (1984) ("Damages on the contract that result from the rejection of an executory contract, as noted, must be administered through bankruptcy and receive the priority provided general unsecured creditors.").

[34] *See* Gilhuly, Posin, & Dillman, *supra* note 3, at 36 ("[I]f the rejection damages claim is unliquidated, the licensee may have to further litigate to establish the amount of its claim.").

[35] *See id.* ("[R]ejection damages are treated as pre-petition unsecured claims under section 502(g), which have a relatively low priority in bankruptcy and generally will not be paid in full.").

contract and the court has approved the rejection, the licensee is barred from any specific performance remedies.[36]

B. The Rise of the Circuit Split

It seems inequitable that a debtor may "pull the rug out" from under a licensee as just described, especially when the debtor is the root cause of the breach. However, after the seminal case by the Fourth Circuit, *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*,[37] this was exactly what courts held for all forms of intellectual property.[38] In *Lubrizol*, the court held that a patent licensor going through bankruptcy could reject a license agreement through 11 U.S.C. § 365, resulting in the licensee being unable to use the licensed property or to seek specific remedies.[39] The *Lubrizol* court also opined that even though the result of the rejections was unfair to the licensees, it was not the court's place to remedy the laws that allowed it.[40]

Other courts followed the Fourth Circuit's holding until Congress enacted the Intellectual Bankruptcy Protection Act of 1988 ("IPBPA") in response to lobbying by the U.S. Department of Commerce.[41] The IPBPA was later codified into the Bankruptcy Code as § 365(n).[42] This section of the Code creates rights for intellectual property licensees if the debtor chooses to reject the license agreement during bankruptcy.[43] Under this section, if the debtor rejects the license agreement,

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[36] Kaonohi Ohana, Ltd. v. Sutherland, 873 F.2d 1302, 1306 n.5 (9th Cir. 1989) ("Specific performance of a rejected executory contract cannot be required.") (citing *In re* Pac. Express, Inc., 780 F.2d 1482, 1486 n.3 (9th Cir. 1986)); Lubrizol Enterprises, Inc. v Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) (holding that specific performance is barred, leaving monetary damages as the only option); Menell, *supra* note 23, at 768 ("The Bankruptcy Code bars the remedy of specific performance for a rejected executory contract.").

[37] Lubrizol Enters., Inc. v Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985). The *Lubrizol* court recognized that allowing debtor-licensors of intellectual property licenses to reject these contracts "imposes serious burdens" and makes parties wary of entering such contract, but that Congress is responsible for the law being written this way. *Id.*

[38] *In re* Chipwich, Inc., 54 B.R. 427, 431 (Bankr. S.D.N.Y. 1985) (allowing unilateral rejection of a trademark license by a licensor going through Chapter 11 bankruptcy even though it meant the licensee could no longer use the licensor's trademark); *In re* Logical Software, 66 B.R. 683, 687 (Bankr. D. Mass. 1986) (holding that software licensor could unilaterally reject software license basing its decision on *Lubrizol*).

[39] *See* Menell, *supra* note 23, at 769.

[40] *Lubrizol*, 756 F.2d at 1048.

[41] S. REP. NO. 100-505, at 11–13 (1988) [hereinafter REPORT 100-505] (basing its decision in part on a U.S. Department of Commerce letter that expressed concern over the "chilling effect" that allowing unilateral rejection of technology licenses in bankruptcy proceedings would have on willingness of others to invest in and enter into licensing contracts).

[42] 11 U.S.C. § 365(n) (2012).

[43] Gilhuly, Posin, & Dillman, *supra* note 3, at 35 (discussing the fact that § 365(n) of the Bankruptcy Code protects intellectual property licensees during a licensor's bankruptcy because the provision "operates to shield the non-debtor licensee or sublicensee from the consequences of the debtor's rejection"); Primoff & Weinberger, *supra* note 23, at 339 ("[§ 365(n)] seeks to protect the licensee without unduly burdening the debtor-licensor's estate" when an intellectual property technology license is involved and the debtor is the licensor.).

the licensee can choose to retain the agreement or to reject the agreement.[44] If both the licensor and licensee choose to reject the agreement, then the licensee can go through § 365(g) and bring a general unsecured breach of contract claim against the licensor, just like what would happen before the IPBPA.[45] Although the end result is the same as before the IPBPA,[46] it is the licensee who now chooses to pursue this route. Alternatively, if the licensee chooses to retain the agreement, then the licensor's rejection of the agreement allows the licensee to continue using the license and to continue to pay royalties to the licensor for the remainder of the agreement's term.[47] Retaining the agreement does not mean that the agreement continues just as it did before the bankruptcy, rather it is changed to allow continuation of the license but remove other future obligations in the contract.[48]

Courts feel this change has created a more equitable situation for intellectual property licensees involved with a licensor going through bankruptcy.[49] However,

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[44] 11 U.S.C. § 365(n)(1) (2012) (stating that an intellectual property licensee who is subject to licensor's rejection of an executory contract during a bankruptcy proceeding can either also reject the contract leading to termination, or retain the license).

[45] *See* Gilhuly, Posin, & Dillman, *supra* note 3, at 35 (noting that in a § 365(n) situation, a licensee may "(1) treat the debtor's rejection as termination of the license and assert a claim for rejection damages, or (2) retain its rights to use the IP as they existed as of the filing of the bankruptcy petition"); Menell, *supra* note 23, at 772 ("the licensee can either treat the rejection as a breach giving rise to a potential claim for money damages under section 365(g), as with other rejected contracts, or retain the rights to the intellectual property covered by the license").

[46] Primoff & Weinberger, *supra* note 23, at 339–40 (explaining that when the licensee also rejects a license under § 365(n)(1)(A) the licensee is in the same position as any other non-intellectual property contract rejection licensee); Menell, *supra* note 23, at 772 ("[a] licensee can . . . treat the rejection as a breach giving rise to a potential claim for money damages under section 365(g), as with other rejected contracts").

[47] 11 U.S.C. § 365(n)(2)(B) (2012); Primoff & Weinberger, *supra* note 23, at 340 (explaining that when a licensee retains a rejected intellectual property executory contract, "the licensee must pay all future 'royalties' due to the licensor under the contract"); Menell, *supra* note 23, at 772 ("Where the licensee elects to retain rights to the intellectual property, the debtor must permit the licensee to exercise its rights and the licensee must continue to pay royalties due under the licensing agreement.").

[48] Biosafe Int'l v. Controlled Shredders (*In re* Szombathy), Nos. 94 B 15536, 95 A 01035, 1996 Bankr. LEXIS 888, at *28 (Bankr. N.D. Ill. July 9, 1996) (commenting that when an intellectual property licensee chooses to retain its rights after a debtor-licensor's rejection under § 365(n)(1)(B), the licensee may continue to use rights it was given in the contract, but the debtor is relieved of affirmative obligations after bankruptcy commenced); Barbara C. Brown, Craig D. Hansen, & Thomas J. Salerno, *Technology Licenses Under Section 365(n) of the Bankruptcy Code: The Protections Afforded by the Technology User*, 95 COM. L.J. 170, 185 (1990) (making a distinction between rights that are retained by the licensee after rejection of an intellectual property license that is governed by § 365(n), such as use and exclusivity provisions, and the termination of further performance obligations by the debtor-licensor); Menell, *supra* note 23, at 772 ("By rejecting the licensing agreement, the debtor is relieved from performing any affirmative duties under the contract.").

[49] Encino Bus. Mgmt. v. Prize Frize (*In re* Prize Frize), 32 F.3d 426, 428 (9th Cir. 1994) (opining that § 365(n) of the Bankruptcy Code has "struck a fair balance" between a bankrupt licensor's interests and a licensee's interests because the licensor cannot terminate the license for the originally agreed upon term, but the licensor cannot use the license without paying for the right); Novon Int'l v. Novamont S.P.A. (*In re* Novon Int'l), Nos. 98-CV-0677E(F), 96-BK-15463B, 2000 U.S. Dist. LEXIS 5169, at *14 (W.D.N.Y. Mar. 31, 2000) (citing *In re* Prize Frize and agreeing that § 365(n) of the Bankruptcy code is a "fair balance" for licensors and licensees); *Biosafe*, 1996 Bankr. LEXIS 888, at *26–27 (citing to *In re* Prize Frize and agreeing that § 365(n) has tried to

the IPBPA of 1988 omitted trademarks from the definition of intellectual property.[50] This appears to have been done consciously by Congress with the intent of addressing trademarks at a later time.[51] Congress has not addressed the trademark issue since, resulting in courts holding that trademark licenses are not subject to the intellectual property license exception to licensor rejections during bankruptcy proceedings.[52] This means that trademark licensee rights are still being unilaterally terminated by a licensor going through bankruptcy.[53]

There have only been a few discussions on this inequitable treatment of trademark licensees through the courts since the enactment of the IPBPA. The first occurred in 1993 with *In re Matulasem*, in which a Florida bankruptcy court noted that continuing the *Lubrizol* holding for trademark licensees was probably inequitable.[54] In 2002, a California bankruptcy court held that because Congress had omitted trademarks from the definition of "intellectual property" in § 365(n), trademark licensees did not have the right to use a licensor's mark after a licensor had rejected a trademark licensing agreement under § 365(g).[55] More recently, a concurring opinion in the Third Circuit discussed how the legislative intent of the IPBPA of 1988 indicated that trademark licensees should be given equitable treatment when the debtor has rejected a trademark license under § 365(g).[56] The

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"evenly balance" the licensor and licensee's rights when an intellectual property license is at issue and it is the licensor who is proceeding through bankruptcy).

[50] 11 U.S.C. § 101(35)(A) (2012) (defining "intellectual property" as a trade secret, patent, patent application, plant variety, work of authorship, or mask work); COLLIER GUIDE, *supra* note 5, ¶ 10.04[3][c][iii][C] ("[A] major shortcoming of section 365(n) for licensees is that it does not cover trademark licenses.").

[51] REPORT 100-505, *supra* note 41, at 5 (1988) ("the bill does not address the rejection of executory trademark, trade name or service mark licenses . . . such contracts raise issues beyond the scope of this legislation. . . . [I]t was determined to postpone congressional action in this area.").

[52] Raima UK Ltd. v. Centura Software Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 669 (Bankr. N.D. Cal. 2002) ("The plain language of the statute, however, indicates that § 365(n) does not include trademark licenses."); *In re* HQ Global Holdings, Inc., 290 B.R. 507, 513 (Bankr. D. Del. 2003) ("Trade names, trademarks, and other proprietary marks are expressly excluded from the definition of 'intellectual property.' As a result, the Franchisees are not protected by section 365(n).") (internal citation omitted).

[53] *HQ Global Holdings*, 290 B.R. at 513 (finding that a trademark license in the form of a franchise agreement was executory and that § 365(n) did not protect the licensees from unilateral rejection of the agreement); *Raima*, 281 B.R. at 674 (determining that the licensee of a trademark is not given protection under § 365(n), resulting in termination of the license and the licensee could only file a general unsecured claim for damages after the rejection of the contract by the debtor-licensor).

[54] *In re* Matusalem, 158 B.R. 514, 522 (Bankr. S.D. Fla. 1993) (noting it did not make sense to allow a combined trade secret and trademark license to undergo executory contract rejection by the debtor-licensor because under § 365(n) for the trade secret and § 365(g) for the trademark the licensee would still be able to sell the product, but without the label). The court held that a trademark license for a rum label could not be terminated by the bankrupt licensor through an executory rejection because the agreement was part of larger agreement that included a trade secret license. *Id.* at 515, 522.

[55] *Raima*, 281 B.R. at 669–70 (making its decision that trademarks were unprotected by § 365(n) because "Congress has deliberately limited § 365(n) protection only to the intellectual property enumerated by the statute [and] has expressly withheld § 365(n) protection from rejected executory trademark licenses") (internal citation omitted).

[56] *In re* Exide Techs., 607 F.3d 957, 967 (3d Cir. 2010) (Ambro, J., concurring) (agreeing in the judgment but writing separately because "the Courts here should have used, I believe, their

majority opinion did not address this issue, because the case focused instead on whether the contract was executory.[57]

The first real break for trademark licensees came from the Seventh Circuit in 2011 in the case *Sunbeam Prods., Inc. v. Chi. Am. Mfg. LLC*.[58] The court held that even though the license had been rejected under § 365(a) by the licensor, the rejection did not terminate the rights in the license.[59] The court rejected the *In re Matusalem* holding that Congress did not intend to give trademark licensees the same treatment as other intellectual property licensees.[60] It also expressly rejected the reasoning in the Third Circuit concurring opinion that trademark licensees should be able to continue using rights in the licenses after rejection based on equitable grounds.[61] Instead, the *Sunbeam* court based its holding on the reasoning that when Congress left trademarks out of the IPBPA of 1988, it was only an omission, not an affirmation of the Lubrizol holding for trademarks.[62] The Seventh Circuit's holding created a circuit split,[63] and as the case was denied certiorari by the Supreme Court, there has been no resolution yet.[64]

III. ANALYSIS

An appropriate resolution for the circuit split depends on first determining why trademarks were excluded from the IPBPA and why the split developed in the first

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equitable powers to give Exide a fresh start without stripping EnerSys of its fairly procured trademark rights").

[57] *Id.* at 964 (majority opinion) ("[W]e have determined that the Agreement is not an executory contract because it does not contain at least one ongoing material obligation for EnerSys. Because the Agreement is not an executory contract, Exide cannot reject it.").

[58] Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 378 (7th Cir. 2012).

[59] *Sunbeam*, 686 F.3d at 377.

> [R]ejection 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." . . . It "merely frees the estate from the obligation to perform" and "has absolutely no effect upon the contract's continued existence."

Id. (quoting Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294, 1306 (11th Cir. 2007)) (internal citation omitted). The Seventh Circuit holding created a circuit split on how to handle licensor-debtor rejections of trademark licenses. Gilhuly, Posin, & Dillman, *supra* note 3, at 47.

[60] *See Sunbeam*, 686 F.3d at 375 ("Some bankruptcy judges have inferred from the omission that Congress codified *Lubrizol* with respect to trademarks, but an omission is just an omission."). The Seventh Circuit then opines on the absence of trademarks from the definition of "intellectual property" of the Bankruptcy Code. *Id.* ("The limited definition in § 101(35A) means that § 365(n) does not affect trademarks one way or the other. According to the Senate committee report on the bill that included § 365(n), the omission was designed to allow more time for study, not to approve *Lubrizol*.") (citing to REPORT 100-505, *supra* note 41, at 5 (1988)).

[61] *Sunbeam*, 686 F.3d at 375 ("What the Bankruptcy Code provides, a judge cannot override by declaring that enforcement would be 'inequitable.'").

[62] *Id.* ("Some bankruptcy judges have inferred from the omission that Congress codified *Lubrizol* with respect to trademarks, but an omission is just an omission.").

[63] Gilhuly, Posin, & Dillman, *supra* note 3, at 47 ("The Sunbeam decision creates a circuit split.").

[64] Sunbeam Prods. v. Chi. Am. Mfg., LLC, 2012 U.S. LEXIS 9472, at *1 (U.S. Dec. 10, 2012).

place. First, this section will probe into the factors contributing to the exclusion of trademarks from the IPBPA. Next, it will investigate how the courts have interpreted the absence of trademarks from the IPBPA. Finally, this section will determine the root cause of the circuit split.

A. Factors Underlying Trademark Exclusion from the Definition of Intellectual Property in the IPBPA

Two factors contribute to the exclusion of trademarks from the IPBPA: (1) the conflicting policies for trademark laws, and (2) the requirement of quality control by the trademark owner in trademark laws. The conflicting policies for trademark laws will be addressed first. Unlike copyright and patent laws, which share constitutional origins,[65] trademark law originated from the growth of the manufacturing industry and concerns for consumer protection.[66] The two main policies in trademark law have a tendency to compete against each other outside of infringement actions.[67] The first policy is to protect consumers from confusion and deception, and the second policy is to protect trademark owners from infringement.[68]

At least one scholar has noted that differences in policies between trademarks and other forms of intellectual property may have factored into why trademarks required further investigation before defining them as "intellectual property" in the Bankruptcy Code.[69] Patents, copyrights, and trade secrets are all defined as "intellectual property".[70] The primary policies for patents and copyrights are to spur

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[65] U.S. CONST. art. I, § 8, cl. 8 ("To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.").

[66] The Trade-Mark Cases, 100 U.S. 82, 93–94 (1879) (holding that a federal trademark statute enacted in 1870 was unconstitutional because Congress did not have power under article 1 section 8 of the Constitution to regulate trademarks). Instead, federal trademark laws evolved out of interstate business and manufacturing practices. United Drug Co. v. Theodore Rectanus Co., 248 U.S. 90, 97 (1918) (commenting that trademark law stemmed from unfair competition laws, that a trademark arises from use rather than adoption of it, and that trademark laws serve the dual purpose of designating the source of a product while protecting the mark owner's goodwill); Menell, *supra* note 23, at 741 (2007) (describing that federal trademark law has evolved through the Commerce Clause in the Constitution).

[67] S. REP. NO. 79-1333, at 3 (1946). The report states there are two competing policies in trademark law:

> One is to protect the public so it may be confident that, in purchasing a product bearing a particular trade-mark, which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of a trade-mark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats.

Id.

[68] *Id.*

[69] Nguyen, *supra* note 13, at 1297–1300 (discussing the similarities and differences between policies with different forms of intellectual property and concluding that it is possible that the reason for exclusion of trademarks from the Bankruptcy Code's definition of intellectual property may be due to quality control, which is based on trademark policy concerns).

[70] 11 U.S.C. § 101(35A) (2012). According to the statute,

innovation by giving inventors and creators legal protection of their works.[71] Trade secrets policy is also rooted in protecting innovations.[72] In contrast, trademark laws are directed at protecting consumers and the owner's established goodwill.[73] Comparison at this level indicates that policy could have factored into the omission of trademarks from the "intellectual property" definition in the Bankruptcy Code, because consumer protection and protection of goodwill is different from protecting innovations. However, on a broader level all of these policies share the same goal, protecting creations. For patents, the policy is aimed at protecting the creation of inventions. Copyright policy protects the author's creation of a work of art.[74] The policy for trade secrets protects the creation of formulas and formula-like information.[75] The common theme of these intellectual property policies is to protect the creation of the property itself. Similarly, trademark policy includes protecting the creation of brand recognition.

Regardless of the fact that all intellectual property has a goal of protecting creations, trademark law has evolved to put more stringent restrictions on the licensing of trademarks. To help satisfy the narrower goals of protecting consumers and a trademark owner's goodwill, trademark laws specify that a mark's validity depends on the owner's control of the quality associated with the mark.[76] However, what constitutes sufficient "quality" or "control" is not defined in the statutes.[77] As a

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> The term "intellectual property" means—
> (A) trade secret;
> (B) invention, process, design, or plant protected under title 35;
> (C) patent application;
> (D) plant variety;
> (E) work of authorship protected under title 17; or
> (F) mask work protected under chapter 9 of title 17;
> to the extent protected by applicable nonbankruptcy law.

Id.

[71] J. THOMAS MCCARTHY, 1 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 6:3 (4th ed. 2013) [hereinafter MCCARTHY ON TRADEMARKS] ("'Unlike a patent, copyright gives no exclusive rights to the art disclosed; protection is given only to the expression of the idea—not to the idea itself.' Patent law deals with the concept of functional and design inventions, in order to encourage investment in new technology and invention.") (quoting Mazer v. Stein, 347 U.S. 201, 217 (1954).

[72] PepsiCo, Inc. v. Redmond, No. 94 C 6838, 1995 U.S. Dist. LEXIS 19437, at *87 (N.D. Ill. Jan. 26, 1995) ("The maintenance of standards of commercial ethics and the encouragement of invention are the broadly stated policies behind trade secret law.").

[73] MCCARTHY ON TRADEMARKS, *supra* note 71, § 6.3 ("[T]he purpose of trademark and trade dress law is to prevent customer confusion and protect the value of identifying symbols, not to encourage invention by providing a period of exclusive rights.").

[74] U.S. CONST. art. I, § 8, cl. 8.

[75] RESTATEMENT (FIRST) OF TORTS § 757, cmt. b (1939) ("A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it.").

[76] MCCARTHY ON TRADEMARKS, *supra* note 71, § 2:4 (explaining that the requirement of quality creates protection of consumers by encouragement of product or service uniformity, and aids protection of trademark owners from infringers). "Control" is only important in trademark licensing situations. *Id.* § 7:6.

[77] Calboli, *supra* note 14, at 345 ("Unfortunately, like the judiciary before its adoption, the statute neither provided a definition of 'quality' and 'control' nor indicated how much control must be used for licensing to be valid.").

result, judicial interpretations of the terms have been different depending on the jurisdiction,[78] and when in time the cases were decided.[79] This has led to a lot of confusion and debate over the level of "quality control" necessary for a trademark to retain protection.[80] Legislators explicitly noted the troubling intersection of quality control with trademark licenses and bankruptcy law:

> 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, 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.[81]

The legislative branch has not addressed this concern since the report was written,[82] resulting in an unresolved area of law.

The problem is the lack of consensus on an adequate amount of "control" over "quality" that a trademark owner must maintain over a licensee, such that the mark remains protected. This particular problem stems from trademark law rather than bankruptcy law.[83] Supporters of the quality control requirement for trademark licenses argue that its absence could cause consumer confusion and affect product or service quality.[84] Insufficient quality control can lead to cancellation or

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[78] *Id.* (commenting that the lack of statutory definition of quality control has led to contradictory decisions stemming from interpretations on a case-by-case basis).

[79] *Id.* at 346.

> In particular, courts progressively relaxed the interpretation of the control that licensors must exercise over their licensees and held that first "adequate," then "sufficient," and then "minimal" control was sufficient to fulfill the statutory requirement. In some instances, courts also declared that evidence of control was unnecessary as long as product quality remained consistent and the public was not deceived.

Id.

[80] *See* MCCARTHY ON TRADEMARKS, *supra* note 71, § 18:55 ("Because of the wide range of types of licensing encompassed within the legal rule requiring 'adequate' quality control, the reported decisions appear inconsistent and difficult to reconcile."); Calboli, *supra* note 14, at 345 (noting that a case-by-case approach to what constitutes quality control "has often led to contradictory decisions and uncertainty as to what constitutes a valid license").

[81] REPORT 100-505, *supra* note 41, at 5 (1988) (internal citation omitted).

[82] Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 375 (7th Cir. 2012) (noting that after the IPBPA of 1988, the further study to look into defining trademarks as "intellectual property" in the Bankruptcy Code "seems to have fallen off the legislative agenda"); Calboli, *supra* note 14, at 351 ("[N]either the courts nor the statute have provided a definition of 'quality control' or any guidance as to how to interpret the requirement.").

[83] *See* MCCARTHY ON TRADEMARKS, *supra* note 71, § 18:50 (discussing that quality control is part of the requirements for trademark licensing under federal trademark laws).

[84] Calboli, *supra* note 14, at 352; F. Vern Lahart, *Control—The Sine Qua Non of a Valid Trademark License*, 50 TRADEMARK REP. 103, 104, 107, 134 (1960). Quality control is important for

abandonment of the trademark,[85] and could make the mark's owner liable for defrauding the public.[86]

Although legislators singled out quality control as a problematic area in bankruptcy and trademark law,[87] courts have since changed the level of control required for legal sufficiency to account for the evolution of how trademarks are used within a business.[88] Courts have lessened what is considered sufficient quality control over the years because trademark licensing has become a major aspect in business practices.[89] Specifically, trademark licensing has shifted from a traditional sense[90] to use of trademark licenses for promoting a brand or entity.[91] The modern standard for quality control for most courts is that only some evidence of quality control is required.[92] The quality control requirement is met even in the absence of contractual language, so long as some evidence of actual control is present.[93] Even

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protecting consumers and making sure that only marks that identify a particular source are being used:

> [w]ithout such control, it has been argued, product quality could be affected and consumers could be confused. In addition, allowing licenses without control would facilitate trademark owners' trading in their marks as "things," thus limiting the availability of words and symbols available as marks for competitors to identify similar products.

Calboli, *supra* note 14, at 352.

[85] Calboli, *supra* note 14, at 356 (discussing the effects of a trademark license being declared invalid, stating, "In addition to trademark cancellation, invalid licenses can also lead to abandonment of the licensed mark.").

[86] *Id.* ("Failure to control their licenses reasonably can also render trademark owners liable for false advertising under the Federal Trade Commission Act when the licensees use the marks as instruments to defraud the public."); MCCARTHY ON TRADEMARKS, *supra* note 71, § 18:48 (citing to Waltham Watch Co. v. FTC, 318 F.2d 28, 29, 32 (7th Cir. 1963)).

[87] REPORT 100-505, *supra* note 41, at 5 (1988).

[88] Calboli, *supra* note 14, at 364–67 (discussing the history of quality control interpretations over time, noting that in general courts have decreased the requirements for control and that some modern courts use an even lesser standard of "minimal" control).

[89] *Id.*

[90] *See id.* at 348, 365 (describing that traditional licensing involved outsourcing production of goods to a licensee). Licensing of trademarks in the traditional sense included the requirement that the mark continued to be "associated with the same product or business with which it ha[d] become associated in the public mind." E. F. Prichard Co. v. Consumers Brewing Co., 136 F.2d 512, 519 (6th Cir. 1943).

[91] *See* Calboli, *supra* note 14, at 349 (describing modern trademark licensing as also including types such as collateral licensing (mark on different but related products or services) and promotional licensing (mark on unrelated products or services)); David J. Franklyn, *Toward a Coherent Theory of Strict Tort Liability for Trademark Licensors*, 72 S. CAL. L. REV. 1, 14 (1998) ("In promotional licensing, the trademark functions primarily as an advertising tool, not as an indicator of the physical source of the goods or that the goods are of the same quality as all other goods bearing the same mark.").

[92] Ky. Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368, 387 (5th Cir. 1977) (holding minimal control over quality of products with a trademark license is sufficient to satisfy the quality control requirement of the Lanham Act); Calboli, *supra* note 14, at 367 (stating that most courts have found "licensing valid as long as trademark owners exercised some control over their licensees").

[93] Embedded Moments, Inc. v. Int'l Silver Co., 648 F. Supp. 187, 194 (E.D.N.Y. 1984) ("It is not necessary, however, for the licenses themselves to contain a written provision for control; actual

when no evidence of quality control is present, some courts have held that such control is implied so long as the public is not misled and product quality is consistent.[94] While some courts still adopt a stricter standard,[95] the modern trend shows a general acceptance that in a licensing scenario, quality control means a trademark owner monitoring the product quality and use of the mark.[96] The modernization of quality control requirements with trademark law should be considered when determining whether trademarks should now be included in the definition of "intellectual property" under the IPBPA.[97]

B. The Sunbeam *Court's Interpretation of "rejection" Regarding Trademark Licenses*

Courts have interpreted the absence of trademarks from the IPBPA differently depending on the jurisdiction. This may be due in part to the youthfulness of both trademark law and modern bankruptcy law. Modern bankruptcy law evolved out of legislative reform with The Bankruptcy Reform Act of 1978.[98] Legislative recognition of federal trademark laws did not even begin until enactment of The Lanham Act in

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control by the licensor is sufficient."); Printers Servs. Co. v. Bondurant, No. CV 91-0916 JSL (Sx), 1991 U.S. Dist. LEXIS 20561, at *14 (C.D. Cal. Apr. 16, 1991) ("Quality control is adequate, even in the absence of any written provision, when the licensor relied upon the integrity of the licensee to fulfill the requirement, and no customer complaints are received.").

[94] *See* Land O'Lakes Creameries, Inc. v. Oconomowoc Canning Co., 330 F.2d 667, 670 (7th Cir. 1964) (holding that even though licensor had relied on licensee for quality control, the relationship had been ongoing for forty years without any quality complaints, which was sufficient evidence of quality control); Calboli, *supra* note 14, at 371 (stating that some courts that have held no evidence of quality control is required if product quality is consistent).

[95] *See, e.g.*, Heaton Enters. of Nev., Inc. v. Lang, 7 U.S.P.Q.2d 1842, 1847 (T.T.A.B. 1988) (holding that the trademark license was invalid because it did not contain any quality control provisions in the contract and there was no evidence of quality control being performed).

[96] Taco Cabana Int'l, Inc. v. Two Pesos, Inc. 932 F.2d 1113, 1121 (5th Cir. 1991) (holding that the quality control requirement is met when parties to the license have a close working relationship, rely on each other for consistent quality, and "no actual decline in quality standards is demonstrated"); Transgo, Inc. v. Ajac Transmission Parts Corp., 768 F.2d 1001, 1017–18 (9th Cir. 1985) (determining that there was sufficient quality control to prevent abandonment of a licensor's trademark when the components were made by the licensor, the licensee manufactured the product with the components, and no quality complaints had been received during the licensing agreement); *Land O'Lakes*, 330 F.2d at 670 (affirming the district court judge's decision that the quality control requirement was met when the licensor's name appeared on the product and there had been no complaints about the quality of the goods during the forty years the licensing agreement had been going on); Calboli, *supra* note 14, at 371 ("Because of the ambiguities surrounding the concept of 'control' and, in particular, of what represents 'adequate' control, the past decades have also witnessed a shift in focus directly onto product quality, rather than on control, to assess the validity of trademark licensing.").

[97] *See* Nguyen, *supra* note 13, at 1310–14 (proposing that trademarks should be included in the definition of trademarks with inclusion of a provision in § 365(n) that requires quality control practices to be maintained throughout the term of the remainder of the license agreement).

[98] Charles Jordan Tabb, *The History of Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 32 (1995) ("The [Bankruptcy Reform Act of 1978] is unique in the history of the nation's bankruptcy legislation in that it was the first major enactment that was not enacted as a response to a severe economic depression. The Bankruptcy Code governs bankruptcy law in the United States today.").

1946.[99] It is likely that the immaturity of these two legal areas created prime circumstances for different judicial interpretations to appear, particularly where the two areas happen to intersect.

For the purposes of this article, only the differences in decisions regarding trademark licenses during bankruptcy are discussed. All courts except one have refused any protection for trademark licensees in bankruptcy proceedings after a debtor has rejected a license, interpreting the omission of trademarks from the definition of "intellectual property" as proof that legislators affirmed *Lubrizol*'s holding for trademarks.[100] In *Sunbeam*, the Seventh Circuit took a different approach.[101] The court instead interpreted the omission of trademarks from the definition of "intellectual property" as neither favoring nor disfavoring the *Lubrizol* holding.[102] It focused on determining what the consequences were of a rejection under § 365(g) of the Bankruptcy Code.[103] The court explicitly stated:

> What § 365(g) does by classifying rejection as a breach is establish that in bankruptcy, as outside of it, the other party's rights remain in place. After rejecting a contract, a debtor is not subject to an order of specific performance . . . . The debtor's unfulfilled obligations are converted to damages; when a debtor does not assume the contract before rejecting it, these damages are treated as a pre-petition obligation, which may be written down in common with other debts of the same class. But nothing about this process implies that any rights of the other contracting party have been vaporized.[104]

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[99] Ethan Horwitz & Benjamin Levi, *Fifty Years of the Lanham Act: A Retrospective of Section 43(a)*, 7 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 59, 60 ("Prior to the Lanham Act, federal trademark statutes were largely ineffective and had limited success.").

[100] *See e.g.*, Lewis Bros. Bakeries Inc. v. Interstate Brands Corp. (*In re* Interstate Bakeries Corp.), 690 F.3d 1069, 1072, 1075 (8th Cir. 2012) (affirming that the trademark license was executory and so rejection by the debtor terminated the licensee's use of the trademark); Licensing by Paolo, Inc. v. Sinatra (*In re* Gucci), 126 F.3d 380, 393–94 (2d Cir. 1997) (allowing rejection of a trademark license and stating that trademarks are not permitted to have § 365(n) protections); *In re* Old Carco LLC, 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009) (holding that since trademarks are excluded from the Bankruptcy Code's definition of intellectual property, trademarks are not part of the § 365(n) protections and so the licensee's right to use the trademark is terminated); *In re* Blackstone Potato Chip Co., 109 B.R. 557, 562 (Bankr. D. R.I. 1990) (ordering termination of licensee's use of a trademark after licensor rejected the trademark license during bankruptcy proceedings); Gilhuly, *supra* note 3, at 45 (describing the effects of post-*Lubrizol* courts regarding bankrupt trademark licensors, "leav[ing] trademark licensees with pre-petition claims for damages caused by the rejection (as with any other non-IP executory contract), while allowing the debtor-licensor to sell its trademark free and clear of the licensee's interests in the trademark under the license agreement.").

[101] Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 378 (7th Cir. 2012).

[102] *Sunbeam*, 686 F.3d at 375 ("Some bankruptcy judges have inferred from the omission that Congress codified *Lubrizol* with respect to trademarks, but an omission is just an omission.").

[103] *Id.* ("We need to determine whether Lubrizol correctly understood § 365(g), which specifies the consequences of a rejection under § 365(a).").

[104] *Id.* at 376 (internal citations omitted).

The court then explained that rejection of a contract is not equivalent to rescission of a contract.[105] It claimed that other sections of the Bankruptcy Code handle if and when a debtor can rescind a contract.[106] Based on this explanation, the court stated that the *Lubrizol* court "confuse[d] rejection with the use of an avoiding power."[107] The Seventh Circuit affirmed the Bankruptcy Court's decision that the trademark licensee could continue to use the debtor-licensor's trademark even though the debtor's trustee had rejected the trademark license.[108] However, it rejected the Bankruptcy Court's reasoning behind the decision.[109]

The *Sunbeam* court's rationale can be summarized into four parts. First, the rejection of an executory contract by a debtor-licensor under § 365(g) of the Bankruptcy Code should be interpreted as a breach of contract, not a termination of it.[110] Second, a licensor's breach of an intellectual property contract generally does not terminate a licensee's right to use the intellectual property.[111] Third, the *Sunbeam* court makes the assumption that an intellectual property license is a type of intellectual property contract, although it never explicitly states this assumption.[112] Therefore, when a debtor-licensor rejects an intellectual property license during a bankruptcy proceeding it should result in the licensor breaching the contract.[113] Finally, the licensee's right to use the intellectual property does not automatically terminate, because a breach of contract is not equivalent to the termination of the rights given by the contract.[114]

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[105] *Id.* at 377 ("[R]ejection 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.'") (quoting Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294, 1306 (11th Cir. 2007)).

[106] *Id.* (explaining that trustees (or debtors) have alternative pathways to get out of contracts specified by the Bankruptcy Code).

[107] *Id.*

[108] *Id.* at 378 ("Because the trustee's rejection of Lakewood's contract with CAM did not abrogate CAM's contractual rights, this adversary proceeding properly ended with a judgment in CAM's favor.").

[109] *Id.* at 376 ("Although the bankruptcy judge's ground of decision is untenable, that does not necessarily require reversal.").

[110] *Id.* at 377 (concluding that rejection is not equivalent to rescission).

[111] *Id.* ("What §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.").

[112] Note that this is speaking of intellectual property license-contract relationships in general, not the narrower "intellectual property" definition supplied by the Bankruptcy Code. It is merely an inference the *Sunbeam* court relies upon without explicitly stating it.

[113] This is inferred from the case because the *Sunbeam* court is claiming that a trademark license, like any non-intellectual property contract, should fall under the proceedings governed by § 365(g), which if deemed an executory contract and then rejected by the debtor, results in a pre-petition breach of contract.

[114] *Sunbeam*, 686 F.3d at 376–77. The *Sunbeam* court explains that when any executory contract is breached due to a rejection by the debtor:

> [t]he debtor's unfulfilled obligations are converted to damages; when a debtor does not assume the contract before rejecting it, these damages are treated as a pre-petition obligation, which may be written down in common with other debts of the same class. But nothing about this process implies that any rights of the other contracting party have been vaporized.

Id.

C. Root Cause of the Circuit Split on Treatment of a Post-Rejection Trademark License During Bankruptcy

In light of the *Sunbeam* court's rationale, the root cause of the circuit split lies in the interpretation of the § 365(g) Bankruptcy Code. More specifically, the circuit split grew from differing judicial interpretations regarding the effect of an executory contract rejection under § 365(g).[115] However, the scope of this split goes beyond rejections of trademark licenses, it pertains to non-intellectual property licenses and leases as well.[116] The *Sunbeam* court follows courts that interpret rejection under § 365(g) to mean that a breach of contract has occurred, which means that rights present in the contract have not been terminated.[117] Some of these courts also stress that rejection and avoidance are separate sections under the Bankruptcy Code, and so a debtor wanting termination of a contract should seek relief under the avoidance sections of the Code, not the rejection sections.[118] Conversely, other courts interpret rejection under § 365(g) as terminating the contract under federal law.[119] Following this type of reasoning, breach of contract is used for pre-petition damages only because rights in the contract are terminated with the rejection.[120] The *Lubrizol*

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[115] *See id.* at 377 ("What §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. . . . [N]othing about this process implies that any rights of the other contracting party have been vaporized."). The *Sunbeam* court's holding applies the reasoning that rejection of an executory contract under § 365(g) does not result in termination of the contract and therefore does not result in termination of rights given in the contract. Other courts use an opposite reasoning that the rejection of an executory contract has the same effect as terminating it, resulting in termination of any rights that were given in the contract. *See, e.g.*, Lubrizol Enters., Inc. v Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) (holding that the rejection of a contract under § 365 of the Bankruptcy Code only allows for the non-debtor to collect monetary damages resulting from breach of contract, and that any rights granted by the contract are terminated).

[116] *See e.g.*, Eastover Bank for Sav. v. Sowashee Venture (*In re* Austin Dev. Co.), 19 F.3d 1077, 1082–83 (5th Cir. 1994) (holding that a real property lease rejected by the lessor during bankruptcy proceedings did not result in termination of the rights given in the lease, only a breach of the contract by the lessor); Cohen v. Drexel Burnham Lambert Grp., 138 B.R. 687, 703 (Bankr. S.D.N.Y. 1992) (describing the interpretation of a § 365(g) rejection, when a bankrupt employer rejected an employment contract, as "the term 'rejection,' a product of the exclusionary doctrine does not embody the contract-vaporizing properties so commonly ascribed to it").

[117] *See Sunbeam*, 686 F.3d at 376–77.

[118] *Cohen*, 138 B.R. at 709 ("'Rejection is not itself an avoiding power. Rights in property that arise from a contract may, however, be terminated by bankruptcy law's normal avoiding powers.'") (quoting Michael T. Andrew, *Executory Contracts Revisited: mA Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1, 17 (1991) [hereinafter Andrew, *Reply to Westbrook*]); *Eastover*, 19 F.3d at 1083 ("While the Bankruptcy Code expressly authorizes avoidance of certain liens and other preferential rights against the debtor, the avoidance power read into § 365 is, uncharacteristically, an implied authority.") (internal citation omitted) (citing to Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U. COLO. L. REV. 835, at 901–02 (1988) [hereinafter Andrew, *Understanding Rejection*]).

[119] *See*, *e.g.*, Blackstone Potato Chip Co, Inc. v. Mr. Popper, Inc. (*In re* Blackstone Potato Chip Co., Inc.), 109 B.R. 557, 562 (Bankr. D.R.I. 1990).

[120] *In re* HQ Global Holdings, Inc., 290 B.R. 507, 513 (Bankr. D. Del. 2003) ("In other words, since the Bankruptcy Code does not include trademarks in its protected class of intellectual property, *Lubrizol* controls and the Franchisees' right to use the trademarks stops on rejection.") (citing to Raima UK Ltd. v. Centura Software Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 673 n.24 (Bankr. N.D. Cal. 2002)); *Blackstone*, 109 B.R. at 562 (Bankr. D.R.I. 1990).

court followed this line of reasoning when it held that a trademark licensee's right to use the mark was terminated after a debtor-licensor rejected the contract under § 365(g).[121]

IV. PROPOSAL

The judicial split interpreting the term "rejection" in § 365 of the Bankruptcy Code must be settled. Currently, whether rights exist for a non-bankrupt party after the rejection of an executory contract is jurisdiction dependent. Trust in the federal legal system depends in part on uniform decisions across all jurisdictions.[122] The split can be resolved by either: (1) amending § 365 of the Bankruptcy Code, (2) interpreting of the term "reject" within § 365 uniformly across jurisdictions, or (3) employing a test that takes into consideration the concerns that led to the split.

A. Option 1: Amendment to the Bankruptcy Code.

An amendment to § 365 by Congress could be done either by defining the term "rejection," or by including trademarks in the definition of "intellectual property." Narrowly amending the definition of "intellectual property" under § 101(35A) to include trademarks has been previously proposed.[123] Those who adhere to traditionalist notions of trademark law may state that allowing trademarks to be defined as property is "inconsistent with the historical focus of trademark law on the protection of consumers from confusion and deception."[124] These sentiments are without merit as the Supreme Court has clearly stated that trademarks are considered a legally recognizable type of property.[125] However, others will rightfully argue that merely including trademarks in the definition without addressing quality control fails to address the quality control concern raised by Congress.[126] To address

[121] Lubrizol Enters., Inc. v Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985).

[122] *See* Hanna v. Plumer, 380 U.S. 460, 468 ("[T]he twin aims of the *Erie* rule [are] discouragement of forum-shopping and avoidance of inequitable administration of the laws.") (referring to the case that gave rise to the Erie doctrine) (Erie R. Co. v. Tompkins, 304 U.S. 64 (1938)); COLLIER GUIDE, *supra* note 5, ¶ 4.02[2][b] (explaining that forum shopping is prevalent in Chapter 11 bankruptcy proceedings with large corporations). It is a common legal principle that a federal judicial system should have consistent outcomes, regardless of where the case is being heard, otherwise forum shopping results.

[123] Nguyen, *supra* note 13, at 1310 ("In light of both the changing role of trademarks in the Internet economy and the integration of trademarks with other protected intellectual property in licensing arrangements, the IPLBA should be amended to include trademarks within its protections.") (internal citations omitted).

[124] MCCARTHY ON TRADEMARKS, *supra* note 71, § 2:1.

[125] Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 673 (1999) (explaining that provisions of the Lanham act "protect constitutionally cognizable property interests—notably, its provisions dealing with infringement of trademarks, which are the 'property' of the owner because he can exclude others from using them").

[126] REPORT 100-505, *supra* note 41, at 5 (1988) (discussing that trademarks were not included in the definition of intellectual property in the Bankruptcy Code because the quality control

this, an additional provision in § 365(n) is needed to require trademark licensees to maintain the quality of the product or service throughout the debtor-licensor's bankruptcy process or to the end of the license's term.[127] While this narrow approach fixes the immediate problem with trademarks, it is merely a temporary solution, like the § 365(n) provision itself. It perpetuates the misnomer that a debtor rejecting a contract is equivalent to terminating a contract except for where Congress has made explicit provisions.[128] So, while this approach is a possible solution, it is not the best one.

The best solution is to fix the root of the problem, which means defining the word "rejection" in the Bankruptcy Code. Defining "rejection" merely requires Congress to state whether a rejection of an executory contract under § 365 terminates contract rights automatically or not. A 1997 bankruptcy committee proposed the following amendment to Congress, but for an unknown reason, it was never adopted:

> The concept of "rejection" in section 365 should be replaced with "election to breach."[129]

If Congress rejected this proposal because it had instead intended a § 365 "rejection" to be a termination of the rights in a contract, the following amendment is proposed:

> The concept of "rejection" in section 365 should be replaced with "election to terminate."

The initial amendment would prevent rejection of an executory contract during Chapter 11 bankruptcy from automatically terminating rights as well as any other contract. The other amendment would specify that such a rejection was an automatic termination of rights in the contract.

Even though Congress did not adopt the initial amendment after it was proposed, it is the more correct amendment. Critics may point to the absence of adoption as a basis to say the other amendment is the correct one. However, this basis is unfounded because it ignores the most likely reason the first amendment was

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requirements for trademark protection warranted further investigation, which was outside the scope of the bill at that time).

[127] Nguyen, *supra* note 13, at 1314 ("Congress should explicitly amend the IPLBA to impose on trademark licensees the obligation to continue, for the remainder of the term of the license agreement, the quality control standard to which the licensees have agreed.").

[128] NAT'L BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS, § 2.4.2, at 464 (1997) [hereinafter BANKRUPTCY] (purporting that the existing Bankruptcy Code leads to contrary holdings and results in Congress continually adding provisions, and that rejection is equivalent to "election to breach").

[129] *Id.* at 453. The commission was allocated $1.5 M by Congress, "to investigate and study issues relating to the Bankruptcy Code, to solicit divergent views on the operation of the bankruptcy system, to evaluate the advisability of proposals, and to prepare a report." *Id.* § I.A at 47. The committee found that "the concept of rejection has been applied inconsistently by the courts, and has led to the numerous special interest amendments to section 365." *Id.* § 2.4.2 at 460. The committee advocated that rejection was not meant to be an avoiding power during bankruptcy and so did not terminate the rights in a contract when a debtor or trustee chose to reject a contract. *Id.* at 460–61, n.1116.

not adopted. If Congress were to adopt the initial amendment, it would have to overhaul the existing Bankruptcy Code to prevent further confusion. The committee report that proposed the initial amendment alluded to this, but it failed to elaborate on what else was required or to propose a solution.[130] This amendment essentially nullifies the additional special provisions for particular industries Congress kept putting in whenever a court interpretation on the subject got public attention.[131] If Congress fails to remove those when it adopts the amendment, the change may just cause additional confusion.[132] This means that Congress would have to set up an additional committee to investigate and propose how to remedy the rest of the Bankruptcy Code before it could incorporate the amendment. Congress' apprehension at spending more time and money on another committee to do this was the most likely cause of the failed adoption of the initial amendment—not because it did not agree with the amendment. Congress should determine the changes that need to be made to the existing code so that "rejection" can be replaced with "election to breach." Doing this will clarify bankruptcy laws and improve the uniformity of bankruptcy case outcomes.

However, it seems unlikely that Congress will revisit the "rejection" amendment. Congress was given a report in 1997, more than fifteen years ago, explaining that the term "rejection" needed clarification, along with explanations and a recommended solution.[133] Yet nothing has been done.

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[130] *Id.* at 463 (noting that the amendment alone could be seen an inadequate solution because it does not address the existing provisions, and that it is up to Congress to decide whether the provisions are still required or can be removed).

[131] *See id.* ("It is Congress' prerogative to consider whether this package of amendments vitiates the need for several of the subsections of section 365 that apply only to one type of industry or contract."). Commentators have noted that Congress has added provisions to § 365 since the 1978 enactment of the modern Bankruptcy Code, each time as an adverse reaction to judicial rulings that rejection was equivalent to termination. *See e.g.*, Andrew, *Reply to Westbrook*, *supra* note 118, at 11 ("Every time Congress has been presented with the consequences of the avoiding-power rejection doctrine in a particular context, it has disapproved the doctrine with a specific provision.").

[132] *See* BANKRUPTCY, *supra* note 128, § 2.4.1, at 463 (bringing up a potential concern if the word "rejection" was replaced with the term "election to breach" stating, "[T]he proposed changes call into question the interpretation of the complicated, industry-specific provisions that remain in section 365.").

[133] *Id.* § 2.4.1, at 460–61. The bankruptcy committee was tasked to find areas of the Bankruptcy Code that were problematic and to make recommendations to fix the problem:

> The Commission recommends a common-sense clarification of the term "rejection" by replacing it with "election to breach." The Commission further recommends that the Bankruptcy Code delineate the consequences of electing to breach to correct on a generic basis the contrary results reached by some courts. The bankruptcy trustee's election not to perform a contract is nothing more or less than a breach of the contract and should be treated accordingly. Rejection does not "nullify," "rescind," or "vaporize" the contract or terminate the rights of the parties; it does not serve as an avoiding power separate and apart from the express avoiding powers already provided in the Bankruptcy Code.

Id. (internal citations omitted).

B. Option 2: A Uniform Interpretation of "Rejection."

Although not the best solution, creation of a uniform judicial interpretation of "rejection" would also remedy the problem. A Supreme Court decision would be the most straightforward way to have uniform court interpretation. If the Court takes up a case for review, it should determine the meaning of the term "rejection" before determining whether a trademark licensee can continue to use a trademark after the license has been rejected. This is because the interpretation of "rejection" will apply to all licenses, including trademark licenses. As described in Section II, the Supreme Court could adopt one of two general interpretations for "rejection."[134] One interpretation holds that rejection is the same as termination of contract rights.[135] The other interpretation holds that rejection is only a breach of contract and therefore rights remain in place.[136]

Is one a more correct interpretation than the other? Both sides have valid reasons for their views.[137] Perhaps the best answer is that both are correct, at least for contracts involving leases or licenses. Instead of trying to choose which of two

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[134] *See supra* note 115 and accompanying text.

[135] *See supra* notes 115 & 119 and accompanying text.

[136] Andrew, *Reply to Westbrook*, *supra* note 118, at 2 (explaining the points of agreement with Westbrook about the meaning of rejection under § 365, stating, "[W]e agree that rejection does not cancel, repudiate, or terminate contracts; that no preliminary test of the 'executoriness' of a contract is necessary as a pre-condition to its rejection; and that rejection does not, like bankruptcy law's 'avoiding powers,' terminate state-law rights in or to specific property.") (internal citation omitted).

[137] *See* Andrew *Reply to Westbrook*, *supra* note 118, at 2 ("rejection does not cancel, repudiate, or terminate contracts"). Andrew argues that based on the history surrounding enactment of § 365(g) of the modern Bankruptcy Code, § 365(g) is codification of earlier Supreme Court decisions that created a presumption that not assuming a contract was a breach of contract. *Id.* at 5–,8. *Westbrook* argues a slightly different reason; rejection of a contract is not termination of it because the rights of a trustee do not allow it. Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 230 (1989). He argues that a trustee only has the same rights as a debtor, which is to breach a contract or fulfill it, and that the plain meaning of § 365(g) says rejection is a breach, so rejection under this section cannot be equivalent to termination. *Id.* at 244. *See also* Andrews, *Understanding Rejection*, *supra* note 118, at 922 (stating that five arguments have been purported for why revocation is an automatic termination in the Bankruptcy Code). One argument is that property rights and contracts are different, and contract rights do not survive rejection. *Id.* at 922–23 (explaining that this argument is based on the notion that licenses do not transfer property rights, and so are not afforded the same protection as real property). A second argument is that specific performance is prevented under bankruptcy law, and allowing licensees to use a product after rejection is forcing specific performance on the debtor-licensor. *Id.* at 924–25 (explaining that a common basis for treating a § 365 rejection as termination is rooted in an interpretation of bankruptcy policy for remedies available to a non-debtor). A third argument is that when the licensee's future breach of contract claim includes a possible remedy of specific performance, it fits into the Bankruptcy Code's definition of "claim" which results in it being dischargeable. *Id.* at 926–27 (noting that this argument is related to specific performance, but that this argument is instead rooted in the interpretation of the word "claim" in the Bankruptcy Code § 101(4)(B)). A fourth argument is that because Congress created special provisions preventing termination, it is negatively inferred that in all other situations Congress intends rejection to be equivalent to termination. *Id.* at 928 (stating that the negative inference argument stems from the fact that Congress created express provisions that do not allow a rejection to be termination in particular circumstances). The fifth argument is that treating rejection as termination furthers the end goal of Chapter 11 bankruptcy, which is to rehabilitate the debtor. *Id.* at 929 (contending that courts that see rejection as termination often use this argument to explain why they allow rejection as termination).

valid, but opposing, arguments is the "correct" one by creating a single interpretation, the underlying reasoning for each interpretation can be incorporated into a multi-factor test. The outcome then depends on the type of contract involved and the circumstances surrounding the parties, which may be a more equitable solution. Critics may argue that a multi-factor test still allows for different court interpretations and therefore doesn't resolve the split. However, this type of test allows for the competing considerations leading to the split to both be taken into account before making a court makes a determination. This could lead to more consistent outcomes for licenses and leases, the primary victims of rejection decisions.[138] This approach is also immediately applicable because it does not require waiting for years or decades for an opinion from the Supreme Court or an amendment from Congress. A multi-factor test would allow immediate resolution of the "rejection" interpretation split that has been around for at least twenty-eight years.[139]

C. Option 3: Employ a Multi-Factor Test to Balance the "Rejection" Interpretations.

The following factors are proposed to reconcile the conflicting meanings of "rejection" within the Bankruptcy Code for executory contracts: (1) whether the contract involves a license or lease for property, or something with the characteristics of property, (2) the benefit to the debtor and the trustee of treating the rejection as termination of the contract, (3) the detriment to the non-debtor by treating the rejection as termination of the contract, and (4) the intent of the debtor or trustee in seeking rejection of the contract.

1. Licenses and Leases

The "rejection" test should be used when a contract involves a lease or license. Contracts involving leases, licenses, and real property are subjects already explicitly protected from rejections being treated as automatic termination of rights given by a contract.[140] All of these subjects involve the situation in which a remedy of only monetary damages would be an insufficient remedy for the non-debtor because of the uniqueness of the right given. It is therefore important to know whether a contract fits into this category of exceptions. Any contract that gives a unique right or a unique property to the non-debtor should be subject to the "rejection test" factors. This is because other types of contracts can be remedied through monetary damages

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[138] *See* 11 U.S.C. § 365 (2012) (creating provisions preventing the automatic termination of rights for many types of licenses and leases when a debtor rejects an executory contract).

[139] *See* Andrews, *Understanding Rejection*, *supra* note 118, at 848 (explaining that the term "rejection" needs to be defined because courts are interpreting the term differently). The split on rejection has been around since at least the time of the *Lubrizol* decision. Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985).

[140] 11 U.S.C. § 365 (2012).

by existing bankruptcy proceedings.[141] The above test should also be applied to other situations where an agreement exists and monetary damages may be insufficient. Expanding the test to other situations that generate a unique right when the agreement is made will prevent the need for § 365(n)-like amendments in the Bankruptcy Code.

2. Benefits of Terminating the Agreement

While the first factor of the "rejection test" ensures that situations similar to special provisions existing in § 365 are considered, this factor takes into account the concern that debtors and trustees should be given leeway to make decisions based on what will be best to rehabilitate the debtor.[142] It accounts for both the benefits to the debtor when an agreement is terminated and the debtor-friendly bankruptcy policy of giving debtors flexibility to get out of existing contracts.[143] A subset of factors ensures this bankruptcy policy is accounted for. These factors include: (1) whether the license or lease is exclusive; (2) the obligations required of the debtor and trustee for the license or lease to continue; and (3) the detriment of continuing the license or lease to the debtor and trustee.

Whether or not a license is exclusive can impact how detrimental retaining it can be to the debtor or trustee. When a license is exclusive, the debtor cannot try to increase revenue for the estate by licensing out the trademark to additional parties. This may impair the debtor from emerging from bankruptcy. The less the impairment, the less weight this sub-factor should be given. The same principle applies to the third sub-factor, detriment to the debtor if the contract is retained.

Along this same vein, what obligations a licensor or lessor must continue to fulfill can also have an impact on whether or not a termination of a contract is beneficial. When obligations are high, it is a greater benefit to terminate the contract than when obligations are low. Similarly, when obligations are high, the detriment of retaining a contract is likely to be higher than when obligations are low.

3. Detriment to the Non-Debtor if the Agreement is Terminated

The third factor should guarantee that policies underlying contracts regarding the non-debtor are considered. It is important to consider general contract considerations, even in bankruptcy proceedings.[144] One of the cornerstones of society in this nation is that people feel comfortable entering into contracts because of the

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[141] BANKRUPTCY, § 2.4.1 at 461–62 (explaining that remedies in bankruptcy are generally limited to monetary damages, except in cases where specific performance cannot be converted to monetary damages because the contract involves something unique).

[142] *See supra* note 137 and accompanying text.

[143] Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 792 (1987) (discussing that one policy of bankruptcy is to allow rejection of contracts which benefits the bankrupt estate by allowing it to limit damages and still get out of contracts, thereby helping the bankrupt business to survive).

[144] *See id.* at 778 (discussing that bankruptcy is a sub-part of contracts between parties).

reasonable expectations that one has when entering into a contract.[145] If one party can breach a contract and the non-breaching party that has spent money for the purpose of the contract is only allowed nominal damages, a strong disincentive to enter into contracts is created.[146]

Again, a subset of factors should be employed to determine the extent of detriment the non-debtor will incur if the agreement is terminated. These factors include: (1) the actions taken towards fulfilling the license or lease, (2) the impact of the non-debtor's loss of rights if the contract is unilaterally terminated by the debtor, and (3) the alternative options available to the non-debtor if the contract is terminated. It is a huge disincentive to enter into a contract when one party can breach a contract and the non-breaching party who has spent money for the purpose of the contract, is only allowed nominal damages. This sub-test is a measure of how severe the detriment is to a non-debtor if the rejection of a contract is treated as terminated.

4. Intent of the Debtor

The fourth factor is present because courts often consider intent of the debtor and trustee when determining whether or not to allow rejection. A debtor's intent in rejecting the agreement is also important to ensure the debtor is terminating the license in good faith.[147] Courts have the power to stop rejections by the debtor that are done in bad faith.[148] This factor is not dispositive, but this factor should weigh against a debtor who tries to terminate the agreement in bad-faith.

5. Balancing the Factors

The "rejection" test, with the additional considerations for interests of the debtor and non-debtor separately, supplements the existing Bankruptcy Code and case law.

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[145] ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1.1 (Matthew Bender ed. 2013) ("The Main Purpose of Contract Law Is the Realization of Reasonable Expectations Induced by Promises").

[146] Lon L. Fuller & William R. Perdue, *The Reliance Interest in Contract Damages: I*, 46 YALE L.J. 52, 61–62 (1936). The authors state:

> Agreements can accomplish little, either for their makers or for society, unless they are made the basis for action. When business agreements are not only made but are also acted on, the division of labor is facilitated, goods find their way to the places where they are most needed, and economic activity is generally stimulated. These advantages would be threatened by any rule which limited legal protection to the reliance interest.

Id.

[147] *See, e.g.*, *In re* Trans World Airlines, Inc., 261 B.R. 103, 121 (Bankr. D. Del. 2001) ("A debtor's decision to reject an executory contract must be summarily affirmed unless it is the product of 'bad faith, or whim or caprice.'") (quoting *In re* Wheeling-Pittsburgh Steel Corp., 72 B.R. 845, 849–50 (Bankr. W.D. Pa. 1987)).

[148] *Id.* at 121; *In re* Chipwich, Inc., 54 B.R. 427, 430–31 (Bankr. S.D.N.Y. 1985) ("[T]he debtor's business judgment should not be interfered with, absent a showing of bad faith or abuse of business discretion."). However, if the debtor or trustee has sought rejection in bad-faith, this factor weighs against allowing the rejection to be considered a termination of the contract.

The first factor is a threshold factor for the test. If the first factor is not satisfied, then none of the rest needs to be considered. The second and third factors allow the policy considerations underlying each version of the "rejection" interpretation to be weighed against each other before deciding whether to allow a debtor to terminate a non-debtor's rights automatically through rejection. Neither factor should be dispositive. Finally, the fourth factor ensures that the intent of the debtor in rejecting the agreement is done in good faith. If the debtor rejects the agreement in bad faith, this factor will heavily weigh in favor of letting the non-debtor decide whether to terminate or maintain the agreement.

6. Additional Factors for Trademark Licenses

Trademark licenses are one candidate for the above "rejection" test. However, the quality control requirement of trademark law warrants further consideration. If the "rejection" test factors weigh in favor of treating the rejection as termination of rights in the contract, quality control over the trademark will become the sole responsibility of the trademark owner again. This means that quality control becomes irrelevant for the context of bankruptcy in this situation. However, if the "rejection" test factors weigh in favor of treating the rejection as merely a breach, quality control still requires consideration because at the time of rejection the licensee is still allowed to use the trademark.

Additional factors for quality control should be considered before determining whether to treat a debtor's trademark license rejection as merely a breach of contract. These factors include: (1) what role the debtor and non-debtor have in assuring quality control; (2) the length and type of relationship between the debtor and non-debtor; and (3) the ability of the debtor and trustee to oversee quality control matters during the bankruptcy proceedings. These factors address Congress' primary concern regarding quality control that led to the exclusion of trademarks from the Bankruptcy Code's definition of intellectual property.[149]

As long as there is sufficient evidence or assurance that quality control will be maintained, then quality control concerns are no greater than they were prior to the debtor entering bankruptcy. However, if there is insufficient evidence and assurance that quality control will be maintained, this weighs strongly against the licensee being able to stop termination of the trademark agreement. Including factors for quality control into the overall determination of whether an agreement should be terminated essentially eliminates the legislative concern over quality control issues.

7. The STARBUCKS™ Hypothetical Revisited

For an example of application of the "rejection" test, consider the STARBUCKS™ hypothetical from Section I. The threshold factor of an agreement being a license or lease is met because the STARBUCKS™-UCM contract is for a trademark license. The second factor, the benefit to the debtor, weighs in favor of STARBUCKS™ because it entered into an exclusive license with the UCM. An

[149] REPORT 100-505, *supra* note 41.

exclusive license prevents STARBUCKS™ from entering into an agreement with the larger manufacturer, which prevents it from earning more in royalties. However, STARBUCKS™ would only be obligated to let the UCM continue to use the trademark for the agreement term.

The third factor weighs heavily in favor of the UCM because the UCM would be estopped from selling the items it already manufactured under the STARBUCKS™ name. The UCM had already fulfilled its obligations to produce the STARBUCKS™ products, and only had to pay royalties for the remainder of the agreement. The fourth factor goes against STARBUCKS™ because it wanted to terminate the contract solely to enter into a more profitable contract and it gave no option to the UCM to sell its already made goods.

Next, the factors are weighed against each other. While STARBUCKS™ would make more profit off a new contract, it still makes a profit off the existing contract with the UCM, so the overall detriment to STARBUCKS™ is not great. On the other hand, ending the UCM's right to use the trademark results in a huge loss to the UCM. As the contract involves a trademark license, the additional factors concerning trademarks will also be taken into consideration. So long as there are adequate assurances that quality control could be maintained through the bankruptcy proceedings, a court would decide that rejection of this contract could not result in an automatic termination of the contract. Instead, STARBUCKS™ would need to go through a prescribed alternative route of the Bankruptcy Code to try and terminate or change provisions in the license.[150]

An advantage to a test-based approach to the "rejection" conundrum is that the "rejection" problem is shifted away from trying to come to a consensus on the meaning of "rejection," and instead allows lower courts to determine whether automatic termination is warranted for license and lease agreements. It also removes the burden of having to wait for a Supreme Court decision or Congressional definition. Instead, lower courts can begin unifying decisions and help ensure that outcomes are taking into consideration both the circumstances of the parties and the policies underlying contracts, bankruptcy, and the area of law the contracts involve.

V. CONCLUSION

Courts are split on whether rejecting a trademark license under § 365 of the Bankruptcy Code results in the termination of the right to use the trademark. The root of this split lies in the interpretation of the word "rejection" by courts. It would be best if Congress defined the word, or in the alternative, if the Supreme Court would interpret the word so outcomes in judicial proceedings were consistent. However, it is unlikely that either of these will occur because of inaction in both government branches since the splits began over 25 years ago. The proposed solution is to employ a multi-factor test that takes into consideration concerns of all parties involved in the suit and the competing policies underlying bankruptcy, contract, and trademark laws.

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[150] *See* 11 U.S.C. §§ 544–51 (2012) (giving the avoiding powers that a trustee has during a bankruptcy proceeding).