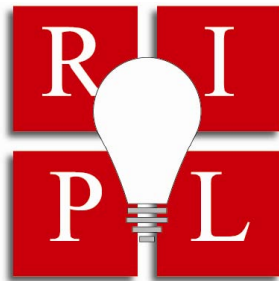


# THE JOHN MARSHALL REVIEW OF INTELLECTUAL PROPERTY LAW



## INSOLVENCY AND TRADEMARKS: HOW THE BANKRUPTCY CODE'S TREATMENT OF TRADEMARKS PROMOTES NAKED LICENSING

MICHAEL HOPKINS

### ABSTRACT

In 1988, Congress amended § 365 of the Bankruptcy Code, which deals with the rejection of executory contracts, in order to allow intellectual property licensees to retain usage rights. However, this amendment did not include adding trademarks to the Bankruptcy Code's definition of "intellectual property." As such, Circuit Courts are divided on what remedies are available to trademark licensees following a licensor's rejection of their agreement. Recently, the circuit split escalated when the First Circuit decided *Mission Product Holdings, Inc. v. Tempnology, LLC*, which was inconsistent with the Seventh Circuit's 2014 holding in *Sunbeam Products, Inc. v. Chicago American Manufacturing*. Both sides of the circuit split fail to recognize the unique policies of trademark law—that if not respected in a licensing agreement, could result in naked licensing. This Comment proposes the bankruptcy code be amended to include trademarks in the definition of IP, or amended to allow the licensee to enforce terms that have been negotiated if the licensor enters bankruptcy.

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I. INTRODUCTION.....	476
II. BACKGROUND .....	477
A. The Proliferation of Trademarks .....	477
B. Trademark Licensing and Quality Control.....	479
C. The Source of the Circuit Split .....	482
D. The Sunbeam Interpretation of the “rejection” of a trademark licensing agreement.....	483
E. The Tempnology Interpretation of the “Rejection” of Trademark Licensing Agreements .....	484
III. ANALYSIS.....	485
A. Reasons Underlying the Exclusion of Trademarks from the IPBPA Definition of Intellectual Property .....	485
B. The Sunbeam Court Underestimated the Debtor-licensors Duty to Monitor Quality Control Post-Rejection. ....	489
C. The First Circuit Approach in Tempnology is Less Equitable to Licensees But Better Protects Trademarks from Naked Licensing Abandonment. ....	489
D. A Common Theme Among the Split: Naked Licensing and Potential Abandonment.....	490
IV. PROPOSAL.....	490
A. Preliminary Considerations of the Judicial Avenues in Bankruptcy Proceedings.....	490
B. Option 1: Amend the Bankruptcy Code .....	491
C. Option 2: Amend the Bankruptcy Code to Allow Enforcement of Negotiated Quality Control Provisions.....	492
V. CONCLUSION.....	494
VI. POST-SCRIPT.....	494

## INSOLVENCY AND TRADEMARKS: HOW THE BANKRUPTCY CODE'S TREATMENT OF TRADEMARKS PROMOTES NAKED LICENSING

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### I. INTRODUCTION

Over the past 40 years, intellectual property (hereinafter, “IP”) has evolved rapidly and other areas of law that seek to regulate IP assets have struggled to keep up. With companies deriving more value from their IP assets than ever before,<sup>1</sup> IP law continually runs up against other less progressive areas of law; especially in the context of business.<sup>2</sup> One of these lagging areas of law that has failed to effectively control a booming IP industry is bankruptcy law.<sup>3</sup>

Simple timing has played a major role in this disconnect. The Bankruptcy Code was adopted in 1978 during a time when many did not consider IP assets to play a significant role in the economy and the law and practices that regulated IP rights were only on the precipice of taking off.<sup>4</sup> It is hard to justify blaming Congress for not foreseeing the plethora of IP assets that businesses now rely on for economic success, such as copyrighted software code<sup>5</sup>, patented products<sup>6</sup>, and trademarked goods.<sup>7</sup> In 1978, the Bankruptcy Code prematurely defined “intellectual property” when IP had not yet revealed its full potential.<sup>8</sup> This time lapse has led to a regulatory black hole

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<sup>1</sup> Kelvin King, *The Value of Intellectual Property, Intangible Assets and Goodwill*, WORLD INTELLECTUAL PROPERTY ORGANIZATION (June 2003) [https://www.wipo.int/sme/en/documents/value\\_ip\\_intangible\\_assets\\_fulltext.html](https://www.wipo.int/sme/en/documents/value_ip_intangible_assets_fulltext.html) (analyzing the significant impact that intellectual property plays in the modern economy and recognizing the role intangible assets play in various business valuation methods).

<sup>2</sup> *Why is Intellectual Property Important to Business?*, WORLD INTELLECTUAL PROPERTY ORGANIZATION, [http://www.wipo.int/export/sites/www/sme/en/documents/wipo\\_magazine/01\\_2002.pdf](http://www.wipo.int/export/sites/www/sme/en/documents/wipo_magazine/01_2002.pdf) (last visited September 20, 2018) (describing how businesses, now more than ever, have the ability to derive economic value from their intellectual property assets due to increasing numbers of exploitable markets and noting how the internet has facilitated the ability to advertise and market products bearing trademarks allowing trademarks to reach into foreign markets and capture new customers).

<sup>3</sup> *Id.*

<sup>4</sup> Brink Lindsey and Steven M. Teles, *Intellectual Property Laws: Wolves in Sheep’s Clothing*, PROMARKET BLOG (Sept 15, 2017), <https://promarket.org/intellectual-property-laws-wolves-sheeps-clothing> (describing IP use and its regulation in the late 1970s and early 1980s in the United States as a sleepy little backwater of American law due to a lack of adequate federal regulation and the uncertainty of the economic potential that IP assets hold).

<sup>5</sup> See *Data Gen. Corp. v. Grumman Sys. Support Corp.*, 825 F. Supp. 340 (D. Mass. 1993) (considering copyright infringement of software code).

<sup>6</sup> See *FTC v. Actavis, Inc.*, 570 U.S. 136 (2013) (considering patent infringement of brand-name drugs).

<sup>7</sup> See *United Drug Co. v. Parodney*, 24 F.2d 577, 579 (E.D.N.Y. 1928) (describing the right to license one’s IP as a “hard-earned right” and as “valuable as money in the bank.”).

<sup>8</sup> 11 U.S.C. § 101(35)(A)(2012) (defining “intellectual property” solely as a trade secret, patent, patent application, plant variety, work of authorship, or mask works).

and an awkward twentieth-century approach to solving complex twenty-first-century problems.

One of the major issues resulting from attacking modern intellectual problems with a dated Bankruptcy Code arises in the context of intellectual property licensing agreements—specifically, what happens to a trademark licensee’s rights when a debtor-licensor goes “belly up.”<sup>9</sup> The Bankruptcy Code’s treatment of trademarks has led to inconsistent court rulings that run contrary to trademark policy and lead to the abandonment of a trademark altogether.

This Comment explores the potential dangers of allowing insolvent trademark licensors to “assume” executory agreements in bankruptcy proceedings and proposes an equitable solution for post-rejection licensees. Part II of this Comment provides necessary background information on the proliferation of trademarks and the benefits of IP licensing agreements. Part II also provides background information necessary for understanding the Bankruptcy Code, trademark law generally, the current circuit split between the Seventh and First Circuits, and the potential of trademark abandonment due to “naked licensing.”

Part III of this Comment analyzes why Congress left trademarks out of the Bankruptcy Code’s definition of IP, and the First and Seventh Circuit approaches as to whether trademark licensees retain usage rights after a debtor-licensor rejects the license. Lastly, Part IV proposes that the Bankruptcy Code should be amended to either: (1) include trademarks in the definition of IP, or (2) allow the licensee to enforce terms that have been negotiated if the licensor enters bankruptcy.

## II. BACKGROUND

### *A. The Proliferation of Trademarks*

Trademarks became a legally recognized form of intellectual property under the Lanham Act of 1946.<sup>10</sup> A trademark is something that is used in association with a good to identify or distinguish the good and indicate its origin.<sup>11</sup> The purpose of a trademark is to “induce a purchaser to choose a particular good or product based on its source.”<sup>12</sup> Traditionally, a trademark can be “any word, name, symbol, or device, or any combination thereof.”<sup>13</sup> However, trademarks can also include things such as packaging<sup>14</sup>, sounds<sup>15</sup>, or colors<sup>16</sup>.

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<sup>9</sup> Samuel S. Cavior, Richard L. Epling, *Bankruptcy Issues in Trademarks*, PILLSBURY LAW (November 30, 2013) <https://www.pillsburylaw.com/en/news-and-insights/bankruptcy-issues-in-trademarks.html>.

<sup>10</sup> The Lanham Act, 15 U.S.C. § 1051 (2012). The Lanham Act contains the federal statutes for trademark law. *Id.*

<sup>11</sup> 15 U.S.C. § 1127 (2012).

<sup>12</sup> *Mishawaka Rubber & Woolen Mfg. Co. v. S. S. Kresge*, 316 U.S. 203, 205 (1942) (“A trademark is a merchandising short-cut which induces a purchaser to select what he wants, or what he has been led to believe he wants.”).

<sup>13</sup> 15 U.S.C. § 1127 (2012).

<sup>14</sup> 1 ANNE GILSON LALONDE, *GILSON ON TRADEMARKS* § 1.02[1][a](Matthew Bender, rev. ed. 2013) [hereinafter *GILSON ON TRADEMARKS*](Product packaging is protected as a “trade dress”).

To accommodate all of the possible uses of a trademark, IP law has expanded to protect harm to marks, such as cybersquatting<sup>17</sup> and dilution.<sup>18</sup> A trademark owner may also protect his more notable trademarks against dangers such as blurring<sup>19</sup> or tarnishment<sup>20</sup> by a third party. All of these tools are available to provide trademark owners with legal mechanisms to redress damage done to their IP assets and safely maximize the presence of their marks in the marketplace. Now more than ever, technology helps IP owners extract value from their IP assets.<sup>21</sup> One of the most common ways for trademark owners to expand their brand recognition and maximize

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<sup>15</sup> See *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.”).

<sup>16</sup> See GILSON ON TRADEMARKS, *supra* note 14, § 2.11[2][a]; see also *Qualitex Co. v. Jacobson Prods. Co., Inc.*, 514 U.S. 159, 161 (1995)(holding that colors satisfy both of the requirements for trademark registration and use under the statutory definition.); see also Michael Bernet, *Can you Trademark a Color?*, IPWATCHDOG (July 14, 2018), <https://www.ipwatchdog.com/2018/07/14/can-you-trademark-a-color/id=99237/> (stating that under certain circumstance, colors may be trademarked, including “red soles for women’s high-heel dress shoes where the rest of the shoe is not also red (Louboutin), pink fiberglass insulation (Owens-Corning), red knobs on cooking appliances (Wolf), light blue for jewelry boxes (Tiffany), brown for parcel delivery trucks and uniforms (UPS), magenta for telecommunications services (T-Mobile), and orange for scissor handles (Fiskars).”).

<sup>17</sup> Anti-cybersquatting Consumer Protection Act, Pub. L. No. 106-113, 113 Stat. 1501 (1999) (codified as 15 U.S.C. § 1125(d) (2000)).

<sup>18</sup> Federal Trademark Dilution Act of 1995, Pub. L. No. 104-98, 109 Stat. 987 (1995)(codified as amended at 15 U.S.C. § 1125 (c)(2000)). The act states that trademark dilution is the lessening of the capacity of a famous mark to identify and distinguish goods or services, regardless of the presence or absence of “(1) competition between the owner of the famous mark and other parties, or (2) likelihood of confusion, mistake, or deception.” Therefore, federal dilution law protects the identifying or distinguishing power of a trademark. *Id.*

<sup>19</sup> See Beth Hutchens, *Trademark Tarnishment: Trademark Law’s Dirty Little Secret*, IPWATCHDOG (October 21, 2010), <http://www.ipwatchdog.com/2010/10/21/trademark-tarnishment-trademark-law-dirty-little-secret/id=12905/> (stating “[d]ilution by blurring “slowly whittles away at a trademark’s distinctiveness whereas dilution by tarnishment is an attack on the reputation and positive image of the mark.”); see generally TRADEMARK BASICS, [https://www.inta.org/TrademarkBasics/FactSheets/Pages/Trademark-Dilution-\(Intended-for-a-non-legal-audience\).aspx](https://www.inta.org/TrademarkBasics/FactSheets/Pages/Trademark-Dilution-(Intended-for-a-non-legal-audience).aspx) (last visited November 2, 2018). “Dilution by blurring occurs when a third party uses an identical or virtually identical mark on or in connection with goods and/or services that may be completely different and unrelated to the plaintiff’s goods or services.” *Id.* “Dilution by blurring weakens the distinctiveness of a famous mark. Hypothetical examples of dilution by blurring would be a third party’s use of the POLAROID mark for shoes or the ROLLS-ROYCE mark for toothpaste.” *Id.*

<sup>20</sup> See generally *Trademark Tarnishment: Trademark Law’s Dirty Little Secret*, *supra* note 19 (characterizing tarnishment as a “flavor of dilution” in which an infringing mark portrays the infringed mark in a negative light, which is usually in connection with “sex, drugs, or crime.”) Tarnishment “threatens to destroy the commercial value of the mark because people will associate the lack of quality of the infringer’s goods with the plaintiff’s unrelated goods. *Id.*; see also *Pfizer Inc. v. Sachs*, 652 F. Supp. 2d 512, 525 (S.D.N.Y. 2009) (the defendants’ display at an adult entertainment show depicting two models riding a VIAGRA-branded missile and distributing condoms would likely harm the reputation of Pfizer’s trademark); see also *Mattel, Inc. v. Internet Dimensions Inc.*, 55 U.S.P.Q.2d 1620, 1627 (S.D.N.Y. 2000) (connecting BARBIE with pornography will adversely paint the public’s impression of BARBIE and thereby tarnish the brand name.).

<sup>21</sup> Keith Tully, *How is intellectual property valued when selling a business?*, IPWATCHDOG (April 24, 2018), <https://www.ipwatchdog.com/2018/04/24/intellectual-property-valued-sellingbusiness/id=96098/>.

the economic value is through licensing agreements.<sup>22</sup> This Comment will focus on how bankruptcy negatively impacts these agreements and potentially may lead to an abandonment of a trademark altogether.

### *B. Trademark Licensing and Quality Control*

As with all other forms of intellectual property, a trademark owner may license his mark to a third party. A trademark license is a form of executory contract between two parties where the licensor grants the licensee the right to use, distribute, manufacture, and sell products bearing the licensor's mark, generally in exchange for royalties from the licensee.<sup>23</sup> This is a major benefit to the licensor as he is able to gain revenue without having to worry about manufacturing or marketing the products himself.<sup>24</sup> In other words, a trademark licensor can passively develop the goodwill of the trademark through the licensee's use without having to actually use the mark itself.<sup>25</sup> The trademark licensor is essentially able to expand its reach and access into other markets that it otherwise wouldn't be able to.<sup>26</sup>

While there are many benefits to trademark licensing agreements, trademark licensors are tasked with monitoring the quality control of their marks throughout the agreement. In order to protect both consumers and the trademark licensor's goodwill, trademark laws dictate that a trademark's validity rests on the quality control measures set in place by the licensor.<sup>27</sup> The reasoning behind requiring

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<sup>22</sup> Oliver Herzfeld, *The Most Significant Unresolved Legal Issue In Trademark Licensing*, FORBES (September 13, 2018) <https://www.forbes.com/sites/oliverherzfeld/2018/09/13/the-most-significant-unresolved-legal-issue-in-trademark-licensing/#6c984aad2932> (describing the benefits of trademark licensing).

<sup>23</sup> ROGER MILGRIM & ERIC BENSON, 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."); *see generally* Robin Bicket White, *Do You Have a License for That? Rejection of Trademark Licenses in Bankruptcy*, FROST BROWN TRODD ATTORNEYS BLOG, (Oct. 6, 2018), <https://www.frostbrowntodd.com/resources-trademark-licenses-in-bankruptcy.html> (noting that when 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).

<sup>24</sup> *See Assignment, Licensing, and Valuation of Trademarks*, INTERNATIONAL TRADEMARK ASSOCIATION, <http://www.inta.org/TrademarkBasics/FactSheets/Pages/AssignmentsLicensesValuationFactSheet.aspx> (last visited Oct. 26, 2018). Through licensing agreements, a trademark owner may gain entry into markets that may not be readily accessible to it, assign risks of product development to an outside organization, and share the cost of advertising and promoting the trademark, and enhance earnings through royalty income. *Id.*

<sup>25</sup> Stephen P. Ladas, *Patents, Trademarks and Related Rights* 1127 (1975) (stating that licensing to an unrelated third party yields greater profitability).

<sup>26</sup> *See generally* Oliver Herzfeld, *How to Establish a World Class Corporate Brand Licensing Program*, FORBES, (February 15, 2017) <https://www.forbes.com/sites/oliverherzfeld/2017/09/18/how-to-establish-a-world-class-corporate-brand-licensing-program-part-three/> (expressing that World-class brands regularly enter markets via licensing agreements that they otherwise would not have the opportunity to enter. Successful licensing agreements allow the licensor to do things such display their trademark on the product of another company that is already well-established in their respective industry).

<sup>27</sup> *See* J. THOMAS MCCARTHY, 1 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 2:4 (4th ed. 2013) [hereinafter MCCARTHY ON TRADEMARKS] (explaining that quality control

quality control measures is to protect consumers from buying products that they believe will be of a certain quality but instead receiving something else.<sup>28</sup> Quality control requirements promote consumer protection while also protecting the trademark owner's goodwill.<sup>29</sup> Further, trademark licensors are incentivized to fulfill their duty to monitor quality control because if they do not, they risk abandoning their mark under the doctrine of naked licensing.<sup>30</sup> A trademark is deemed "naked" or "uncontrolled" if the licensor fails to provide adequate control over the quality of the uses of the mark.<sup>31</sup>

While licensing agreements have shown to be mutually beneficial to the licensor and licensee, such agreements can quickly fall apart when the licensor encounters financial troubles and files for bankruptcy. A business typically enters bankruptcy as a final effort to avoid going out of business altogether.<sup>32</sup> Businesses have two options when their financial difficulties force them into bankruptcy: they can elect to file for either Chapter 7 or Chapter 11 bankruptcy.<sup>33</sup> Chapter 7, which is not available to certain entities including insurance companies and banking institutions, entails

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requirements protect consumers by encouragement of product or service uniformity, and aids protection of trademark owners from infringers); *see Id.* at § 6.3 ("The 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.").

<sup>28</sup> *See generally Supervising Quality of Trademark Usage: The Prohibition on Naked Licenses*, NOLO, <https://www.nolo.com/legal-encyclopedia/supervising-quality-of-trademark-usage-the-prohibition-on-nakedlicenses.html> (last visited November 12, 2018)(explaining that a failure to monitor one's trademark is seen as an effective abdication of a trademark owner's responsibility and may result in abandonment of the mark).

<sup>29</sup> *Overview of Trademark Policy*, THE IP LAW BLOG, <https://www.theiplawblog.com/articles/trademark-law/> (last visited Sept. 20, 2018)(explaining that the primary policies of trademark law include consumer protection and protecting the trademark owner's goodwill).

<sup>30</sup> 15 U.S.C. § 1127 (stating that "[a] mark shall be deemed to be abandoned. . . [w]hen any course of conduct of the owner, including acts of omission as well as commission, causes the mark to become the generic name for the goods or services on or in connection with which it is used or otherwise to lose its significance as a mark.").

<sup>31</sup> 15 U.S.C. § 1055 (2012). The Lanham Act allows licensing of trademarks so long as the licensor continuously maintains quality control: "Where a registered mark or a mark sought to be registered is or may be used legitimately by related companies, such use shall inure to the benefit of the registrant or applicant for registration, and such use shall not affect the validity of such mark or of its registration, provided such mark is not used in such manner as to deceive the public." 15 U.S.C. 1055 (2012); *Id.* at 1127 (the term "related company" means any person whose use of a mark is controlled by the owner of the mark regarding the nature and quality of the goods or services on or in connection with which the mark is used).

<sup>32</sup> *See Gerri Detweiler, Filing Bankruptcy: What You Need to Know About Chapter 7 vs. Chapter 11 vs. Chapter 13*, CREDIT.COM, <https://www.credit.com/debt/filing-for-bankruptcy-difference-between-chapters-7-11-13/> (last visited September 28, 2018) (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)).

<sup>33</sup> UNITED STATES COURTS, Chapter 11 - Bankruptcy Basics <https://www.uscourts.gov/services-forms/bankruptcy>

</bankruptcy-basics/chapter-11-bankruptcy-basics> (last visited December 1, 2018) (explaining that entities, such as partnerships and corporations, are eligible for liquidation under Chapter 7 that partnerships and corporations are alternatively eligible for reorganization, which is known as Chapter 11 bankruptcy.).

liquidating assets to pay creditors.<sup>34</sup> Alternatively, Chapter 11 bankruptcy allows restructuring and reorganization for businesses with the goal of bouncing back from financial failure in the future.<sup>35</sup>

There is a section of Chapter 11 of the Bankruptcy Code that where the debtor will file any information regarding executory contracts the debtor is a party to.<sup>36</sup> While there is no definition of “executory contract” in Chapter 11 of the Bankruptcy Code,<sup>37</sup> it is generally accepted that executory contracts are those where both parties owe duties of future performance; therefore, IP licenses are executory.<sup>38</sup> Under the Bankruptcy Code, a bankrupt licensor may elect to “assume” an executory contract and keep performing, or “reject” the agreement, which is a termination of the agreement.<sup>39</sup>

Under current bankruptcy law, trademark licenses receive different treatment than other types of IP licenses, such as trade secrets, patents, and copyrights.<sup>40</sup> A licensee of copyrights, trade secrets, or patents may continue operating under the licensing agreement after the debtor-licensor goes bankrupt and “rejects” the agreement.<sup>41</sup> However, trademark licensees do not have the same guaranteed rights when their licensors go bankrupt. In other words, when a bankruptcy licensor rejects a trademark licensing agreement, the licensee does not have the right to continue using the mark and all he is left with is a claim for breach of contract.<sup>42</sup> In order to fully understand why it is that trademark licensing agreements are treated

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<sup>34</sup> See UNITED STATES COURTS, <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics> (last visited September 13, 2018) (explaining that Chapter 7 of the Bankruptcy Code provides for the sale of a debtor's property to pay creditors).

<sup>35</sup> See *Id.* (explaining that restructuring a business is preferred over termination, because businesses are essential to the economy and termination will go so far as to affect employees, customers, creditors, and stockholders).

<sup>36</sup> 11 U.S.C. § 1007(b)(1)(C) (stating that a debtor filing bankruptcy under Chapter 11, is required to file information related to “schedules, statements, and other documents” for “executory contracts and unexpired leases.”).

<sup>37</sup> Bob Eisenbach, *Executory Contracts — What Are They And Why Do They Matter In Bankruptcy?*, IN THE (RED) BUSINESS BANKRUPTCY BLOG (July 18, 2006), <https://bankruptcy.cooley.com/2006/07/articles/business-bankruptcy-issues/executory-contracts-what-are-they-and-why-do-they-matter-in-bankruptcy/> (The term “executory contract” is not defined in the Bankruptcy Code. The absence of a definition of the words executory contract has led to a lot of confusion surrounding intellectual property agreements when bankruptcy comes into play.)

<sup>38</sup> *Id.* (describing executory contracts as those which require future performance by one or more parties to an agreement, such as real estate leases, equipment leases, and development contracts).

<sup>39</sup> 11 U.S.C. § 365(a) (2012) (stating that a trustee or debtor may “assume or reject executory contracts”); 11 U.S.C. § 365(n) (explaining that a debtor may assume or reject an IP license, but if the debtor elects to reject it, the licensee may choose to continue the license or allow the rejection).

<sup>40</sup> See Dan Goldberger & Alessandra Glorioso, *You Can't Reject my Trademark License, Can you?*, THETMCA (May 23, 2018), <https://thetmca.com/you-cant-reject-my-trademark-license-can-you/> (trademarks are excluded from bankruptcy protection that covers other forms of intellectual property such as copyrights and patents.)

<sup>41</sup> *In re Logical Software*, 66 B.R. 683, 687 (Bankr. D. Mass. 1986) (holding that software licensor could unilaterally reject software license under *Lubrizol*).

<sup>42</sup> *In re HQ Global Holdings, Inc.*, 290 B.R. 507, 513 (Bankr. D. Del. 2003) (stating “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.”).



differently than other IP, it is important to understand some history and case law behind the Bankruptcy Code.

### *C. The Source of the Circuit Split*

The original and enduring dispute comes from the Fourth Circuit's decision in *Lubrizol Enterprise, Inc. v. Richmond Metal Finishers, Inc.*<sup>43</sup> In *Lubrizol*, a bankruptcy court held that a bankrupt patent licensor could reject his licensing agreement under 11 U.S.C. § 365, and as a result, the licensee's ability to use the licensor's patent was terminated.<sup>44</sup> The bankruptcy court asserted that rejection simply created a pre-petition damages claim for the licensor's failure to continue to perform under the license.<sup>45</sup> In one of the most controversial bankruptcy decisions in U.S. history, the Fourth Circuit Court of Appeals affirmed the lower court's holding that the licensee only had a claim for damages.<sup>46</sup> In making its decision, the court stated, "the legislative history of § 365(g) makes clear that the purpose of the provision is to provide only a damages remedy for the non-bankrupt party."<sup>47</sup>

Courts followed *Lubrizol* until Congress overturned the holding by passing the Intellectual Bankruptcy Protection Act of 1988 (hereinafter, "IPBPA") in response to lobbying efforts by the U.S. Department of Commerce.<sup>48</sup> Shortly thereafter, the IPBPA was codified and added to the Bankruptcy Code as § 365(n).<sup>49</sup> Section 365(n) of the Bankruptcy Code details the rights of IP licensees when a debtor-licensor elects to reject a licensing agreement.<sup>50</sup> While the IPBPA solved many issues for patent, trade secret, and copyright licensees, trademarks were still omitted from the definition of IP and therefore the only recourse for trademark licensees was a pre-petition claim for damages.<sup>51</sup> Therefore, § 365(n) was merely a half-fix that left uncertainty for post-rejection trademark licensee's.

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<sup>43</sup> *Lubrizol Enters., Inc. v Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1048 (4th Cir. 1985) (The *Lubrizol* court acknowledged that allowing debtor-licensors of intellectual property licenses to reject executory contracts "imposes serious burdens" and makes parties hesitant to enter such contracts, however also noted that Congress is responsible for the way the law was written.).

<sup>44</sup> *Lubrizol*, 756 F.2d at 1048.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> S. REP. NO. 100-505, at 11--13 (1988) [hereinafter, REPORT 100-505]. The report bases its decision on a U.S. Department of Commerce letter that expressed concern over the "chilling effect" that would result from allowing unilateral rejection of licenses in bankruptcy proceedings, such as decreasing the willingness of potential licensees to enter into licensing contracts).

<sup>49</sup> 11 U.S.C. § 365(n)(2012).

<sup>50</sup> JONES DAY, *Trademark Licenses in Bankruptcy: The Seventh Circuit Fires a Shot Across the Bow of Lubrizol*, <https://www.jonesday.com/trademark-licenses-in-bankruptcy-the-seventh-circuit-fires-a-shot-across-the-bow-of-lubrizol-10-01-2012/> (last visited September 30, 2018). The fact that § 365(n) of the Bankruptcy Code protects intellectual property licensees during a licensor's bankruptcy because the provision was enacted to shield the non-debtor licensee from the ramifications of the debtor's rejection of the agreement. Section 365(n) seeks to protect the licensee while not overly burdening the debtor-licensor's estate when an intellectual property technology license is involved. *Id.*

<sup>51</sup> See *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).

*D. The Sunbeam Interpretation of the “rejection” of a trademark licensing agreement.*

In 2011, things finally started to look up for trademark licensees when the Seventh Circuit decided *Sunbeam Prods., Inc. v. Chi. Am. Mfg. LLC*.<sup>52</sup> There, the court held that even though a debtor-licensor rejected a licensing agreement under §365(a), the rejection did not terminate the licensee’s usage rights entirely.<sup>53</sup> Even though the *Sunbeam* decision created a circuit split, the Supreme Court denied certiorari so there has not yet been a resolution.<sup>54</sup>

The *Sunbeam* court interpreted the omission of trademarks from the § 365’s definition of “intellectual property” as neutral in light of the *Lubrizol* holding.<sup>55</sup> There, the Seventh Circuit focused its analysis on whether the *Lubrizol* court fully considered the potential consequences of rejections under §365 of the Bankruptcy Code.<sup>56</sup> The Court explained that seeking a “rejection” of a contract is not the same as seeking “rescission” of a contract.<sup>57</sup> The Seventh Circuit affirmed the bankruptcy court’s decision that a licensee may continue to use a trademark despite the fact that the debtor’s bankruptcy trustee had decided to reject the mark.<sup>58</sup> The Seventh Circuit, however, did not agree with the reasoning behind the bankruptcy court’s decision.<sup>59</sup>

The *Sunbeam* court’s reasoning can easily be dissected into four parts. First, when a debtor-licensor rejects an executory contract under §365(g) of the Bankruptcy Code, such a rejection results in a breach of contract and not a termination of the agreement.<sup>60</sup> Second, a licensor’s breach of an intellectual property licensing agreement does not terminate a licensee’s right to continue using the intellectual property.<sup>61</sup> Third, the *Sunbeam* court operates under the assumption that an IP license is a sort of IP contract, and therefore when a licensor rejects an IP license when entering bankruptcy, a breach should result.<sup>62</sup> Lastly, the licensee’s legal right

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<sup>52</sup> *Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC*, 686 F.3d 372, 378 (7th Cir. 2012).

<sup>53</sup> *Sunbeam*, 686 F.3d at 377 (holding that rejection is not the “functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions they occupied before the contract was formed”...It “merely frees the estate from the obligation to perform and has absolutely no effect upon the contract’s continued existence.”) (quoting *Thompkins v. Lil’ Joe Records, Inc.*, 476 F.3d 1294, 1306 (11th Cir. 2007).

<sup>54</sup> *Sunbeam Prods. v. Chi. Am. Mfg., LLC*, 2012 U.S. LEXIS 9472, at \*1 (U.S. Dec. 10, 2012).

<sup>55</sup> *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.”).

<sup>56</sup> *Id.* (“We need to determine whether *Lubrizol* correctly understood § 365(g), which specifies the consequences of a rejection under § 365(a).”).

<sup>57</sup> *Id.* at 377.

<sup>58</sup> *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.”).

<sup>59</sup> *Id.* at 376 (“Although the bankruptcy judge’s ground of decision is untenable, that does not necessarily require reversal.”).

<sup>60</sup> *Sunbeam*, 686 F.3d at 377 (concluding that rejection is not equivalent to rescission).

<sup>61</sup> *Id.* (“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.”).

<sup>62</sup> Note that this is speaking of intellectual property license-contract relationships in general and not the Bankruptcy Code’s definition of “IP”. It is simply an inference the *Sunbeam* court relies upon without stating it outright.

to use the IP does not automatically terminate upon rejection because a breach of contract does not terminate the rights under the contract.<sup>63</sup> When one dissects the Sunbeam court's reasoning, it is apparent that the root cause of the circuit split emanates from the interpretation of § 365 of the Bankruptcy Code.<sup>64</sup>

*E. The Tempnology Interpretation of the "Rejection" of Trademark Licensing Agreements*

Most recently, the First Circuit created a further divide in case law in *Mission Product Holdings, LLC v. Tempnology, LLC (In re Tempnology)*.<sup>65</sup> In *Tempnology*, the aggrieved licensee supported its argument with the *Lubrizol* holding, and asserted that rejection of a trademark does not deprive the licensee of its rights and invited the First Circuit to follow the Seventh Circuit approach.<sup>66</sup> However, the First Circuit was not persuaded. The court stated that "Congress expressly listed six kinds of intellectual property" in the Bankruptcy Code's definition of IP, including less prevalent types of IP such as "mask work protected under Chapter 9 of Title 17," but did not include trademarks.<sup>67</sup> The First Circuit reasoned that Congress intentionally left trademarks out of the IP definition because they did not want them to be protected under Section 365(n).<sup>68</sup>

The court then emphasized the particular burdens of trademark agreements from which Congress might well have intended to free reorganizing debtors from.<sup>69</sup> A trademark licensor bears an unavoidable duty to monitor and control the quality of

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<sup>63</sup> *Sunbeam*, 686 F.3d at 376-77 (the *Sunbeam* court explains that when a debtor breaches an executory contract by choosing to reject the contract: "[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.").

<sup>64</sup> *Id.*; *See also* *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 the licensing parties maintain a close working relationship, rely on each other for consistent quality, and "no actual decline in quality standards is demonstrated."); *see also* *Transgo, Inc. v. Ajac Transmission Parts Corp.*, 768 F.2d 1001, 1017-18 (9th Cir. 1985) (concluding that there was sufficient quality control to prevent the 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); *see also* *Land O'Lakes*, 330 F.2d at 670 (affirming the district court judge's decision that the quality control requirement was met); *see also* *Mission Product Holdings, Inc. v. Tempnology, LLC*, 879 F.3d 389 (1st Cir. 2018) (the court held that the rejection of a trademark license in bankruptcy means that the licensee loses the ability to use the licensed intellectual property because trademarks are not among the categories of "intellectual property" afforded special protection under the Bankruptcy Code).

<sup>65</sup> *See* *Mission Product Holdings, LLC v. Tempnology, LLC (In re Tempnology, LLC)*, 879 F.3d 389 (1st Cir. 2018).

<sup>66</sup> *Id.* at 395 (noting that the *Lubrizol* decision is no longer the state of the law the IPBPA was enacted to displace that notion that licensees' rights are extinguished when their licensor rejects a trademark licensing agreement).

<sup>67</sup> *Id.* at 401; *see* 11 U.S.C. § 101(35A).

<sup>68</sup> *Id.* at 401.

<sup>69</sup> *Id.* at 402-403 (noting that trademark licensing agreements requires more active involvement from the licensor in order to maintain the quality of the trademark).

all products that bear its trademark.<sup>70</sup> If the licensor breaches this duty, he may face a claim of abandonment of the mark for “naked licensing.”<sup>71</sup> The First Circuit also stated that the *Sunbeam* approach would “force Debtor to choose between performing executory obligations arising from the continuance of the license or risking the permanent loss of its trademarks.”<sup>72</sup> The decision in *Tempnology* keeps in mind an essential requirement that comes with rejection under §365 which the *Sunbeam* court ignored: maintaining quality control of the trademark to prevent abandonment.<sup>73</sup>

### III. ANALYSIS

This section will begin by analyzing why trademarks were not included in the Bankruptcy Code’s definition of IP by comparing and contrasting trademark law policies with the policies of the forms of IP included in the Bankruptcy Code’s definition, and analyzing modern quality control requirements. Next, it will analyze the advantages and disadvantages of the Seventh Circuit and First Circuit approaches to § 365 rejection. Finally, this section will analyze the common theme of potential trademark abandonment due to naked licensing and discuss why the First Circuit approach in *Tempnology* makes the most practical sense from both trademark and bankruptcy perspectives.

#### *A. Reasons Underlying the Exclusion of Trademarks from the IPBPA Definition of Intellectual Property*

There are two primary factors that may have contributed to the exclusion of trademarks from the IPBPA’s definition of intellectual property: (1) ostensibly different trademark law policies in comparison to other forms of IP, and (2) the trademark licensors’ duty to monitor quality control of their marks. The incompatible policies of trademark law and other forms of IP will be analyzed first.

Unlike copyright and patent law, which originate from the United States Constitution,<sup>74</sup> trademark law was a product of a growing manufacturing industry

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<sup>70</sup> *Id.* at 402.

<sup>71</sup> *In re Tempnology*, 879 F 3d at 403.

<sup>72</sup> *Id.* at 403.

<sup>73</sup> John C. Paul, D. Brian Kacedon, Susan Y. Tull, *Loss of Trademark Rights from Naked Licensing*, FINNEGAN LAW BLOG (Jan. 17, 2011), <https://www.finnegan.com/en/insights/loss-of-trademark-rights-from-naked-licensing.html> (expressing that a legally-binding trademark license agreement must contain quality control provisions and, at a minimum, those provisions should obligate the licensee to maintain the quality of the licensed goods and services, and should give the licensor the right to monitor quality and cancel the license if the quality standards are not maintained.).

<sup>74</sup> 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.”).

and an increased need for government intervention to regulate commercial activity.<sup>75</sup> The two primary policies behind trademark law that have developed over time include: (1) the desire to protect consumers from confusion and deception, and (2) the desire to protect trademark owners from having their mark infringed.<sup>76</sup> When comparing trademark law's policies to those of other fields of IP, clear differences exist that may reveal why Congress was not comfortable including trademarks in the §365 definition of IP.

Under the Bankruptcy Code, trade secrets, copyrights, and patents are all included in the definition of "intellectual property."<sup>77</sup> For copyright law, the driving policy is protecting the author's creation of a work of art.<sup>78</sup> For patent law, the underlying policy is directed at protecting the creation of inventions.<sup>79</sup> Similarly, trade secret policy is aimed at protecting the creation of formulas and related formula-esque information.<sup>80</sup> All of these policies have something in common: they seek to protect the innovation and creation of the property itself. Ostensibly, the underlying policies of trademark law appear to be geared more towards protecting consumer expectation and the trademark owner's goodwill than the creation of a "thing".<sup>81</sup> However, in reality, trademark law is also aimed at the creation of something: brand recognition.<sup>82</sup> These policy variations very well could have played a role in the exclusion of trademarks from the Bankruptcy Code's definition of IP, as consumer protection and protecting goodwill vary greatly from protecting the creation of inventions.<sup>83</sup>

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<sup>75</sup> See *History of Trademarks: Everything You Need to Know*, Upcounsel, <https://www.upcounsel.com/history-of-trademarks> (last visited Nov. 1, 2018) (describing the origins of trademark law and how it progressed along with manufacturing advancements).

<sup>76</sup> 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.*

<sup>77</sup> 11 U.S.C. § 101(35A)(2012). According to the bankruptcy code, 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 non-bankruptcy law." *Id.*

<sup>78</sup> U.S. CONST. art. I, § 8, cl. 8.

<sup>79</sup> *Id.*

<sup>80</sup> *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (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.")

<sup>81</sup> See MCCARTHY ON TRADEMARKS, *supra* note 27, § 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.")

<sup>82</sup> THE TRADEMARK COMPANY, <https://www.thetrademarkcompany.com/learning-center/3-ways-to-guard-your-trademark> (last visited November 11, 2018) (discussing how trademarks help to establish a businesses' brand recognition).

<sup>83</sup> MCCARTHY ON TRADEMARKS, *supra* note 27, § 6.3 ("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)).

The second reason that Congress may have omitted trademarks from the IPBPA is the quality control and monitoring required to sustain a trademark licensing agreement.<sup>84</sup> In determining whether the trademarks should be included in the Bankruptcy Code's definition of "intellectual property," it is important to consider the development of quality control standards in trademark licensing agreements. Trademark law necessitates that trademark owners exercise "decision-making authority over quality."<sup>85</sup> A major issue with imposing such a duty is that the terms "quality" and "control" are not defined in the Lanham Act.<sup>86</sup> Adequate levels of control have been found when the licensee's goods satisfy the "expectations created by the presence of the mark."<sup>87</sup> Therefore, there is no "bright line" test because "[i]t is difficult, if not impossible to define in the abstract exactly how much control and inspection is needed to satisfy the requirement of quality control" over licenses in the marketplace.<sup>88</sup> Consequently, courts in varying jurisdictions have attached different definitions to both terms.<sup>89</sup> Such contradictory interpretations have led to an inconsistent "quality control" requirements to maintain ownership of a trademark.<sup>90</sup>

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<sup>84</sup> Luke S. Curran, *NSFW: Naked Licensing and Uncontrolled Trademark Use*, BANNERWITCOFF.COM (December 2016), <https://bannerwitcoff.com/wp-content/uploads/2016/12/Curran.Licensing-Executive-Society.Naked-Licensing.pdf> (describing the quality control requirements that trademark licensors must fulfill in order to sustain trademark licensing agreements and avoid abandonment of the mark as a naked license).

<sup>85</sup> *Eva's Bridal, Ltd. v. Halanick Enters.*, 639 F.3d 788, 791 (7th Cir. 2011); see generally Tom Kulik, *When The Emperor Has No Clothes: 3 Tips To Avoid Inadvertent 'Naked Licenses' Under Trademark Law*, ABOVEHELAW (October 2, 2017), <https://abovethelaw.com/2017/10/when-the-emperor-has-no-clothes-3-tips-to-avoid-inadvertent-naked-licenses-under-trademark-law/> (discussing the quality control requirement to maintain a trademark licensing agreement and to prevent future issues with abandonment of the mark as a naked license).

<sup>86</sup> 15 U.S.C. § 1127 (stating that "[a] mark shall be deemed to be abandoned . . . [w]hen any course of conduct of the owner, including acts of omission as well as commission, causes the mark to become the generic name for the goods or services on or in connection with which it is used or otherwise to lose its significance as a mark."); see *Trademark Quality Control: Everything You Need to Know*, UPCOUNSEL, <https://www.upcounsel.com/trademark-quality-control> (last visited Nov. 12, 2018). The absence of any clear and definite definition of what is required to maintain quality control standards has led to a great deal of confusion as to what a licensor must do in order to avoid abandoning his or her mark. *Id.*

<sup>87</sup> See *Eva's Bridal*, 639 F.3d at 790; See *FreecycleSunnyvale v. Freecycle Network*, 626 F.3d 509, 511 (9th Cir. 2010) (citing *Barcamerica*, 289 F.3d at 596–98) (noting that by failing to enforce the terms of the mark's use, the licensor may forfeit its rights to enforce the exclusive nature of the mark, and in determining whether a trademark has been abandoned as a naked license, courts will consider: "1) Whether a mark owner retained contractual rights over quality of the use of the mark; 2) Whether a mark owner actually controlled quality of the mark's use by licensee; and 3) Whether a mark owner reasonably relied on the licensee to maintain the quality.").

<sup>88</sup> *Fuel Clothing Co. v. Nike, Inc.*, 7 F. Supp. 3d 594, 606 (D.S.C. 2014) (quoting *Barcamerica Int'l USA Trust v. Tyfield Importers, Inc.*, 289 F.3d 589, 595–96) (9th Cir. 2002)) (emphasizing that "the standard of quality control and the degree of necessary inspection and policing by the licensor will vary with the wide range of licensing situations in use in the modern marketplace"); *Eva's Bridal, Ltd. v. Halanick Enters.*, 639 F.3d 788, 790–91 (7th Cir. 2011) (recognizing that the level of authority exercised over the licensee "can't be answered generally" and the "licensor's self-interest largely determines the answer" when examining the nature of the business and customers' expectations).

<sup>89</sup> BAKER BOTTS, *Can Bankruptcy Terminate Intellectual Property Licenses?*, <http://www.bakerbotts.com/insights/publications/2018/12/can-bankruptcy-terminate/> (last visited Nov. 11, 2018) (the absence of a statutory definition of "quality control" has created conflicting court

It is clear, however, that the level of control that courts require has decreased gradually over the years. Now, the minimum requirement for quality control is just some showing of evidence of actual control by the licensor.<sup>91</sup> Even when such evidence of quality control is available, courts have held that control may be present so long as product quality is consistent and consumers are not being misled.<sup>92</sup> While there are courts that have imposed more stringent quality control standards, the modern trend is that quality control entails a trademark owner simply monitoring the use of the mark and the quality of the licensee's product.<sup>93</sup> While the requirements for quality control seem to have declined since the Bankruptcy Code was last amended, it is clear that it was an issue that Congress considered in drafting Bankruptcy Code's definition of IP.

The Bankruptcy Code is not to blame for these heightened trademark licensing requirements.<sup>94</sup> Proponents of quality control requirements believe that without them, consumer confusion is inevitable, thereby leading to a negative impact on the quality of a product. Another possible outcome is the abandonment of a trademark all together as a result of a naked license.<sup>95</sup> This is a consideration that the *Sunbeam* court underestimated and the *Tempnology* court accounted for when interpreting rejection under § 365.

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decisions as there is no clear bright line as to what a licensor must do to protect his mark and avoid the risks of naked licensing).

<sup>90</sup> MCCARTHY ON TRADEMARKS, *supra* note 27, § 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.").

<sup>91</sup> *Naked License Strips Brand Owner of Name Rights*, SHULMAN ROGERS, <https://www.shulmanrogers.com/news-events/naked-license-strips-brand-owner-of-name-rights/> (last visited November 21, 2018) (explaining that at the very least a trademark owner must demonstrate some evidence, no matter how small, that he exerted some degree of actual control).

<sup>92</sup> 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).

<sup>93</sup> See *Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113, 1121 (5th Cir. 1991) (determining that the quality control supervision requirement is met when parties to the license have a close working relationship, rely on each other for consistent quality production, and "no actual decline in quality standards is demonstrated"); See also *Transgo, Inc. v. Ajac Transmission Parts Corp.*, 768 F.2d 1001, 1017--18 (9th Cir. 1985) (concluding 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 said components, and no quality complaints had been made during the licensing agreement); See also *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 received about the goods' quality during the years that the licensing agreement had been going on.).

<sup>94</sup> MCCARTHY ON TRADEMARKS, *supra* note 27, § 18:50 (discussing that quality control is part of the requirements for trademark licensing under federal trademark laws).

<sup>95</sup> See *Barcamerica International USA Trust v. Tyfield Importers Inc.*, 289 F.3d 589 (9th Cir. 2002) (the U.S. Court of Appeals for the Ninth Circuit canceled the trademark rights of a licensor of a wine trademark because the company failed to supervise a company that had licensed the trademark by the trademark owner for approval and quality control).

*B. The Sunbeam Court Underestimated the Debtor-licensors Duty to Monitor Quality Control Post-Rejection.*

Courts that follow the Seventh Circuit *Sunbeam* approach of allowing licensees to continue using a trademark post-rejection ignore the risks of naked licensing. One of the *Sunbeam* decision's major flaws was comparing the rejection of a trademark licensing agreement to that of leasehold interests in property.<sup>96</sup> Under § 365, when a landlord elects to reject a lease, the tenant retains the right of possession to the property. The landlord need only hold off until the expiration of the lease, and then he may re-lease the property to someone else. However, rejecting trademark licensors must provide sufficient quality control or risk completing abandoning his mark forever. This approach over-burdens the debtor-licensor and presents more serious consequences, including losing IP altogether.

There are, however, a few benefits available to trademark owners in jurisdictions that follow the Seventh Circuit approach. For example, trademark owners who are struggling financially, but have not yet reached the need for bankruptcy, are more likely to find business partners that will help restore their financial health. Also, when licensees have developed goodwill and trust in the mark in the minds of consumers, that confidence is not removed when the mark's bankrupt owner rejects the license. The *Sunbeam* approach allows for continued development of marks, which is not possible under the *Tempnology* approach.

*C. The First Circuit Approach in Tempnology is Less Equitable to Licensees But Better Protects Trademarks from Naked Licensing Abandonment.*

While cutting off the licensee's post-rejection ability to use a trademark prevents naked licensing, the economic harm to licensee's could be catastrophic. In many cases, licensees have used marks so extensively that they, rather than the licensor, are viewed as the manufacturer or source of the goods. A large chunk of a licensee's business could be wiped out when their usage rights are terminated, which a monetary judgment for breach of contract might not be able to remedy.

An additional pitfall to the First Circuit approach is the possibility that trademark licensees may become much less likely to enter agreements with financially unstable trademark owners. Licensees will not want to invest in implementing the marks in its own products out of fear that the trademark owner may enter bankruptcy and reject the contract. Struggling businesses who may have been able to avoid bankruptcy by licensing some of their marks will have a difficult time finding trusting licensees.

While neither the First Circuit nor the Seventh Circuit approach is perfect, it is clear that supervision of the quality of the mark is a paramount consideration under trademark law, and burdening reorganizing debtors with quality control obligations runs contrary to bankruptcy law. Of the two approaches, the *Tempnology* holding does a better job of balancing the policy interests of trademark and bankruptcy law.

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<sup>96</sup> *Sunbeam*, 686 F.3d at 377.



*D. A Common Theme Among the Split: Naked Licensing and Potential Abandonment.*

While both the *Sunbeam* and *Tempnology* courts considered the impacts of allowing a debtor-licensor to reject an IP licensing contract, the *Tempnology* court's holding serves the goals of both trademark and bankruptcy law. From an IP perspective, the *Tempnology* court foresaw the practical issues associated with a rejecting debtor-licensor being put in a position where he must supervise the licensee when he has no desire to continue the business relationship. The *Tempnology* court noted that this sort of "adversarial relationship" between the debtor-licensor and licensee would drastically increase the possibility of naked licensing.<sup>97</sup>

From a bankruptcy perspective, the policy of unencumbering a party to allow them to begin reorganization is served by allowing the debtor-licensor to free himself of unmanageable executory obligations and start afresh. While the *Tempnology* decision may result in harsh treatment to innocent licensees, bankruptcy is a reality of the business world and forcing the licensor to continue performing under an agreement with the possibility of losing his trademark all together is not exactly fair either.

Any solution to this problem will require a reconciliation of competing bankruptcy and trademark policy interests and a new approach to how IP agreements are drafted and negotiated. Trademark law has had sufficient time to develop and it is time to take action.

#### IV. PROPOSAL

The circuit split over the interpretation of the word "rejection" in Section 365 of the bankruptcy code must be resolved. As of now, trademark licensees are at the whim of their bankrupt licensors when it comes to retaining usage rights post-rejection. I propose that Congress should amend § 101(35A) of the Bankruptcy Code to include trademarks under the definition of "intellectual property," or as an alternative, Congress should amend § 365 of the Bankruptcy Code in some fashion to allow the licensee to enforce the licensing agreement if quality control provisions have been expressly stipulated by both parties and included in the agreement.

*A. Preliminary Considerations of the Judicial Avenues in Bankruptcy Proceedings*

The two proposed solutions in this Comment are shaped around an understanding of the judicial channels that an aggrieved licensee must pass through when a debtor-licensor rejects a licensing agreement. A bankruptcy court is the first judicial body that will address bankruptcy disputes and it will often interpret the Bankruptcy Code most favorably to the restructuring debtor. Bankruptcy courts will place the underlying policies of bankruptcy law, such as reorganization, above trademark policies like quality control and consumer protection.<sup>98</sup> Both proposed

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<sup>97</sup> *In re Tempnology*, 879 F.3d at 404.

<sup>98</sup> Eric Anthony Lanigan, *Important Goals and Policies of Bankruptcy*, LAWYERS.COM (May 26, 2012) <https://blogslawyers.com/attorney/bankruptcy/important-goals-and-policies-of-bankruptcy->

solutions provide a licensee recourse that cannot be bypassed by bankruptcy courts that may not be familiar with trademark law policy. By explicitly amending the Bankruptcy Code in the following two ways, trademark licenses will receive the same treatment as licensing agreements for other forms of IP.

### *B. Option 1: Amend the Bankruptcy Code*

Amending § 101(35A) to include trademarks in the definition of “intellectual property” would be the most efficient way to resolve the current circuit split. This solution has been previously proposed in the form of the Innovation Act (“IA”).<sup>99</sup> In addition to including trademarks in the definition of IP, the IA proposes shifting quality control supervision over the mark to the licensee.<sup>100</sup> Unfortunately, the IA has not been able to gain much legislative traction yet as it also proposes numerous revisions to patent laws that have received pushback.<sup>101</sup>

Legislation such as the IA would resolve many of the inequities that currently exist for licensees while also eliminating the risk for naked licensing. Section 365(n) currently provides a debtor-licensor too much leverage when it enters bankruptcy. The licensor has the ability to take advantage of his bankrupt status by threatening to terminate a licensing agreement altogether unless the licensee agrees to renegotiate and accept lopsided terms. Allowing debtor-licensors this unilateral bargaining power does not serve the goals of bankruptcy or trademark law and fosters faulty business relationships. Under the current law, bankruptcy can be used as a bargaining chip to put a debtor-licensor in a more fortuitous position than they were in before entering bankruptcy and result in a windfall for the licensor. A fear of renegotiation is one only trademark licensees bear and it is not conducive to mutually beneficial business relationships.

Rejection is a major factor licensees must consider when deciding whether or not they want to do business with a company. As previously stated, businesses will often build large inventories of products bearing trademarks, and when they no longer have the ability to use them, the financial effects could be catastrophic.<sup>102</sup> The

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21014/ (describing the policies of bankruptcy law as primarily remedial such as preservation of businesses and estates, the debtor’s fresh start, and the protection of the debtor’s interests).

<sup>99</sup> The Innovation Act, H.R. 9, 114th Cong., § 6(e) (2015); PATENT Act, S. 1135, 114th Cong. 11(b) (2015).

<sup>100</sup> The Innovation Act, H.R. 9, 114th Cong., § 6(e) (2015).

<sup>101</sup> See Bob Eisenbach, *Innovation Act, Passed By The House, Would Make Major Changes To Section 365(n)’s IP Licensee Protections*, IN THE RED BUSINESS BANKRUPTCY BLOG, (December 13, 2017), <https://bankruptcy.cooley.com/2013/12/articles/business-bankruptcyissues/innovation-act-passed-by-the-house-would-make-major-changes-to-section-365ns-ip-licensee-protections/> (describing the proposed changes that the Innovation Act would make to § 101(35A) and § 365 Bankruptcy Code, and patent law); Bob Eisenbach, *Patent Reform Bill, And Its Revisions To Bankruptcy Code Section 365(n), Stalls In The Senate*, IN THE RED BUSINESS BANKRUPTCY BLOG, (May 22, 2014) <https://bankruptcy.cooley.com/2014/05/articles/business-bankruptcy-issues/patent-reform-bill-and-its-revisions-to-bankruptcy-code-section-365n-stall-in-the-senate/> (expressing that the Innovation Act has encountered legislative roadblocks, as in addition to amending the Bankruptcy Code, there are also many proposed changes to patent law).

<sup>102</sup> *Sunbeam Prods., Inc. v. Chicago Am. Manuf., LLC*, 686 F.3d 372 (7th Cir. 2012). In *Sunbeam*, a trademark licensee amassed large numbers of box fans bearing the licensor’s

licensee may have spent a great deal of time and resources to establish goodwill with the mark through advertising and marketing campaign, maintaining the quality of the mark, and even establishing agreements with other businesses under the impression that the licensee would be able to continue using the mark into the foreseeable future. By amending the Bankruptcy Code to include trademarks in the definition of IP and better defining rejection, licensees will not be left reeling when the rug is pulled out from beneath them by the licensor rejecting the agreement. Congress thought that trademarks were not ready to be included in the Bankruptcy Code when it was enacted because it was skeptical that debtor-licensors would be able to continue monitoring the quality control of the mark while restructuring. However, this is no longer an issue as time has shown that parties regularly negotiate quality control terms and the licensees are incentivized to maintain high quality products.

*C. Option 2: Amend the Bankruptcy Code to Allow Enforcement of Negotiated Quality Control Provisions*

The next best option is to amend the Bankruptcy Code to reflect the way quality control is actually conducted in practice by allowing enforcement of negotiated quality control mechanisms. Quality control monitoring may be conducted in a variety of ways. One of the simplest examples is an arrangement where the licensor delegates the quality control duties to the licensee at the outset of the agreement. While it is true trademark licensing agreements usually include quality control provisions for the licensor in order to avoid forfeiture under a “naked license,”<sup>103</sup> more often than not the licensor merely sets forth a quality control standard that the licensee must adhere to.<sup>104</sup> Under this type of agreement, the licensor is not hovering over the licensee to make sure that the quality standard is being met.<sup>105</sup> This makes

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trademarks under the presumption they would retain usage rights in the future for the duration of the contract. *Id.*

<sup>103</sup> *Barcamerica Int'l USA Trust v. Tyfield Imps., Inc.*, 289 F.3d 589, 595 (9th Cir. 2002) (“Naked licensing may result in the trademark ceasing to function as a symbol of quality and controlled source.”); *Stanfield v. Osborne Indus., Inc.*, 52 F.3d 867, 871 (10th Cir. 1995) (“Naked (or uncontrolled) licensing of a mark occurs when a licensor allows a licensee to use the mark on any quality or type of goods the licensee chooses.”).

<sup>104</sup> Monique L. Ribando & Michael S. Pavento, *Quality Control In Trademark Licensing*, CCB Journal, (Aug. 1, 2007), <http://ccbjournal.com/articles/8654/quality-control-trademark-licensing>. Quality assurance is often included in trademark licensing agreements. The licensee will acknowledge that if the product is designed, manufactured, and sold by it were inferior in quality, design, or material to the licensor’s product or services, then the licensor’s goodwill will be negatively impacted. Further, by executing the trademark licensing agreement, the licensee is representing that its products bearing the mark will be of a high quality and that consumers can expect to receive that same quality every time. *Id.*

<sup>105</sup> Brett Heavner, Sergey Medvedev, Christian Thomas, Theodore Sum, & Timothy O Stevenson, *Licensing Best Practice*, WORLD TRADEMARK REVIEW BLOG, (Sept. 1, 2017), <https://www.worldtrademarkreview.com/brand-management/licensing-best-practice>. (explaining that in practice, many times the licensor will merely reserve the right to inspect the licensee’s facility during the term of the agreement. This is often referred to as “Inspection Rights.” A typical provision may state the following: “Throughout the term of licensing agreements, a licensor and its designated representatives shall have the right, and the licensee shall ensure such right, at any

the most sense as the licensee has the best understanding of its own business model and has the incentive to maintain the quality control for its customers.<sup>106</sup> When a licensee has built so much of its business around establishing the goodwill around a trademark, it is not likely that it will ruin that goodwill by putting out products of lower quality under the mark.<sup>107</sup> While a debtor-licensor is occupied during the restructuring process, the licensor has the same incentives to maintain the quality of its product and continue providing customers the goods that they expect.

Further, concerns of quality control in trademark licenses are similar to concerns of confidentiality in trade secret licenses which were raised by opposers to the IPBPA's legislative predecessor.<sup>108</sup> Concerns of confidentiality arose from a fear that allowing the licensee to continue using trade secrets following rejection would effectively compromise the confidentiality of trade secrets.<sup>109</sup> However, these concerns were quelled when the confidentiality concern was addressed in practice because licensees that obtain trade secrets have an interest in protecting confidentiality.<sup>110</sup> Moreover, both the debtor-licensor and licensee have the ability to seek a court order of confidentiality protection under bankruptcy law.<sup>111</sup>

This requirement should only be enforced when the licensee wants to continue using the trademark for the duration of the agreement when the licensor has elected

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time during ordinary business hours to inspect any factory, warehouse, showroom, business office, retail store, or other facility or premises used or occupied by the licensee, or sale of licensed products or associated labels or packaging, to inspect and test licensed Products, and to take any other action necessary or useful, in Licensor's opinion in its sole discretion, to assure that the Licensed Products are produced and sold in compliance with this Agreement.”).

<sup>106</sup> Jeffrey Pietsch, *Naked Licensing: Trademark Owners Beware*, LEXOLOGY, (Nov. 7, 2011), <https://www.lexology.com/library/detail.aspx?g=71c98330-9133-4fe3-b037-63bf5f329c50>. The possibility of forfeiting a trademark under the doctrine of “naked licensing” may be avoided by allowing the licensor to delegate to the licensee the role of maintaining quality control. The trend of lessening the licensor's duty of quality control may indicate that the licensor does not want to increase its potential liability and push the duty licensee. Theoretically, too much quality control would lead to potentially bad results such as the licensee being unable to implement quality control measures that it knows are needed. Contemporary case law is fairly generous toward trademark license agreements, and naked licenses are rarely an issue even where the licensee has been delegated the duty of monitoring trademark quality. *Id.*

<sup>107</sup> *What Happens To A Trademark License When The Licensor Is In Bankruptcy*, STARTUP BLOG, <http://www.startupblog.com/blog/what-happens-to-a-trademark-licensee-when-the-licensee-is-in-bankruptcy> (last visited November 11, 2018).

<sup>108</sup> Intellectual Property Contracts in Bankruptcy: Hearing on H.R. 4657 Before the Subcomm. on Monopolies and Commercial Law, 100th Cong. 10 (1988) [hereinafter, “Hearings”]. The legislative history of the IPBPA indicates that Congress became concerned about the treatment of intellectual property licenses under bankruptcy law primarily because of *Lubrizol* and the awareness that the “high technology industry...is...so vital to our nation's economy.” (statement of Rep. Peter W. Rodino, Jr. Chairman, Subcomm. on Monopolies and Commercial Law). Similarly, Representative Don Edwards, who introduced H.R. 4657, had similar concerns about technology licenses, noting that he introduced this bill last month because of his concerns about the need for continued licensing of intellectual property rights and about the impairment on the free flow of intellectual property created under the bankruptcy code by recent court precedent. Rep. Don Edwards also noted that the technological revolution that the United States has undergone since the passing of the Bankruptcy Conduct warrants an update to the statute. *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

to reject the agreement during bankruptcy proceedings.<sup>112</sup> By amending the Bankruptcy Code in this manner, quality control standards will be maintained under the licensing agreement and trademark policies will be furthered by ensuring consumers will receive the quality of services or products they expect.<sup>113</sup>

## V. CONCLUSION

Ultimately, it is time for the Bankruptcy Code to be amended to include trademarks in the definition of intellectual property or to allow quality control standards to be shifted to licensees. The current divergence in case law will not change until either the Supreme Court or Congress directly addresses the issue.<sup>114</sup> Quality control concerns with assumed licensing agreements can be resolved the same way Congress addressed confidentiality concerns with trade secrets by simply amending the IPBPA the confidentiality provision for trade secrets. Section 365 should be explicitly amended in order to allow licensees to enforce the quality control standards stipulated by both parties during preliminary negotiations. The current exclusion of trademarks does no good for the debtor, the consumer, nor unsecured creditors. Therefore, it is time to solve the quality control issues in trademark licensing agreements by amending the Bankruptcy Code.

## VI. POST-SCRIPT

On May 20, 2019, the United States Supreme Court decided *Mission Product Holdings, Inc. v. Tempnology, LLC*.<sup>115</sup> In its 8-1 decision authored by Justice Kagan, the Court held that agreements which are rejected by a debtor in bankruptcy will not be deemed terminated.<sup>116</sup> Instead, the trademark licensees retain the usage rights that they would have under non-bankruptcy law following the debtor's breach of the agreement.<sup>117</sup> While the focus of this case was trademark licenses, the Court

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<sup>112</sup> *Barcamerica International USA Trust v. Tyfield Imports, Inc.*, 289 F.3d 589-598 (9th Cir. 2002). In *Barcamerica*, the plaintiff licensee entered into trademark license agreements with Renaissance Vineyards ("Renaissance") to produce wines under the trademark "DA VINCI." In this case, Barcamerica never actually "had any involvement whatsoever regarding the quality of the wine and maintaining it at any level." *Id.*

<sup>113</sup> See *Trade Secret Licensing Agreements: Everything You Need to Know*, UPCOUNSEL, <https://www.upcounsel.com/trade-secret-license-agreements> (last visited Nov. 12, 2018) (expressing that the confidentiality provision of trade secrets in the Bankruptcy Code has long been addressed in section 107(b)(2)).

<sup>114</sup> See Hearings, *supra* note 108. Unlike the trade secret confidentiality provision which has already been addressed in the Bankruptcy Code, implementing a provision on the licensee's continued ability to monitor quality control will not be redundant and will resolve the confusion causing the current circuit split. *Id.*

<sup>115</sup> Since this Comment has been written, the Supreme Court has granted a writ of certiorari in the First Circuit decision in *Tempnology, Mission Prod. Holdings, Inc. v. Tempnology, LLC*, No. 16-9016, 2018 U.S. App. LEXIS 870 (1st Cir. 2018), petition for cert. granted (Oct. 26, 2018) (No.17-1657).

<sup>116</sup> *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 U.S. 1652 (2019).

<sup>117</sup> *Id.* at 1661.

<sup>118</sup> *Id.*

emphasized that its ruling applies broadly to all varieties of agreements rejected under § 365 of the Code. Now that non-debtor parties will retain post rejection rights, debtor must be cognizant of how rejection will impact their reorganization goals. As such, the Court reversed the First Circuit's decision and remanded the case to the bankruptcy court.<sup>118</sup>

In its analysis, the court recognized that the Code was a byproduct of legislative enactments which occurred over a span of half a century and was a result of a “mash-up of legislative intervention” which have led to confusion.<sup>119</sup> The court further made clear that, while § 365(n) applied to certain intellectual property licenses, it does not apply to trademark licenses. Therefore, the fact that Congress left trademark licensees out of the protection of 365(n) means that trademark licensees may even be better off following rejection, as they are not bound to fit within the terms of 365(n).

While this case has answered whether a rejection should be treated as a termination or rescission, many questions may still arise going forward. Justice Sotomayor noted in her concurrence that it will now be necessary to conduct an analysis of non-bankruptcy law to determine the scope of the non-debtor party's post-rejection rights.<sup>120</sup> Additionally, although the concept of rejection is no longer as powerful as it was interpreted by some lower courts to be, creative debtors very well could begin using other bankruptcy tools to their benefit to avoid post-rejection obligations.

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<sup>118</sup> *Id.* at 1666.

<sup>119</sup> *Id.* at 1664.

<sup>120</sup> *Id.* at 1666-1667.