THE GREAT BANKRUPT DIVIDE: AMENDING THE RIGHTS OF TRADEMARK LICENSEES UNDER THE CODE

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I. INTRODUCTION

In nearly twenty-five years since Congress passed the Intellectual Property Bankruptcy Protection Act of 1988 (IPBPA),[1] a split has arisen among the federal circuit courts concerning whether a licensee has a right to use a licensed trademark after its intellectual property license is rejected in bankruptcy.[2] In *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*,[3] the Fourth Circuit held that rejection strips the licensee of all trademark rights under an intellectual property licensing agreement, leaving the licensee with only a money damages remedy.[4] In *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*,[5] the Seventh Circuit held that rejection neither operates as a rescission nor affects a licensee's rights under a trademark licensing agreement.[6] The court concluded that the bankruptcy trustee's rejection of an executory licensing agreement does not abrogate the licensee's contractual privileges, allowing the licensee to continue exercising its bargained-for trademark rights.[7]

This Note argues that courts addressing § 365(n) of the Bankruptcy Code (Code) in the future should follow the Fourth Circuit's holding in *Lubrizol* because the court applied the law accurately in that case. However, since trademark licensing agreements frequently address rights that, if stripped, could lead to the adverse effects that Congress sought to redress under the

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[1] Pub. L. No. 100-506, 102 Stat. 2538 (1988) (codified as amended at 11 U.S.C. § 365(n) (2006)).

[2] *Compare* Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 377–78 (7th Cir. 2012) (finding that rejection of a trademark license in bankruptcy does not end a licensee's right to use the licensed mark), *with* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1044 (4th Cir. 1985) (holding that when an intellectual property license is rejected in bankruptcy, the licensee loses the right to use the licensed copyright, trademark, or patent).

[3] 756 F.2d 1043 (4th Cir. 1985).

[4] *Id.* at 1048 (finding that an order of specific performance would sidestep the purpose of rejection under the Code).

[5] 686 F.3d 372 (7th Cir. 2012).

[6] *Id.* at 377–78 (finding that rejection does not affect the contract's continued existence, thus allowing the licensee to continue exercising its contractual rights).

[7] *Id.* at 378.

IPBPA,[8] this Note argues that, in most cases, trademark licensees should have the right to continue using their licensed trademarks after their intellectual property licensing agreements are rejected in bankruptcy. If they are stripped of this right, trademark licensees may be left with nothing more than the option to file a claim under § 365(g) for damages resulting from a rejected licensing agreement.[9] For this reason, Congress should revise § 365(n) so as to ordinarily allow trademark licensees to continue using their licensed trademarks if their licensing agreements are rejected in bankruptcy.

To be sure, "[a] license to use a trademark is a contract."[10] If breached, a trademark license may be the subject of litigation in state or federal court.[11] Notwithstanding an action for trademark infringement,[12] state law determines the remedy for a claim of breach of contract,[13] and the nonbreaching party may be entitled to monetary damages or equitable relief. This means that, outside

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[8] S. REP. NO. 100-505, at 3 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3202 ("Licensing of technology, which the bill is intended to protect and to facilitate, plays a substantial role in the process of technological development and innovation.").

[9] *See, e.g.*, Raima UK Ltd. v. Centura Software Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 674–75 (Bankr. N.D. Cal. 2002) ("Because § 365(n) plainly excludes trademarks, the court holds that [the licensee] is not entitled to retain any rights in [the licensor's trademarks] under the rejected [trademark licensing agreement]. As a result of the rejection, [the licensee's] remedy was to file a claim under § 365(g) for its damages resulting from the breach.").

[10] Geneva Int'l Corp. v. Petrof, Spol, S.R.O., 608 F. Supp. 2d 993, 998 (N.D. Ill. 2009).

[11] Pursuant to 28 U.S.C. § 1334(b), the United States Code grants bankruptcy jurisdiction to Article III federal courts. 28 U.S.C. § 1334(b) (2006) ("[T]he district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 . . . .").

[12] In federal court, plaintiffs are entitled to monetary or equitable relief under the Lanham Act. 15 U.S.C. § 1114 (2006). Although the Lanham Act does not impose liability for breach of contract, it imposes liability for trademark infringement and provides remedies for registrants whose marks are reproduced, copied, or imitated "in connection with the sale, offering for sale, distribution, or advertising of any goods or services" without consent of the registrant. 15 U.S.C. § 1114(1)(a) (2006). The Lanham Act remedy scheme provides plaintiffs with legal or equitable relief. *See, e.g.*, Masters v. UHS of Del., Inc., 631 F.3d 464, 471 (8th Cir. 2011) ("We have acknowledged that all Lanham Act remedies are equitable in nature and that there might be some situations in which a Lanham Act plaintiff would be entitled to monetary but not injunctive relief." (quoting Minn. Pet Breeders, Inc. v. Schell & Kampeter, Inc., 41 F.3d 1242, 1247 (8th Cir. 1994) (internal quotation marks omitted))).

[13] *See* Twentieth Century Fox Film Corp. v. Marvel Enters., Inc., 155 F. Supp. 2d 1, 13 (S.D.N.Y. 2001) (applying California law in suit involving breach of trademark license), *aff'd in part*, 277 F.3d 253 (2d Cir. 2002).

of bankruptcy, a trademark licensor cannot reclaim trademark rights once they are bargained away.[14]

However, Congress created a device in § 365(a) that permits the trustee—or debtor-in-possession[15]—to assume or reject any executory contract, subject to certain conditions.[16] Courts have interpreted § 365(a) to authorize a trustee to exercise its business judgment in determining which contracts should be assumed or rejected in order to maximize the value of the estate,[17] unless Congress provides an express limitation otherwise.[18]

In 1988, Congress provided such a limitation by enacting § 365(n) under the Code.[19] Section 365(n) concerns the right of the bankruptcy trustee to reject certain types of executory intellectual property licensing agreements where the debtor is the licensor of the intellectual property.[20] At first blush, § 365(n) appears to protect licensees of any form of intellectual property. Yet, the

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[14] *See Sunbeam*, 686 F.3d at 376 ("Outside of bankruptcy, a licensor's breach does not terminate a licensee's right to use intellectual property.").

[15] With regard to the issues discussed in this Note, the trustee and debtor-in-possession are equivalents. In liquidation bankruptcies, the trustee is appointed on behalf of the outstanding claimants to collect and distribute the property of the debtor's estate. ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 141 (6th ed. 2009). In reorganizations, the debtor remains in possession and represents the estate. *Id.* at 396.

[16] *See* 11 U.S.C. § 365(a) (2006). For a discussion of the limits Congress placed on the trustee or debtor-in-possession, see *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984). There, the Court explained:

> Although Congress granted the debtor-in-possession a broad power to assume or reject executory contracts, it qualified that power in certain situations. Very generally, subsections (b) and (c) [of § 365] limit the debtor-in-possession's or trustee's power of assumption in several circumstances; subsection (d) requires assumption or rejection within 60 days in cases of liquidation.

NLRB v. Bildisco & Bildisco, 465 U.S. 513, 522 n.7 (1984).

[17] *See Bildisco*, 465 U.S. at 523 (explaining that courts apply a business judgment standard in determining whether to authorize rejection of an executory contract); *see also* Grp. of Institutional Investors v. Chi., Milwaukee, St. Paul & Pac. R.R. Co., 318 U.S. 523, 550 (1943) (explaining that the decision to reject or assume a lease under § 365(a) is one of business judgment).

[18] *See Bildisco*, 465 U.S. at 522–23 (asserting that § 365(a) applies to any executory contract unless Congress expressly indicates otherwise).

[19] Pub. L. No. 100-506, 102 Stat. 2538 (1998) (codified as amended at 11 U.S.C. § 365(n) (2006)).

[20] *Id.* § 365(n)(1)(B) ("If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—(B) to retain its rights . . . as such rights existed immediately before the case commenced, for—(i) the duration of such contract . . . .").

Code defines intellectual property as trade secrets, patents, plant varieties, copyrights, and mask works; it does not include trademarks.[21] Some courts have interpreted this omission as Congress's unambiguous intent to exclude trademark licenses from § 365(n).[22] Consequently, in some jurisdictions, if the trustee chooses to reject an executory trademark license, the licensee forfeits all rights bargained for under that contract.[23] As a result, some trademark licensees are destined to stand by in pain,[24] unless Congress amends § 365(n) to protect the rights of trademark licensees. Until such time, courts will be forced to side with the Fourth or Seventh Circuit, leaving trademark licensees uncertain as to the stability of their licensing agreements in the event of rejection under the Code.[25]

This Note argues that trademark licensing plays a fundamental role in technological development,[26] that the benefits of trademark licensing coincide with the goals that Congress sought to achieve

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[21] 11 U.S.C. § 101(35A) (2006).

[22] *See, e.g.*, Raima UK Ltd. v. Centura Software Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 670 (Bankr. N.D. Cal. 2002) ("Congress has unambiguously indicated that trademark licenses are to be excluded from § 365(n) . . . .").

[23] *See id.* (reasoning that the unambiguous omission of trademark licenses from the definition of intellectual property under the Code demonstrates that Congress intended to exclude trademark licenses from § 365(n) protection). *Contra* Sunbeam Products, Inc. v. Chi. American Mfg., LLC, 686 F.3d 372, 375 (7th Cir. 2012) ("[Section] 365(n) does not affect trademarks one way or the other.").

[24] For example, in *In re Exide Technologies*, 607 F.3d 957, 960 (3d Cir. 2010), the licensee invested nearly $135 million in the debtor's trademark, additional manufacturing plants, equipment, and inventory for use in the industrial battery business. For almost ten years, the licensee operated under the parties' exclusive trademark license agreement and sold batteries under the name "Exide." *In re Exide Technologies*, 607 F.3d 957, 961. After expanding its business in reliance on the parties' agreement, the licensee lost its right to use the "Exide" mark when the bankruptcy court granted the Chapter 11 debtor's motion to reject the parties' licensing agreement. 340 B.R. 222 (Bankr. D. Del. 2006), *aff'd*, 2008 WL 822516 (D. Del. Feb. 27, 2008), *vacated* 607 F.3d at 964 (finding that the licensing agreement was not executory and therefore not subject to rejection).

[25] Negative implications can arise from unsettled questions of law. Perhaps for this reason, the United States Supreme Court is guided by Supreme Court Rule 10 to consider the resolution of a split of authority among the federal appellate courts and the resolution of unsettled questions of federal law as compelling reasons for granting a writ of certiorari. SUP. CT. R. 10.

[26] *See* S. REP. NO. 100-505, at 3 ("Licensing of technology, which the bill is intended to protect and to facilitate, plays a substantial role in the process of technological development and innovation.").

by adopting § 365(n),[27] and that the risk that a licensor will not exercise quality control is insufficient to exclude trademarks under the statute.[28] Accordingly, Congress should amend § 365(n) to clarify that trademark licensees are intended beneficiaries of the Code's protections.

This Note proceeds in three parts. Part II first describes the primary similarities and differences of trademark, patent, and copyright law. Part II then discusses the goals of bankruptcy law generally and § 365(n) of the Code specifically. Part II also discusses *Lubrizol* and *Sunbeam*, the opposing decisions that divide the circuits over the issue presented. Part III first poses a hypothetical to consider alternative analyses under § 365(n). Next, Part III proposes an amendment to § 365(n), which provides trademark licensees with some limited protection. Finally, Part IV suggests that courts will almost always defer to the trustee's business judgment under § 365(a) to determine "whether the contract should be rejected."[29] For this reason, Congress should revise § 365(n) to protect the right of trademark licensees to continue using their licensed trademarks in the event their intellectual property licensing agreements are rejected in bankruptcy.

II. BACKGROUND

The Code's primary purpose is to operate as a debt-collection device[30]—an instrument that exists to further the expansion of the

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[27] *See id.* (noting that the amendment to § 365 was intended to foster technological development and the economic rewards of licensing).

[28] *See* Xuan-Thao N. Nguyen, *Bankrupting Trademarks*, 37 U.C. DAVIS L. REV. 1267, 1300 (noting that successful modern quality control practices should eradicate quality control as the primary reason for excluding trademarks from the protection of § 365(n)).

[29] GEORGE M. TREISTER ET AL., FUNDAMENTALS OF BANKRUPTCY LAW 291 (4th ed. 1996); *see also* Lubrizol Enters. v. Richmond Metal Finishers, 756 F.2d 1043, 1047 (4th Cir. 1985) ("[A] bankrupt's decision to reject an executory contract because of perceived business advantage requires that the decision be accepted by courts unless it is shown that the bankrupt's decision was one taken in bad faith or in gross abuse of the bankrupt's retained business discretion.").

[30] *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 7 (1986) ("This debate [about bankruptcy law and policy] is not so much about whether bankruptcy law should exist at all but about how much it should do. All agree that it serves as a collective debt service.").

debtor's estate for the benefit of creditors.[31] However, by enacting § 365(n), Congress betrayed the Code's objective by protecting the interests of certain intellectual property licensees over those of secured creditors.[32] Because licensing "plays a substantial role in the process of technological development and innovation," Congress determined that the Code should not disrupt certain intellectual property licensing rights.[33] At the same time, it acknowledged that trademark-licensing relationships depend on quality control[34]—a requirement aimed to protect the public from deception resulting from unmonitored trademarks.[35] This threat necessarily requires differentiation among the various intellectual property regimes under the Code and perhaps illuminates why the circuits are split on the effect of a debtor's rejection of an executory trademark license.

A. TRADEMARK, PATENT, AND COPYRIGHT

Courts and scholars generally consider trademarks, patents, and copyrights as forms of "intellectual property."[36] However, there are fundamental differences in the laws regarding them.[37] Specifically, licensed trademarks require greater attention from their licensors than do copyrights or patents. That is, licensors of trademarks must exercise quality control—the inspection and

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[31] Note, *Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act*, 117 HARV. L. REV. 2296, 2298 (2004) ("[T]he expansion of the [debtor's] estate [is] the central focus of the Code.").

[32] According to some scholars, a licensee under a rejected intellectual property license not explicitly provided for in § 365(n) is left with a general unsecured claim against the debtor's bankruptcy estate. *See, e.g.*, Stuart M. Riback, *Trademark Issues in Bankruptcy*, 93 TRADEMARK REP. 867, 870 (2003) (explaining that rejection of a trademark license is deemed to be a pre-petition breach by the debtor and only gives rise to a pre-petition claim for damages under §§ 365(g) and 502(g)). Section 365(g) determines "the priority of the non-debtor's claim" while "the breach claim is treated as a pre-petition unsecured claim." *In re* Lavigne, 114 F.3d 379, 389 (2d Cir. 1997).

[33] S. REP. NO. 100-505, at 3 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3202.

[34] *Id.* at 5 ("[T]rademark, 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.").

[35] 3 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:55 (4th ed. 2013) ("[T]he goal of [quality control] is to prevent customer deception . . . .").

[36] *Id.* § 6.4.

[37] *Id.*

evaluation of the goods and services sold by licensees under the licensed mark[38]—in order to protect the consuming public.[39]

1. Trademark. In 1946, Congress passed the Lanham Act to protect trademark licensees.[40] The Act was intended to encourage consumer protection, preserve property rights, and promote economic efficiency.[41] Accordingly, under the Lanham Act, rights in a registered trademark are designed to last indefinitely.[42]

A trademark is a word, phrase, logo, symbol, or device,[43] which is used to indicate the quality of a product or service to its source.[44] That is, trademarks signify the quality of a particular product or service and distinguish products on the market.[45] They aid consumers in purchasing goods of a certain known quality, which in turn reduces the consumer's search costs.[46] To that end,

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[38] *See id.* § 18:42 (discussing the function and importance of quality control by the trademark owner).

[39] *See id.* § 18:40 ("[T]he consumer assumes that products sold under the same trademark will be of equal quality regardless of the actual physical source or producer of the goods.").

[40] Lanham Act, Pub. L. No. 79-489, 60 Stat. 427 (1946) (codified as amended at 15 U.S.C. §§ 1051–1072 (2006)). Congress's authority to regulate trademarks derives from the Commerce Clause of the United States Constitution, "which permits federal legislation to regulate commerce with foreign nations, and among the several states, and with the Indian Tribes." 4 CHARLES MCMANIS ET AL., WEST'S FEDERAL ADMINISTRATIVE PRACTICE § 4057 (3d ed. 1999) (quoting U.S. CONST. art. 1, § 8, cl. 3) (internal quotation marks omitted).

[41] *See* Nguyen, *supra* note 28, at 1273 n.24 (citing William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 269–70 (1987)) (explaining that the Lanham Act was passed to encourage production of high-quality products and reduce consumer search costs); *see also* 3 MCCARTHY, *supra* note 35, § 2:1 (explaining that the sister goals of trademark law are to protect consumers from deception and to protect property in a trademark).

[42] 15 U.S.C. § 1059(a) (2006) ("[E]ach registration may be renewed for periods of 10 years at the end of each successive 10-year period following the date of registration . . . ."). At common law, the trademark continued to exist so long as the mark was properly used. 3 MCCARTHY, *supra* note 35, § 6:6. An indefinite lifetime distinguishes trademarks from patents and copyrights. *Id.* Under the Copyright Term Extension Act, which was enacted in 1998, Congress extended the duration of copyrights from creation until seventy years after the author's death. PUB. L. NO. 105–298(b), 112 Stat. 2827 (1988) (current version at 17 U.S.C. 302(a) (2006)). Moreover, a grant for a patent ends twenty years from the date on which the patent application was filed. 35 U.S.C. § 154(a)(2) (2006).

[43] *See* 15 U.S.C. § 1127 (2006) ("The term 'trademark' includes any word, name, symbol, or device, or any combination thereof . . . .").

[44] *See* 3 MCCARTHY, *supra* note 35, § 3:10 (explaining that the quality of a good could not be traced to its source without trademarks).

[45] *Id.*

[46] *See id.* § 2:5 ("[T]rademarks reduce the customer's cost of acquiring information about products and services."); *see also* A. ALCHIAN & W.R. ALLEN, EXCHANGE AND PRODUCTION:

trademarks incentivize the production of quality goods by offering producers a means to preserve the reputation associated with their mark.[47] If a producer's reputation for producing quality goods is solidified in this way, it is likely to reap significant financial gain.[48]

2. Patent. Distinct from trademarks, patents protect new inventions[49] that offer non-obvious improvements of already-existing science or art.[50] There are two types of patents: (1) functional patents; and (2) design patents. A functional patent protects operative inventions and grants the patentee the exclusive right to create, use, and sell those devices that embody the claimed invention.[51] A design patent, in contrast, protects "only non-functional, ornamental features and configurations."[52] Primarily, patent law is designed to encourage the creation of new technology and the arts.[53] Because patents are intended to

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COMPETITION, COORDINATION, AND CONTROL 193 (2d ed. 1977) (explaining that brand names reduce a consumer's search costs).

[47] *See* 3 MCCARTHY, *supra* note 35, § 2:4 ("[T]rademarks create an incentive to keep up a good reputation for a predictable quality of goods.").

[48] *See, e.g.*, Nguyen, *supra* note 28, at 1274 (citing Brendan Mahaffey-Dowd, *Famous Trademarks: Ordinary Inquiry by the Courts of Marks Entitled to an Extraordinary Remedy*, 64 BROOK. L. REV. 423, 425 n.17 (1998)) ("[I]t is estimated that the Marlboro mark is worth $44.6 billion, the Coca-Cola mark over $43 billion, and the McDonald's mark nearly $19 billion.").

[49] *See* 35 U.S.C. § 102(a) (2006) ("A person shall be entitled to a patent unless—(a) the invention was known or used by others . . . or patented or described in a printed publication . . . before the invention thereof by the applicant for patent . . . ."); *see also* Bilski v. Kappos, 130 S. Ct. 3218, 3221 (2010) (internal quotation marks omitted) ("[A] patentable process must be new and useful.").

[50] *See* 35 U.S.C. § 103(a) (2006) ("A patent may not be obtained . . . if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains.").

[51] 3 MCCARTHY, *supra* note 35, § 6:8 (explaining that functional patents provide the patentee with the exclusive right to make, use, and sell devices which embody the claimed invention).

[52] *Id.* § 6:11.

[53] Quanta Computer, Inc. v. LG Elecs., Inc., 553 U.S. 617, 626 (2008) ("[T]he primary purpose of our patent laws is not the creation of private fortunes for the owners of patents but is to promote the progress of science and useful arts." (quoting Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502, 511 (1917) (internal quotation marks omitted))).

support and stimulate competition, patents, unlike trademarks, have a limited lifetime.[54]

3. Copyright. Copyrights, like patents, have a limited life.[55] Their purpose is to protect the "expression of an idea—not the idea itself."[56] Underlying copyright law is the recognition that original literary or artistic works confer a lasting benefit on society.[57] For this reason, copyrights, unlike trademarks, afford "no exclusive right to the art disclosed."[58]

B. TRADEMARK LICENSING AND QUALITY CONTROL

A trademark license grants an exclusive[59] or non-exclusive[60] licensee the right to use a mark in connection with specific goods or services in commerce.[61] That use may be limited to a specific period of time and geographic territory.[62] For example, the owner of Coffee Shop A may wish to enter into a franchise contract—which may be characterized as a trademark license with attendant duties[63]—in order to expand his business without the expense of operating that business.[64] Under a non-exclusive franchising

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[54] *See* Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225, 231 (1964) (discussing the effects of extending the life of a patent beyond its expiration).

[55] S. REP. NO. 100-505, at 12 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3209–10.

[56] Mazer v. Stein, 347 U.S. 201, 217 (1954).

[57] *See id.* at 219 (explaining the constitutional theory of copyrights and their role in advancing public welfare).

[58] *Id.* at 217; *see also* Emergency One, Inc. v. Am. Fire Eagle Engine Co., 332 F.3d 264, 267 (4th Cir. 2003) ("[T]rademark ownership confers an exclusive right to use the mark."). This exclusive right is limited, however, to continued use. *See supra* note 42 and accompanying text.

[59] "An exclusive licensee may have a [sic] standing to sue under trademark law." Nguyen, *supra* note 28, at 1275 n.36 (citing Ultrapure Sys., Inc. v. Ham-Let Group, 921 F. Supp. 659 (N.D. Cal. 1995). In addition, "[t]rademark law permits exclusive licensees to register the licensed trademarks. The registration of the trademark must be in the name of the trademark owner and all uses of the registered trademark by the licensee inures exclusively to the benefits of the trademark owner." *Id.* (citations omitted) (citing 15 U.S.C. § 1056, 1052, 1127 (2006)).

[60] "Both exclusive and non-exclusive licensees have 'standing to assert a claim of unfair competition under Section 43(a) of the Lanham Act . . . .' " *Id.* (quoting 15 U.S.C. § 1125(a)).

[61] 15 U.S.C. § 1125(a)(1).

[62] Nguyen, *supra* note 28, at 1275.

[63] *See* 3 MCCARTHY, *supra* note 35, § 18:65 ("Many franchise contracts can be legally characterized as a skeleton of a trademark license fleshed out with many duties and restrictions imposed upon the franchisee.").

[64] *Id.*

agreement, a licensee-franchisee situated in the United States or abroad would have the right to sell coffee under Coffee Shop A's brand name for a limited period of time.[65] Not only is the right extremely valuable to a licensee-franchisee,[66] but it also allows the trademark owner to profit from royalty fees and enhance the mark's goodwill as a result of the licensee's use of the mark.[67]

Today, courts permit trademark licensing so long as the quality of goods and services sold under the mark are adequately controlled.[68] Courts require quality control primarily to ensure that consumers are not deceived.[69] If the quality of a product suffers, the consumer's expectations of a specific product will rightly decrease.[70] Yet, courts have relaxed quality control requirements in recent years,[71] perhaps in light of the beneficial effects of modern trademark licensing on trademark owners and society.[72]

The standard of quality control required for licensing is inconsistent across jurisdictions.[73] Some courts require nothing more than a contractual stipulation,[74] while other courts have found that a licensor may reasonably rely on the licensee's own

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[65] *See, e.g.*, Annie Gasparro, *Starbucks to Open First Store in Vietnam*, WALL ST. J., Jan. 2, 2013, *available at* http://online.wsj.com/article/SB10001424127887323374504578218111829498652.html (describing the effects of Starbucks, a Seattle-based coffee company, expanding into the Asia Pacific region).

[66] *See* 3 MCCARTHY, *supra* note 35, § 18:65 ("This right to do business under a well known brand name is usually the single most valuable asset acquired by a franchisee with his franchise.").

[67] *See* Nguyen, *supra* note 28, at 1276–77 (describing the benefits of licensing trademarks).

[68] 3 MCCARTHY, *supra* note 35, § 18:42.

[69] *See supra* notes 34–39 and accompanying text.

[70] 3 MCCARTHY, *supra* note 35, § 3:10 ("The consumer expects, and deserves to get, the same level of quality under identical marks, no matter what the physical source of the products or services he buys.").

[71] Nguyen, *supra* note 28, at 1281.

[72] *See* Linda J. Soranno, *The Business and Legal Fundamentals of Corporate Licensing*, 534 PLI/PAT 127, 131 (1998) (explaining that corporations enjoy the benefits of trademark licensing).

[73] *See* 3 MCCARTHY, *supra* note 35, § 18:55 (explaining that various methods of satisfying the quality control requirement have been accepted by different courts).

[74] *Id.* § 18:56 (citing Wolfies Rest., Inc. v. Lincoln Rest. Corp., 143 U.S.P.Q. 310, 310–11 (1964)) (explaining that courts may find control sufficient even if the licensor fails to exercise the right stipulated in the contract). Contrary to the view taken by some courts, Professor McCarthy argues that courts "misconstru[e] the *reason* for the requirement" when they determine that quality control is "per se sufficient" so long as there is a contractual provision for it. *Id.* § 18:61.

quality control measures.[75] Additionally, courts have found as sufficient a licensor's appointment of a third party to conduct the inspection and evaluation of the licensed goods or services.[76]

C. BANKRUPTCY AND THE CODE

In 1915, the Supreme Court recognized that the purpose of the Bankruptcy Act of 1898[77] was to convert the debtor's assets into cash, properly distribute that cash to creditors, and relieve the debtor from indebtedness so as to allow him a fresh start.[78] The Court's assessment aligns with two distinct purposes of United States bankruptcy law: first, to grant a fresh start to the debtor;[79] and second, to ensure that the debtor pays creditors "the maximum [he] can afford."[80] In 1978, Congress enacted the Code[81]

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[75] *Id.* § 18:57 (citing Land O'Lakes Creameries, Inc. v. Oconomowoc Canning Co., 221 F. Supp. 576, 581 (E.D. Wis. 1963)).

[76] *See, e.g.*, Accurate Merchan., Inc. v. Am. Pac., 186 U.S.P.Q. 197, 186 (S.D.N.Y. 1975) ("[T]he type of licensing relationship we have found—one where the supervision of quality control is reserved in a representative chosen by the licensor—is totally in accord with the provisions and requirements of the Lanham Act."); *see also* 3 MCCARTHY, *supra* note 35, § 18:60 ("There seems to be no reason why the licensor should not be permitted to appoint a third party agent to carry out the actual inspection and evaluation of the licensee's goods and services and to measure them against the standards created or adopted by the licensor."). This Note contends that appointment of a third-party agent is a reasonable guard against the threat of unmonitored, licensed trademarks. *See infra* Part III.C.

[77] The Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978). See Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941, 941–42 (1979), for a discussion of the legislative history and enactment of the Bankruptcy Reform Act of 1978.

[78] Williams v. U.S. Fid. & Guar. Co., 236 U.S. 549, 554–55 (1915).

[79] Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007) ("The principle purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor." (quoting Grogan v. Garner, 498 U.S. 279, 286–87 (1991) (internal quotation marks omitted))).

[80] Ransom v. FIA Card Servs., N.A., 131 S. Ct. 716, 725 (2011); *see also* ROBERT E. GINSBERG ET AL., GINSBERG & MARTIN ON BANKRUPTCY § 1.01[H] (5th ed. 2008) ("United States bankruptcy law has two goals. The first . . . is to promote equality of distribution among similarly situated creditors. The second is to afford . . . a fresh economic start. These goals . . . are sometimes referred to as the 'twin pillars of bankruptcy law.' ").

[81] The Constitution empowers Congress to provide a uniform system of bankruptcy throughout the United States. U.S. CONST. art. 1, § 8, cl. 4; *see also* WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE § 1:8 (3d ed. 2013) ("The Bankruptcy Code was enacted in 1978 and became effective for cases filed on or after October 1, 1979."). It is important to note that "[w]hen Congress enacts bankruptcy legislation, that law is paramount and transcends and supersedes all inconsistent state laws." GINSBERG ET AL., *supra* note 80, § 1.01[F].

to facilitate debtor relief from mounting indebtedness.[82] Some believe that the 1978 modification departs from historical notions of creditor preference to enable bankruptcy law to achieve its goals of distribution and discharge.[83]

In truth, bankruptcy law serves competing interests—those of both debtors and creditors. As a result, judges are regularly required to cite to the "court of equity maxim to justify a particular conclusion" not authorized by the Code.[84] Yet, bankruptcy judges are powerless to override the Code by pronouncing that enforcement of its provisions would be inequitable.[85] Put another way, parties' rights depend "on what the Code provides rather than on notions of equity."[86] If the meaning of the Code is not evident on its face, courts must interpret its provisions "clearly and predictably using well established principles of statutory construction."[87]

The Contracts Clause of the United States Constitution prohibits states from enacting any law that impairs obligations under existing contracts.[88] However, Congress can vest the power in bankruptcy trustees or debtors-in-possession to discharge or adjust a debtor's contractual obligations through the enactment of a bankruptcy statute.[89] For example, § 365(a) provides that a bankruptcy trustee, "subject to the court's approval, may assume

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[82] NORTON, *supra* note 81, § 1:8.

[83] GINSBERG ET AL., *supra* note 80, § 1.01(c); *see also* Cont'l Ill. Nat'l Bank & Trust Co. of Chi. v. Chi., Rock Island & Pac. Ry. Co., 294 U.S. 648, 671 (1935) (noting the "fundamental and radically progressive nature of these [ ] extensions" of debtors' rights throughout the nineteenth century).

[84] Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1, 1 (2006) (internal quotation marks omitted).

[85] Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 375 (7th Cir. 2012).

[86] *Id.* at 376.

[87] RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S. Ct. 2065, 2073 (2012). *See also* Raima UK Ltd. v. Centura Software Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 670 (Bankr. N.D. Cal. 2002) (citations omitted) ("If a statute can be interpreted on its face, it is not necessary to delve into its legislative history. This is because, where the language is clear, judicial inquiry is complete.").

[88] U.S. CONST. art. 1, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts."); *see also* GINSBERG ET AL., *supra* note 80, § 1.01[F] ("When Congress enacts bankruptcy legislation, that law is paramount and transcends and supersedes all inconsistent state laws. . . . Accordingly, any state law purporting to grant a discharge to a debtor would be void because of the federal preemption.").

[89] GINSBERG ET AL., *supra* note 80, § 1.01[B] (explaining that Congress has the power to alter a debtor's contractual obligations by enacting a statute under the Code).

or reject any executory contract or unexpired lease of the debtor."[90] Despite its relatively clear and direct language, § 365(a) has been problematic to courts and litigants.[91] In fact, it has been argued that the confusion over some of its terms has caused § 365(a) to lead to "wasteful litigation, absurd results, and dramatic distortions in bankruptcy law."[92]

D. *LUBRIZOL*

In *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, the Fourth Circuit addressed the effect of a debtor's rejection of an executory intellectual property licensing agreement pursuant to § 365(a).[93] Lubrizol was a nonexclusive patent licensee who was granted the right to utilize a metal coating process technology owned by Richmond Metal Finishers (RMF).[94] Under the agreement, Lubrizol owed RMF the duty to pay royalties for use of the process; RMF owed Lubrizol the reciprocal duties of defending Lubrizol in patent infringement suits, notifying Lubrizol of any other use or licensing of the process, and indemnifying Lubrizol for losses arising from misrepresentation or breach of warranty.[95]

RMF filed a petition pursuant to Chapter 11[96] the year after entering into the licensing agreement with Lubrizol.[97] "As part of

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[90] 11 U.S.C. § 365(a) (2006).

[91] *See* Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding 'Rejection,'* 59 U. COLO. L. REV. 845, 846 (1988) (discussing the problematic interpretation of § 365(a) surrounding the terms "executory" and "rejection"); *see also* 11 U.S.C. § 365(a) advisory committee's note ("Though there is no precise definition of what contracts are executory, it generally includes contracts on which performance remains due to some extent on both sides.").

[92] Andrew, *supra* note 91, at 849.

[93] 756 F.2d 1043, 1044 (4th Cir. 1985). Although the licensing agreement in *Lubrizol* concerned a patent, see *id.* at 1045, the holding of *Lubrizol* holding affected licensed copyrights, trademarks, and patents. *See* Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 375 (7th Cir. 2012) ("*Lubrizol* . . . holds that, when an intellectual-property license is rejected in bankruptcy, the licensee loses the ability to use any licensed copyrights, trademarks, and patents.").

[94] *Lubrizol*, 756 F.2d at 1045.

[95] *Id.*

[96] 11 U.S.C. §§ 1101–1174 (2006). Although the Supreme Court has stated that Congress did not have a single purpose in enacting Chapter 11, see *Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 51 (2008), one objective of Chapter 11 is to facilitate business reorganization. *See* N.C.P. Mktg. Grp., Inc. v. BG Star Prods., Inc., 129 S. Ct. 1577, 1577 (2009) ("The object of Chapter 11 of the Bankruptcy Code is to empower a debtor with going [sic] concern value to reorganize its operations to become solvent once more.").

its plan to emerge from bankruptcy," RMF moved to reject the license agreement with Lubrizol pursuant to § 365(a) "in order to facilitate [the] sale or licensing of the technology unhindered by restrictive provisions in the Lubrizol agreement."[98]

The Fourth Circuit found that the district court improperly substituted its own business judgment for that of the debtor[99] and misinterpreted the controlling law.[100] In its analysis, the Fourth Circuit applied a two-step inquiry and considered whether the parties' licensing agreement was executory[101] and whether rejection would be advantageous to the debtor.[102] Under this approach, the Fourth Circuit found that the licensing agreement was executory and that rejection would be advantageous for RMF, the debtor.[103]

To determine Lubrizol's remedy as a result of RMF's rejection, the Fourth Circuit turned to § 365(g) under the Code,[104] which provides that "the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease."[105] Thus, rejection of an executory contract constitutes a breach of the contract; it does not, however, terminate the contract.[106] As a result, the debtor's estate is freed from the obligation to perform, and the non-debtor is vested with a viable creditor's claim against the debtor.[107] The Fourth Circuit thus concluded that "Lubrizol would be entitled to treat rejection as a breach and seek a money damages remedy."[108] The court limited Lubrizol's available remedies to a claim for damages and expressly refused specific performance of its contractual right to the

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97 *Lubrizol*, 756 F.2d at 1045.

98 *Id.*

99 *Id.* at 1047.

100 *Id.* at 1048.

101 *Id.* at 1045 ("[A] contract is executory [under § 365(a)] if performance is due to some extent on both sides.").

102 *Id.*

103 *Id.* at 1047 ("[The] continu[ing] obligation to Lubrizol under the agreement would hinder RMF's capability to sell or license the technology on more advantageous terms to other potential licensees.").

104 *Id.* at 1048.

105 11 U.S.C. § 365(g) (2006).

106 *In re* Lavigne, 114 F.3d 379, 386–87 (2d Cir. 1997).

107 *Id.* at 387.

108 *Lubrizol*, 756 F.2d at 1048 (citing *In re* Waldron, 36 B.R. 633, 642 n.4 (Bankr. S.D. Fla. 1984)).

technology, even if that remedy would ordinarily be available upon breach of this type of contract.[109]

Most courts agree that § 365(g) affords the non-debtor a damages remedy only.[110] But some courts[111] and scholars[112] view § 365(g) as a provision that has no effect on the rights of the licensee. Those authorities have found that nothing about § 365(g) vaporizes the rights of the licensee; instead, they conclude that the licensee should continue using the licensed marks regardless of the debtor's decision to reject the license.[113] In light of their position, these courts and scholars believe that § 365(a) "imposed a burden on American technological development that was never intended by Congress, and therefore interpret § 365(g) broadly to protect trademark licensees from the potential ills of a poorly drafted statute."[114]

E. SECTION 365(N)

Perhaps in reaction to *Lubrizol*,[115] Congress enacted § 365(n) in 1988[116] "to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to Section 365 in the event of the licensor's bankruptcy."[117] Nevertheless, § 365(n)

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[109] *Id.*

[110] *See, e.g.*, Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294, 1312 (11th Cir. 2007) ("[R]ejection of an executory contract under § 365(g) constitutes a pre-petition breach, and the non-debtor party to the rejected contract becomes a general unsecured creditor who may seek contract damages against the debtor as a pre-petition claim in the bankruptcy.").

[111] *E.g.*, Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372 (7th Cir. 2012); *In re* Exide Techs., 607 F.3d 957, 965 (3d Cir. 2010) (Ambro, J., concurring) ("I believe a trademark licensor's rejection of a trademark agreement under 11 U.S.C. § 365 does not necessarily deprive the trademark licensee of its rights in the licensed trademark.").

[112] *See, e.g.*, Andrew, *supra* note 91, at 894–95 ("I agree . . . that rejection itself should not impair a non-debtor party's rights in or to property created by an 'executory' contract, and such rights typically are enforced by the specific performance remedy. . . . [R]ejection—the election not to assume such a contract—does not itself have the effect of terminating a right in or to property, any more than it has the effect of terminating a liability.").

[113] *Sunbeam Prods., Inc.*, 686 F.3d at 377–78.

[114] S. REP. NO. 100-505, at 1 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3200.

[115] *Id.* at 2 (citing *Lubrizol* as a decision interpreting § 365 as "providing a basis for permitting a licensor of intellectual property to strip its licensee of any continuing right to use the licensed intellectual property").

[116] Pub. L. No. 100-506, 102 Stat. 2538 (1988) (codified as amended at 11 U.S.C. § 365(n) (2006)).

[117] S. REP. NO. 100-505, at 2.

fails to clarify the intended treatment of executory trademark licensing agreements and has engendered litigation and disuniformity among judges across the country.[118] While allowing rejection of intellectual property licensing agreements threatens technological development and innovation,[119] judges and litigants disagree about the implications of 11 U.S.C. § 101(35A) and its omission of the term "trademark" in its definition of intellectual property.[120]

Because § 365(n) addresses "intellectual property" as that term is defined under § 101(35A),[121] and because § 365(n) likewise omits the term "trademark," § 365(n) cannot be understood to affect trademarks. Congress recognized that "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."[122] Given the unique nature of trademark agreements, Congress purposely refrained from addressing a licensee's rights under a rejected trademark licensing agreement to permit more time for study and to allow bankruptcy courts to treat the situation equitably.[123]

Nevertheless, a judge cannot sidestep the Code's dictates by proclaiming that enforcement of its provisions would be inequitable.[124] By omitting trademarks but resolving patent, copyright, and trade secret rights under § 365(n), Congress

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[118] *Compare* Raima UK Ltd. v. Centura Softward Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 674–75 (Bankr. N.D. Cal. 2002) (finding that § 365(n) "plainly excludes trademarks" and allows rejection by the bankruptcy trustee), *with* Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 375–78 (7th Cir. 2012) (finding that the bankruptcy trustee could not reject the licensee's rights under a licensing agreement because § 365(n) does not affect trademarks "one way or the other").

[119] *See* S. REP. NO. 100-505, at 3 ("The court decisions on Section 365 that have stripped intellectual property licensees of their right to continue to use the licensed property . . . threaten an end to the system of licensing intellectual property . . . [which] plays a substantial role in the process of technological development and innovation.").

[120] 11 U.S.C. § 101(35A) (2006) ("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 . . . .").

[121] *See id.*

[122] S. REP. NO. 100-505, at 5 (1988).

[123] *Id.* ("Since [rejection of trademark licensing] 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.").

[124] Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 375 (7th Cir. 2012).

effectively directed courts to find that executory trademark licenses are subject to §§ 365(a) and 365(g), which generally leave the licensee to an unsecured damages claim upon rejection. However, the Seventh Circuit created an avenue in *Sunbeam* that allows trademark licensees to continue using a trademark under a rejected licensing agreement.[125]

F. *SUNBEAM*

In *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*,[126] the Seventh Circuit confronted the question of whether rejection of a trademark license ends the licensee's right to use the licensed mark.[127] Unlike the Fourth Circuit, which addressed the same question presented in *Lubrizol* in 1985,[128] the Seventh Circuit determined that a trademark licensee who suffers rejection in bankruptcy could retain its right to use the licensed mark.[129]

In *Sunbeam*, Lakewood Engineering & Manufacturing Company (Lakewood), a business devoted to producing and selling a variety of consumer products, contracted the manufacture of its products to Chicago American Manufacturing (CAM).[130] The contract approved CAM to use Lakewood's patents and trademarks in the production of Lakewood's fans.[131] In financial distress, Lakewood authorized CAM to sell roughly 1.2 million fans during the 2009 cooling season, provided that Lakewood was unable to purchase the fans for sale first.[132] After three months of production, Lakewood's creditors filed an involuntary bankruptcy

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[125] *See generally id.* (finding that the bankruptcy trustee's rejection of a licensing agreement does not revoke the licensee's right to use the trademark).

[126] *Id.*

[127] *Id.* at 375.

[128] Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1044 (4th Cir. 1985). Other jurisdictions have reached the same conclusion as the Fourth Circuit. *See, e.g.*, Raima UK Ltd. v. Centura Software Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 675 (Bankr. N.D. Cal. 2002) (finding that the licensee "may file an allowable claim for damages" to recover from a debtor's breach of contract under 11 U.S.C. § 365(g)(1) and § 502(g)); *In re* Chipwich, Inc., 54 B.R. 427, 431 (Bankr. S.D.N.Y. 1985) (same). *But see In re* Exide Techs., 607 F.3d 957, 966–67 (3d Cir. 2010) (Ambro, J., concurring) (arguing that rejection under § 365(a) should not end the trademark licensee's right to continue using the licensed marks).

[129] *Sunbeam*, 686 F.3d at 375.

[130] *Id.* at 374.

[131] *Id.*

[132] *Id.*

petition, and Sunbeam Products, Inc. (Sunbeam), under the name of Jarden Consumer Solutions (Jarden), bought the assets, including Lakewood's patents and trademarks.[133] Jarden subsequently informed CAM that it did not intend to purchase the Lakewood-branded fans that CAM held in inventory, nor did it want CAM to sell those fans in the marketplace.[134] The Seventh Circuit ruled that CAM could proceed under the original licensing agreement, unhindered by the rejection or Jarden's preferences.[135]

Perhaps one factor in the court's resolution was the concern that, if permitted, rejection of the trademark licensing agreement could lead to economic waste.[136] Even more illustrative of the court's rationale and holding is its analysis of the Fourth Circuit's understanding of § 365(g)—the provision that specifies the significance of rejection under § 365(a).[137] Unlike the Fourth Circuit in *Lubrizol*, where the court approved the debtor's motion to reject the parties' license under § 365(a) and found that the licensee could seek only a money damages remedy under § 365(g),[138] the Seventh Circuit found that the process of converting the debtor's unfulfilled obligations to money damages does not "impl[y] that any rights of the [licensee] have been vaporized" under § 365(g).[139] Accordingly, the Seventh Circuit allowed the licensee to continue using the licensed trademark, even after it acknowledged that "a debtor is not subject to an order of specific performance" under § 365(g).[140] The court reasoned that *Lubrizol* confused rejection with the use of an avoiding power,

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[133] *Id.*

[134] *Id.*

[135] *Id.* at 378.

[136] However speculative, if the court allowed rejection, CAM could possibly be prevented from selling the Lakewood fans that it had in inventory because Jarden did not want the fans nor did it want CAM to sell those fans. *Id.* at 374. Indeed, the bankruptcy court based its decision in part on the "substantial resources [CAM invested] in making Lakewood-branded box fans." *Id.* at 375.

[137] *Id.* at 376 ("We need to determine whether *Lubrizol* correctly understood § 365(g), which specifies the consequences of a rejection under § 365(a).").

[138] *See* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) ("Under 11 U.S.C. § 365(g), [the licensee] would be entitled to treat rejection as a breach and seek a money damages remedy; however, it could not seek to retain its contract rights in the technology by specific performance even if that remedy would ordinarily be available upon breach of this type of contract.").

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

[140] *Id.* at 377–78.

which, unlike rejection, effectively cancels a contract and puts the parties back in the positions they occupied before entering the contract.[141]

III. ANALYSIS

In 1946, the Lanham Act legalized trademark licensing,[142] so long as the licensor exercises quality control.[143] If the licensor fails to exercise control over the quality of the mark, the license is deemed "naked."[144] Often, uncontrolled marks become abandoned because the mark ceases to function as a symbol of quality and of a particular source.[145] The rationale underlying quality control is to protect consumers from confusion and deceit,[146] a policy that courts should ardently seek to preserve.[147]

Afforded the advantages of modern licensing,[148] trademark owners often include copyrights, patents, and trade secrets in

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[141] *Id.* at 377.

[142] Pub. L. No. 79-489, 60 Stat. 427 (1946) (codified as amended at 15 U.S.C. §§ 1051–1072 (2006)).

[143] *See id.* § 1055 ("Where a registered mark or a mark sought to be registered is or may be used legitimately by related companies . . . such use shall not affect the validity of such mark . . . provided such mark is not used in such manner as to deceive the public.").

[144] *See* FreecycleSunnyvale v. Freecycle Network, 626 F.3d 509, 512 n.1 (9th Cir. 2010) ("Naked licensing occurs when a licensor does not exercise adequate quality control over its licensee's use of a licensed trademark such that the trademark may no longer represent the quality of the product or service the consumer has come to expect.").

[145] 3 MCCARTHY, *supra* note 35, § 18:48. Under 15 U.S.C. § 1060(a)(1) (2006), trademark owners also have the right to assign their trademarks if the goodwill symbolized by the mark accompanies such assignment. *Id.* § 18:17. Selling or assigning a mark unaccompanied by the mark's associated goodwill is called "assignment in gross," which results in invalidity of the mark. *Id.* The rule against assignment in gross, which generally seeks to prevent consumer confusion, has been relaxed by courts in recent decades, inviting an enclave of critics as a result. *See* Stacey L. Dogan & Mark A. Lemley, *A Search-Costs Theory of Limiting Doctrines in Trademark Law*, *in* TRADEMARK LAW AND THEORY: A HANDBOOK OF CONTEMPORARY RESEARCH 65, 82 (Graeme B. Dinwoodie & Mark D. Janis eds., 2008) (discussing effects of assignments in gross); Robert G. Bone, *Enforcement Costs and Trademark Puzzles*, 90 VA. L. REV. 2099, 2119 n.57 (2004) ("[C]ourts in recent years have relaxed the traditional rule against assignments in gross and have allowed trademark owners sometimes to sell marks separate from the underlying business.").

[146] 3 MCCARTHY, *supra* note 35, § 18:48.

[147] *See supra* Part II.B.

[148] *See* Nguyen, *supra* note 28, at 1276–77 (explaining that licensing allows trademark owners to expand their businesses, enhance the goodwill of the mark, and gain revenue from royalty fees).

trademark licensing agreements.[149] Indeed, Congress ensured the protection of those types of intellectual property in its enactment of § 365(n) under the perceptive impression that rejection "is wasteful and cumbersome and is especially chilling to small business technologists."[150]

The following analysis proceeds by setting forth a hypothetical in Part III.A that lends itself to alternative analyses. Part III.B discusses the Code in its current form and the decisions of the Fourth and Seventh Circuits. This Note advises courts confronting § 365(n) to follow *Lubrizol*, notwithstanding the potentially negative practical implications of that decision, because the Fourth Circuit accurately applied the provisions under the Code to the circumstances of the case. Part III.C, however, sets forth an amendment to the Code. The amendment simultaneously recognizes that although § 365(n) should not treat all forms of intellectual property the same, trademark licensees should be protected in certain circumstances. Accordingly, the proposed amendment to § 365(n) requires courts to balance several factors to determine whether rejection of a trademark license is proper.

A. A HYPOTHETICAL

The year is 2013. After seven years of hard work, Lou believes he has finally made it as a professional craft brewer. He spent fifteen years as an amateur, homebrewing his own concoctions; it was nothing more than a hobby. He was satisfied with his eight-hour shift down at the Baltimore docks, and as a longshoreman, he made enough money to feed the family.[151] When he got a call from an old brewing friend, Don, who moved out West to open his own brewery, Lou had no intention of turning his pastime into a profession. But Don made him "an offer he could not refuse."[152]

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[149] *See, e.g.*, Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 374 (7th Cir. 2012) (involving a patent and trademark license agreement); Raima UK Ltd. v. Centura Software Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 663 (Bankr. N.D. Cal. 2002) (involving a software and trademark license agreement).

[150] S. REP. NO. 100-505, at 3 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3202.

[151] The idea for this hypothetical stemmed from *The Wire*. *See generally The Wire* (HBO television broadcast 2003) (depicting the life of longshoremen in Baltimore, Maryland).

[152] THE GODFATHER (Paramount Pictures 1972).

Don was the owner of Ten Foot Falls Brewing Company (TFF), a brewery that operated out of a small warehouse in Southern California. TFF opened in the mid-1990s, and by that time, the craft beer business was gaining popularity throughout the country.[153] After ten years of brewing beer, Don decided to tap into the micro distillery business to make hard liquor in addition to beer.[154] After limited success in the competitive beer industry out West, he thought exposing TFF to craft beer consumers on the East Coast could boost beer sales throughout the country. In hopes of breaking into a new market, Don asked Lou if he would brew TFF beer recipes out of his garage and sell the beer—bearing the TFF registered trademark—to consumers throughout Baltimore.[155] In return, Lou would receive the rights to all profits, but he would be required to pay Don an agreed-upon royalty for use of the TFF recipe and trademark. If the beer was well-received by the Baltimore community, Lou had the option of expanding TFF throughout the East Coast.

After accepting Don's offer, Lou initially brewed TFF in the evenings at home, allowing him to continue working at the docks. Yet by 2011, Lou's operation expanded into a new warehouse. He purchased new boiling and fermentation tanks, formed his own LLC, and employed twenty employees. Although it was difficult to leave his dock duties, Lou decided to turn his full attention to the beer industry. He spent his life savings on the warehouse space, borrowed money from local investors, and received a loan from the bank to cover the cost of the new equipment. In all, Lou invested close to $5 million on his new setup; he determined that he was in the beer business for the long haul. After renegotiating an exclusive franchising agreement with Don in 2012, which allowed Lou to sell beer to consumers throughout the East Coast for a

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[153] *See History of American Beer*, BEER ADVOCATE, http://beeradvocate.com/beer/101/history_american_beer (last visited Sept. 15, 2013) (noting the rapid increase of microbreweries in the United States during the mid-1990s).

[154] *See generally* Katy Steinmetz, *A Booze of One's Own: The Micro Distillery Boom*, TIME, Apr. 6, 2012, http://business.time.com/2012/04/06/craft-distillers/ (explaining the micro distillery business).

[155] *See generally In re* Matusalem, 158 B.R. 514 (Bankr. S.D. Fla. 1993) (discussing a franchise agreement which included the right to make and market rum using the debtor's secret formula and trade name).

period of twenty years bearing the TFF mark, Lou's expectations for the future were high.

While Lou brewed beer for distributors up and down the East Coast, Don suffered financially out West. The micro distillery business had not reached even minor success, and three petitioners filed an involuntary bankruptcy proceeding against Don.[156] The proceeding went forward, and consequently Don sought to reject his licensing agreement with Lou under § 365(a). following the Fourth Circuit's decision in *Labrizol*, the bankruptcy court determined that although Lou had poured millions of dollars into his beer operation in reliance on his right to use the TFF mark—which had become a stamp of approval in the minds of beer advocates on the East Coast—it was within Don's business judgment to reject the agreement concerning the TFF trademark.[157]

Unfortunately, as the law now stands in some jurisdictions, the nineteen years remaining under Lou's licensing agreement saw only the rights to brew TFF beer.[158] By approving rejection of the trademark license agreement, the court entitled Lou to nothing more than a claim under § 365(g) for damages resulting from the breach.[159] Thus, both Lou's and the consumers' future expectations of seeing beer bearing the TFF mark on the East Coast were swallowed by § 365 and its dictates.[160]

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[156] 11 U.S.C.A. § 303(b) (West 2010 & Supp. 2013) (allowing three or more creditors with claims that are not contingent and total at least $15,325 in unsecured debt to force an involuntary bankruptcy). The annotated code is cited because it reflects that 11 U.S.C. § 303(b) has been amended to change $14,425 to $15,325. *See* 11 U.S.C. § 303(b) (2006) ("An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—(1) by three or more entities . . . if such noncontingent, undisputed claims aggregate at least $15,325 . . . .").

[157] *See* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1046 (4th Cir. 1985) (explaining that whether rejection of an executory contract is advantageous is within the debtor's business judgment).

[158] *See* Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 375 (7th Cir. 2012) (noting that § 365(n) presumptively resolves licensees' rights to trade secrets, patents, and copyrights).

[159] *See* Raima UK Ltd. v. Centura Software Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 675 (Bankr. N.D. Cal. 2002) (explaining that rejection of an executory trademark license under § 365 entitles the licensee to a damages remedy under § 365(g)).

[160] *Contra Sunbeam*, 686 F.3d at 378 (finding that rejection under § 365 does not abrogate the licensee's contractual rights to the licensor's trademark).

B. THE EXISTING APPROACHES: *LUBRIZOL* OR *SUNBEAM*

Provided no express exemption exists, § 365(a) unambiguously allows trustees in bankruptcy to reject executory contracts subject to the court's approval.[161] Since trademarks are expressly excluded under §§ 101(35A) and 365(n), courts will likely, as the Code now prescribes under § 365(n), accord trademark licensees no protection.[162] The development of equitable treatment concerning trademark licenses that Congress hoped would occur[163] has been interpreted by some courts as creating essentially a pre-post-rejection dichotomy, allowing courts to balance the equities only during the pre-rejection stage of a proceeding.[164] Other courts have interpreted the exclusion of trademarks under §§ 101(35A) and 365(n) as providing bankruptcy judges no discretion whatsoever.[165] This Note argues that the latter interpretation is proper though its implications are problematic.

In *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, the Supreme Court determined that, "[i]t is a commonplace of statutory construction that the specific governs the general. That is particularly true where . . . Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions."[166] That comprehensive scheme

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[161] 11 U.S.C. § 365(a) (2006) ("[T]he trustee, subject to the court's approval, may assume or reject any executory contract . . . .").

[162] *See, e.g.*, *In re Centura*, 281 B.R. at 670 ("Congress has unambiguously indicated that trademark licenses are to be excluded from § 365(n) . . . .").

[163] *See* S. REP. NO. 100-505, at 3 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3200 (explaining that courts approving rejection "have relieved the debtor . . . of its passive obligation to permit the licensee to use the intellectual property as provided in the license. . . . This view, which several courts have not modified under their powers in equity, leaves licensees in a precarious position . . . .").

[164] *See In re Centura*, 281 B.R. at 671–72 (Bankr. N.D. Cal. 2002) (explaining that the implications of § 365(n) on trademark licensees are significantly different in the pre-rejection and post-rejection stages of a proceeding); *see also In re* Matusalem, 158 B.R. 514, 522 (Bankr. S.D. Fla. 1993) (preventing rejection under § 365(n) in the pre-rejection approval proceeding since rejection would "utterly destroy the business of [the licensee] and with it the livelihood of [its] principals and employees").

[165] *See, e.g.*, *In re* Old Carco LLC, 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009) (citations omitted) (internal quotation marks omitted) (finding trademark licensee's objection to the court's interpretation of § 365(n) meritless because the statute "only allows . . . retention of rights and continued usage if the executory contract is one under which the debtor is a licensor of a right to intellectual property," and trademarks are not considered intellectual property under § 101(35A)).

[166] 132 S. Ct. 2065, 2071 (2012) (citations omitted) (internal quotation marks omitted).

referred to by the Court in this case is the Code.[167] An example of Congress's attempt to target a specific problem is found in its enactment of § 365(n), which seeks to ensure that particular licensees are not left in a precarious position upon rejection.[168] Because the protections of § 365(n) only extend expressly to copyright, patent, and trade secret licenses, it may be inferred that Congress did not see reason to proscribe the stripping of a trademark licensee of its right to continued use of a licensed mark after rejection.[169] Consequently, courts must turn to the effect of rejection under § 365(a) and (g), the provisions governing rejected trademark licensing agreements.

Sections 365(a) and (g) provide the statutory framework controlling the effect of trademark license rejection under the Code.[170] That framework allows a bankruptcy trustee, in its business judgment,[171] to reject any executory contract not exempted from a provision under § 365, and provides the licensee with only a monetary damages claim for breach of contract.[172] Although this may seem unjust,[173] consider the possible effect of granting a licensee specific performance under the Code: the distribution to the debtor's remaining creditors would be

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[167] *Id.*

[168] S. REP. NO. 100-505, at 1–2 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3200.

[169] *See* 11 U.S.C. § 365(n) (2006) (allowing retention of rights in intellectual property, which is not defined to include trademarks under 11 U.S.C. § 101(35A)).

[170] *Id.* § 365(a), (g).

[171] Raima UK Ltd. v. Centura Software Corp. (*In re* Centura Software Corp.), 281 B.R. 660, 673 (Bankr. N.D. Cal. 2002).

[172] *See* Lubrizol Enters. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) ("Even though § 365(g) treats rejection as a breach, the legislative history of § 365(g) makes clear that the purpose of the provision is to provide only a damages remedy for the nonbankrupt party."). Specific performance runs perpendicular to the policies of the Code. Sections 101(5)(B) and 502(c) govern what would otherwise entitle a licensee to specific performance outside of bankruptcy. 11 U.S.C. §§ 101(5)(B), 502(c) (2006). Those provisions, according to one author, provide that, "if the right against the debtor can be quantified as a dollar amount, or is in effect a monetary right against the debtor, the right is a claim for Code purposes." TREISTER ET AL., *supra* note 29, at 311. A claim under the Code is meant to be defined broadly. Ohio v. Kovacs, 469 U.S. 274, 279 (1985). What would otherwise be a claim for specific performance outside of bankruptcy should be reduced to a monetary amount. 11 U.S.C. § 502(c)(2) (2006) (stating that "any right to payment arising from a right to an equitable remedy" shall be estimated). The focus of the Code is one of priority; rejection merely "provides a way of *equalizing* things among creditors." JACKSON, *supra* note 30, at 109.

[173] *See Lubrizol*, 756 F.2d at 1048 (discussing the adverse consequences of rejection).

overridden, and the licensee would obtain unbargained benefit.[174] Despite the adverse effects of leaving the licensee with nothing more than a damages remedy, allowing specific performance would undermine a core purpose of the Code—to expand the value of the debtor's estate for the benefit of creditors.[175]

Courts should therefore adhere to the Fourth Circuit's holding in *Lubrizol*. There, the court resolved the issue of whether rejection strips licensees of their right to practice licensed trademarks by accurately applying the dictates of § 365 and prohibiting the licensee from exercising any right in the trademark.[176] Yet, this rigid application has negative practical implications. Applying *Lubrizol* to the hypothetical set forth in Part III.A would automatically end Lou's right to continue practicing the TFF trademark. The resources invested in reliance on that right could ultimately result in economic waste, defeated aspirations, and disappointed consumers. In addition, the trademark licensing rights to the TFF mark would no longer be available to Lou, and he would be forced to find a different line of work.

C. AN AMENDED APPROACH

Congress must return to the Code to effectively resolve the problems engendered by the rejection of trademark licenses in bankruptcy. While legislators properly considered the traditional view that successful trademark licensing depends on quality control,[177] they should have devoted more attention to the notion that trademark licensees will often produce, on their own initiative, higher quality products because their reputation and

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[174] *See* Anthony Duggan, *Proprietary Remedies in Insolvency: A Comparison of the Restatement (Third) of Restitution & Unjust Enrichment with English and Commonwealth Law*, 68 WASH & LEE L. REV. 1229, 1265 (2011) (noting that equitable remedies are reduced to money damages so that the non-debtor will not receive an unbargained benefit).

[175] *See* Micheal J. Kelly, *Recognizing the Breadth of Non-Assignable Contracts in Bankruptcy: Enforcement of Nonbankruptcy Law as Bankruptcy Policy*, 16 AM. BANKR. INST. L. REV. 321, 321 (2008) ("A key purpose of the Bankruptcy Code . . . is to enhance the debtor's estate for the benefit of parties in interest.").

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

[177] S. REP. NO. 100-505, at 5 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3204.

financial success depend on it.[178] Furthermore, courts have relaxed the quality control requirements in recent years,[179] allowing licensors to demonstrate adequate control in a variety of ways,[180] one of which is particularly important for the model amendment set forth below.

The following revision to § 365(n)[181] suggests that a court must determine whether the benefits of rejection substantially outweigh the harm suffered by the licensee. The revision provides:

> If the trustee rejects an executory contract under which the debtor is a licensor of a right to a trademark, trade name, or service mark, the court shall determine whether the expected benefits of rejection substantially outweigh the harm of such rejection to the nondebtor licensee.

This revision allows courts to exercise discretion through lawful means by determining what outcome is most fair to a particular set of circumstances. In determining what is fair to the parties, the following factors may be considered: (1) whether quality control will be properly exercised; (2) the benefit of rejection for the estate; (3) the expected increase in recovery for creditors; (4) the risks and benefits to the public of allowing the licensee to continue practicing the trademarks; (5) the effect of a monetary damages claim on the licensee; and (7) the amount of economic waste that could result from rejection.

The revision and its accompanying factors account for Congress's concern over the extent to which a licensed trademark will be monitored following liquidation.[182] Put another way, it

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[178] *See* 3 MCCARTHY, *supra* note 35, § 2:4 ("[T]rademarks create an incentive to keep up a good reputation for a predictable quality of goods.").

[179] *See supra* notes 71–76 and accompanying text.

[180] *See* Marshall Leaffer, *Sixty Years of the Lanham Act: The Decline and Demise of Monopoly Phobia*, *in* U.S. INTELLECTUAL PROPERTY LAW AND POLICY 85, 109 (Hugh Hansen ed., 2006) ("In practice, courts have approved a wide range of quality control arrangements, varying from meticulous actual control to that involving little or almost no oversight." (citing Taco Cabana Int'l, Inc. v. Two Pesos Inc., 932 F.2d 1113 (5th Cir. 1991))).

[181] This revision is drafted by the author.

[182] *See* S. REP. NO. 100-505, at 6 ("[T]he bill does not address the rejection of executor trademark, trade name or service mark licenses by debtor-licensors. . . . [T]rademark, trade name and service mark licensing relationships depend to a large extent on control of the

requires judges to determine not only whether the mark will be monitored for its quality, but also the extent to which the trademark will be monitored.[183] As previously mentioned, there are a variety of ways by which licensors may satisfy the quality control requirement.[184] Particularly important in this context is the method of appointing a third-party advocate to inspect and evaluate the licensee's goods or services under the continued use of the mark.[185] Indeed, it seems reasonable for courts to permit licensors or even licensees to appoint independent third-party agents to carry out the inspection and evaluation of the licensed goods and services for the protection of consumers because those independent third party agents can objectively determine whether the quality of the product matches the standards set by the licensor.

IV. CONCLUSION

Courts will soon be faced with the question whether rejection of an intellectual property license ends the licensee's right to use the licensed trademark. As a result of the decisions handed down by the Fourth and Seventh Circuits on this issue, courts will likely side with one of their approaches, leaving trademark licensees uncertain as to the effect of rejection of their licensing contract.

Congress created § 365(n) to resolve the rights of intellectual property licensees when their licensing agreements are rejected in bankruptcy. However, because the Code omits trademarks from its definition of intellectual property, trademark licensees will be left in precarious positions in the event of litigation.

This Note proposes that Congress revise § 365(n) to account for trademark licenses. This suggestion is accompanied with a model provision and seven accompanying factors, which offer a framework that permits bankruptcy judges to exercise their discretion in determining the rights of trademark licensees upon rejection. This discretionary review accounts for the Code's

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quality of the products or services sold by the licensee. . . . [T]hese matters could not be addressed without more extensive study . . . .").

[183] The first balancing factor requires the quality control to be *properly*, not *hopefully*, exercised.

[184] *See supra* notes 73–76 and accompanying text.

[185] *See supra* note 76 and accompanying text.

primary concern—to further the expansion of the debtor's estate—as well as trademark law's demand for quality control in furtherance of consumer welfare. It also uniquely allows judges to consider the important technological and economic functions served by trademark licensing. These functions are valuable not only to trademark licensees, but also to the American public. No longer should "any exercise of business judgment, however reviewed by the court, . . . lead to rejection."[186]

Sumner Riddick Pugh, IV

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[186] S. REP. NO. 100-505, at 3 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3201.