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TRADEMARK ISSUES IN BANKRUPTCY

*By Stuart M. Riback**

I. INTRODUCTION

Trademark lawyers are at home in federal court. Almost all trademark cases are within federal subject matter jurisdiction, so the Federal Rules of Civil Procedure are second nature to them. The same can be said of bankruptcy lawyers: bankruptcy law is almost entirely federal, and the federal courts that administer bankruptcies—United States Bankruptcy Courts—largely apply the Federal Rules of Civil Procedure in disputed matters. Yet trademark lawyers who arrive in bankruptcy court for the first time may experience severe culture shock. The procedures seem different, the rules seem odd—even though superficially the same procedural rules are applied as in federal district court. Although bankruptcy courts are often in the same building as district courts, the difference can sometimes overwhelm. Bankruptcy court can seem like a different universe.

The Bankruptcy Code is not primarily concerned with preventing consumer confusion or protecting identifiers of the source of goods. The concerns and policies of intellectual property law are of secondary importance in bankruptcy. Although the Code purports on its face to apply existing non-bankruptcy law in determining rights and remedies of those who deal with the debtor, the Code has its own unique philosophy that sometimes clashes with the other interests that present themselves in Bankruptcy Court. Specifically, the Bankruptcy Code is mainly concerned with rehabilitating the debtor, providing it with a fresh start and maximizing payments to creditors. To achieve this goal, the Code seeks to enlarge as much as possible the pool of funds that will be available to pay creditors and/or help the debtor reorganize. What is more, the debtor has a “home court advantage”: the main forum for determining disputes with debtors is the bankruptcy court, a specialized forum that exists for the precise purpose of applying the Bankruptcy Code.

The Code’s fresh-start policy, and the consequent inclination of the bankruptcy system to protect the debtor and its creditor body, informs and pervades most decisions the bankruptcy court has to make—including decisions affecting trademarks and other forms of intellectual property. For better or worse, filtering trademark law

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through the procedures and processes of the bankruptcy system can result in the creation of a parallel universe: the surroundings are familiar, the landmarks are recognizable, but everything is skewed by just a few degrees.

This article summarizes some of the more common issues that are likely to arise when an owner or user of intellectual property has filed a petition under the Bankruptcy Code. The debtor may be a licensor, a licensee or an owner; sometimes the debtor will be a borrower that has offered its rights or its licenses as collateral. In each event, the issues will be somewhat different and the concerns will vary. Knowing the usual risks that present themselves may enable trademark practitioners to take steps to insulate clients, to the extent possible, from the more undesirable effects of a bankruptcy.

Part II of this article describes basic mechanisms of the bankruptcy process and how these mechanisms apply to bankruptcies of licensors and licensees, respectively. In particular, Part II focuses on statutory rights of licensees, licensors' rights to terminate or demand performance and limitations on a debtor's right to assign its license.

Part III discusses trademarks that have been pledged to secure loans. It addresses the lender's rights when the debtor continues to use the collateral, and how to value a mark when value is in issue.

Finally, Part IV deals with trademark litigation. It explores which kinds of litigation must be adjudicated in bankruptcy court, which may be heard elsewhere, and what criteria govern the decision as to when trademark litigation may be heard.

II. IMPACT OF BANKRUPTCY ON TRADEMARKS AND TRADEMARK LICENSES

A. Basic Concepts of the Bankruptcy Process

1. Effect of Filing a Petition

The overwhelming majority of bankruptcy proceedings are commenced voluntarily by the debtor. A voluntary bankruptcy petition both requests and grants relief to the debtor.¹ It has two immediate effects. First, it creates a bankruptcy estate. In broad terms, the estate contains all the debtor's interests in property at the moment of filing, as well as the proceeds of such property and any additional interests in property the estate may acquire later.² In Chapter 11 cases, unless the court rules otherwise, the debtor will be "in possession," meaning it will continue to operate the

1. 11 U.S.C. § 301.

2. See 11 U.S.C. § 541.

business while attempting to reorganize.³ In Chapter 7 cases, the debtor liquidates (as opposed to reorganizes), and the liquidation is overseen by a trustee.⁴ This article focuses mainly on Chapter 11 and, thus, will refer usually to the “debtor” rather than the “trustee.”

Filing a petition also triggers one of the most far-reaching features of the Bankruptcy Code: the automatic stay. Under § 362 of the Code, the filing of a petition automatically stays all actions and activities that seek to collect money from the debtor or execute on the debtor’s assets (with several statutorily-defined exceptions not normally applicable to commercial disputes). Thereafter, anyone wishing to proceed against the debtor based on pre-petition (and some post-petition) events, or even to resume proceedings that were already in progress, must first obtain leave of the bankruptcy court.

2. Assumption or Rejection of Executory Contracts Under § 365

Because trademarks are often licensed, trademark practitioners need to be familiar with how the Bankruptcy Code treats licenses. Most licenses of intellectual property are considered executory contracts for purposes of bankruptcy law.⁵ Although the Bankruptcy Code does not define “executory contracts,” they are commonly understood as contracts “on which performance remains due to some extent on both sides.”⁶ Section 365 of the Bankruptcy Code permits the debtor, subject to court approval, to reject, assume or assume and assign an executory contract.

Assuming a contract simply means reinstating its existence. The debtor chooses to be bound by its terms, and from the date of assumption forward, both parties must comply with its terms exactly as they would absent bankruptcy.

The debtor cannot assume a contract, however, without first meeting the statutory preconditions. The debtor must (among

3. See 11 U.S.C. §§ 1107, 1108.

4. See 11 U.S.C. §§ 701-704.

5. See, e.g., *In re Access Beyond Technologies, Inc.*, 237 B.R. 32, 43 (Bankr. D. Del. 1998) (patent license); *In re Blackstone Potato Chip Co., Inc.*, 109 B.R. 557, 560 (Bankr. D.R.I. 1990) (trademark license); *In re Golden Books Family Entertainment, Inc.*, 269 B.R. 300, 308 (Bankr. D. Del. 2001) (copyright license).

6. *NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 522 n.6 (1984), quoting H.R. Rep. No. 95-595 at 347 (1977). The most commonly used working definition of an executory contract is the so-called “Countryman definition,” which defines an executory contract as

a contract under which the obligations of both the bankrupt and the other party are so far unperformed that failure of either to complete performance would constitute a material breach excusing the performance of the other.

Countryman, *Executory Contracts in Bankruptcy Law: Part I*, 57 Minn. L. Rev. 439 (1973).

other things) cure outstanding defaults under the contract (or “provide adequate assurance” that it will do so).⁷ The debtor must “provide adequate assurance of future performance.”⁸ Without adequate assurance of prompt cure or future performance, assumption is prohibited.⁹ Upon assumption, the contractual obligations become those of the estate. A breach of the contract by the debtor after the date of assumption thus will likely result in a post-petition claim for damages for breach of contract (treated as a first priority administrative claim under §§ 507(a)(1) and 503, often at 100¢ on the dollar), rather than a pre-petition claim for damages (which is payable only as set forth in the plan of reorganization, usually at a deep discount).

Rejection of an executory contract is an approximate opposite of assumption: the debtor refuses to be bound further by the contract. Under § 365(g) of the Code, rejection is deemed to be a pre-petition breach by the debtor, and under §§ 365(g) and 502(g), the breach gives rise to a pre-petition claim for damages for breach of contract. This damages claim, if allowed by the bankruptcy court, will be a general unsecured claim, which means the other party to the contract will be a member of the general creditor body. Specific performance is not an available remedy, even if it would be available absent bankruptcy.¹⁰

Alternatively, a debtor may assume and assign the contract. To do so, it must provide adequate assurance that the assignee can perform. As a general rule, the debtor may assign an executory contract even in the face of a contractual provision that prohibits or limits assignment.¹¹ But there are certain types of contracts that a debtor may not assign. For example, a personal services contract, which would not be assignable as a matter of non-bankruptcy law, cannot be assigned.¹²

Whether a contract is executory will depend on the terms of the particular contract and the degree to which the parties performed their duties as of the petition date. Some generalizations are possible, though. Trademark licenses are almost always executory because the licensor will have continuing quality control obligations and the licensee will have payment and

7. The debtor must also make whole any third parties who suffered losses as a result of the defaults. 11 U.S.C. § 365(b)(1)(B).

8. 11 U.S.C. § 365(b)(1).

9. See, e.g., *In re Luce Indus., Inc.*, 14 B.R. 529, 531-32 (S.D.N.Y. 1981).

10. *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers Inc.*, 756 F.2d 1043, 1048 (4th Cir. 1985), cert. denied, 475 U.S. 1057 (1986); *In re EI International*, 123 B.R. 64 (Bankr. D. Idaho 1991).

11. § 365(e).

12. § 365(c). See pp. 19-21, *infra*.

other continuing performance obligations.¹³ Other business terms, like “most favored nation” clauses (under which the licensor agrees to adjust fees downward if it gives a better rate to another licensee) or exclusivity terms, will likewise result in a finding that the contract is executory.¹⁴

3. Pre-Petition Versus Post-Petition Claims

The structure of a license can affect whether a debtor’s obligations under it give rise to pre-petition or post-petition claims. Ordinarily, a debtor who uses another’s property after the petition has to pay for its post-petition use—i.e., the owner has an administrative claim—even if the debtor later rejects the contract. But in certain circumstances the licensor can be left with a general unsecured pre-petition claim even if after the petition, but before rejection, the debtor-licensee continued to use the licensed intellectual property. Microsoft Corporation learned this lesson the hard way. In *In re DAK Industries, Inc.*,¹⁵ the debtor was a computer manufacturer that had licensed Microsoft Word for installation on computers that it would resell to end users. Microsoft provided a master disk to DAK, which DAK then used to install the program on the hardware it sold. Under the license, DAK committed to a series of five payments that had to be made irrespective of how many units it sold, though the specified per-unit rate was \$45. If it sold more units than were covered by the minimum commitment, DAK was obligated to pay \$45 a unit to Microsoft.

DAK filed a voluntary petition after making the first three payments. It continued for almost two years to sell computers with Microsoft Word preloaded. It then rejected the license agreement. Microsoft argued in the bankruptcy court that it had a post-petition administrative claim for the value of all the copies of Microsoft Word that DAK had sold between the date of the petition and the date DAK rejected the license. According to Microsoft, the license was in the nature of permission to use Microsoft’s intellectual property; thus, DAK was using and benefiting from the copyrighted software for its own benefit after the petition, which, Microsoft argued, required DAK to pay Microsoft 100¢ on the dollar for the units DAK sold.

13. See, e.g., *In re Blackstone Potato Chip Co., Inc.*, 109 B.R. 557, 560 (Bankr. D.R.I. 1990); *In re Chipwich, Inc.*, 54 B.R. 427 (Bankr. S.D.N.Y. 1985).

14. See, e.g., *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), cert. denied, 475 U.S. 1057 (1986) (technology license executory because of licensor’s obligation to notify of infringement actions and to grant lowest available rate); *In re Biopolymers, Inc.*, 136 B.R. 28 (D. Conn. 1992) (executory because of exclusivity obligation); *In re Access Beyond Tech., Inc.*, 237 B.R. 32, 43 (Bankr. D. Del. 1999); see also *In re Golden Books Family Entertainment*, 269 B.R. 300, 308 (Bankr. D. Del. 2001).

15. 66 F.3d 1091 (9th Cir. 1995).

The Ninth Circuit disagreed, holding that “the economic realities of this agreement indicate that it was basically a sale, not a license to use.”¹⁶ That meant Microsoft had not supplied any consideration to DAK post-petition, which in turn meant that Microsoft was not entitled to an administrative priority claim. This case underscores the care with which bankruptcy courts scrutinize agreements to ascertain their “true” nature. Without new consideration flowing to the debtor after the petition, courts will be loathe to deem a creditor’s claim post-petition, even if the debtor benefits post-petition. But this does not mean a debtor can use others’ property with impunity. If a debtor-licensee continues to use the licensor’s trademark or other licensed property after the petition, the licensor may have a post-petition claim under § 503(b), for the value of the benefit that use of the mark conferred on the estate. Typically, the value of the benefit is measured by the royalty rate in the license.¹⁷

B. Issues in Licensor Bankruptcies

Obviously, § 365 can give a debtor-licensor enormous bargaining leverage, particularly if the licensee’s business depends on the license. The debtor can use the threat of rejection to renegotiate the terms of licenses, or the debtor can “cherry-pick” licensees in connection with a sale of the licensed property by assigning only certain licenses to the buyer and rejecting the rest, or it can reject all existing licenses and start afresh.¹⁸ And the courts will generally uphold the debtor’s decision to assume or reject so long as it is a good faith exercise of business judgment that may benefit the estate.¹⁹

1. Equitable Limitations on Licensor’s Rejection Power

Although the “business judgment” test is a very deferential one that results in the bankruptcy court approving the vast majority of debtor decisions to assume or reject, the rule has its limits. Bankruptcy courts are courts of equity; a bankruptcy court can and will refuse to permit a debtor to reject a license if it believes that rejection will needlessly inflict great damage on the

16. 66 F.3d at 1096.

17. *In re Beverage Canvers Int’l Corp.*, 255 B.R. 89 (Bankr. S.D. Fla. 2000).

18. Cf. *In re Gucci*, 126 F.3d 380 (2d Cir. 1997) (purchase of mark from estate made conditional on debtor’s first rejecting all licenses).

19. See, e.g., *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984) (collective bargaining agreement); *Lubrizol Enterprises v. Richmond Metal Finishers*, 756 F.2d 1043, 1045 (4th Cir. 1985) (technology license); *In re G Survivor Corp.*, 171 B.R. 755 (Bankr. S.D.N.Y. 1994) (trademark license); *In re Blackstone Potato Chip Co., Inc.*, 109 B.R. 557, 560 (Bankr. D.R.I. 1990); *In re Chipwich, Inc.*, 54 B.R. 427, 430-31 (Bankr. S.D.N.Y. 1985).

licensee, especially if not accompanied by some countervailing benefit to the estate.

In *re* Petur U.S.A. Instrument Co.²⁰ was just such a case. The debtor, Petur U.S.A., licensed to Petur of Canada certain patents for geotechnical instruments, together with associated trademarks. Unlike Petur U.S.A., which suffered significant losses (ultimately leading to its bankruptcy), Petur of Canada was a successful, profitable concern. During its Chapter 11 case, Petur U.S.A. sought to reject the license, arguing that the license had been an improvident deal and that the income from sales of its instruments in Canada would benefit the estate going forward. But the court was unimpressed, and refused to permit rejection.

The court was primarily concerned that rejection would utterly destroy Petur of Canada's business. Rejection thus was inequitable because the harm to Petur of Canada would be vastly disproportionate to any benefit that creditors might receive—particularly in view of the court's doubts that Petur U.S.A. could effectively reorganize, much less manage the Canadian market in a competent way.²¹ In such "vast disproportion" cases, courts are often concerned as well that rejection may lead to licensee having an enormous pre-petition general unsecured claim that may crowd out other creditors.²²

2. Statutory Limitations on Licensor's Rejection Power: § 365(n)

Although the equitable powers of the bankruptcy court can afford some protection to the licensee of a debtor, that protection appears to apply at the fringes, in extreme cases of vast disproportion between the harm to the licensee and the benefit to the estate. Because equity considerations are generally fuzzy and ill-defined, it is difficult to say precisely at what point the balance of harms and benefits becomes "disproportionate." This is of no small concern to intellectual property licensees. For them, rejection can be harsh medicine: although upon rejection, a licensee will have a pre-petition claim for contract damages, that is a pale remedy because intellectual property by definition is unique—the licensee cannot truly "cover" by obtaining similar rights elsewhere. Rejection could very well even sound the death knell for a licensee's business.

This difficulty came to the attention of Congress after the Fourth Circuit's 1985 decision in *Lubrizol Enterprises, Inc. v.*

20. 35 B.R. 561 (Bankr. W.D. Wash. 1983).

21. To similar effect, see *In re Southern California Sound Systems, Inc.*, 69 B.R. 893 (Bankr. S.D. Cal. 1987); *In re Midwest Polychem, Ltd.*, 61 B.R. 559 (Bankr. N.D. Ill. 1986).

22. See, e.g., *Southern California Sound Systems, id.*; *In re Ron Matusalem*, 158 B.R. 514 (Bankr. S.D. Fla. 1993).

Richmond Metal Finishers, Inc.²³ The Lubrizol Court applied the normal analysis that is used in any rejection case. The court first determined that the technology license at issue was executory. It then approved rejection under the “business judgment” standard, noting that so long as the debtor’s decision to reject was neither taken in bad faith nor a gross abuse of business discretion, the court would approve rejection even if it disagreed with the decision on the merits. The Lubrizol court recognized explicitly the difficulties that rejection imposes on licensees, and even noted that the prospect of possible rejection could have a “chilling effect” on intellectual property licensing by any companies other than the financially strongest. Nevertheless, the Fourth Circuit felt bound to apply the law as it then stood.

In response to Lubrizol, Congress enacted the Intellectual Property Bankruptcy Protection Act in 1988, which amended § 365 to ameliorate some of the difficulties highlighted by Lubrizol. Instead of leaving the decision as to the future of the license solely in the hands of the debtor-licensor (subject to court approval), the new § 365(n) gives licensees of “intellectual property” (as defined in the Code) the option to retain certain rights under the license even in the face of the debtor-licensor’s rejection. Under § 365(n), if the court approves rejection of the license, the licensee can either (i) treat the rejection as a breach giving rise to a potential claim for money damages under § 365(g), as with other rejected contracts, or (ii) elect to retain the rights to the intellectual property covered by the license, including any exclusivity rights.²⁴ If the licensee elects to retain its rights under the agreement, the debtor must permit the licensee to exercise its rights and the licensee must continue to make all royalty payments due under the contract.²⁵ The licensee retains this right to the licensed property for the remaining life of the license plus any as-of-right renewal or extension period. However, rejection relieves the debtor from performing any of its ongoing or future affirmative obligations under the contract.²⁶ The debtor is still bound by passive obligations, such as maintaining confidentiality, that are necessary for the licensee to enjoy the benefits of the license.²⁷ The licensee is not entitled, however, to

23. 756 F.2d 1043 (4th Cir. 1985), cert. denied, 475 U.S. 1057 (1986).

24. The right to enforce an exclusivity provision is an exception to the general rule proscribing specific performance as a remedy for the debtor’s breach of the license.

25. § 365(n)(1)(B).

26. § 365(n)(2)(C) provides that a licensee who elects to retain rights under § 365(n) is deemed to waive the right of setoff against royalty payments and the right to collect administrative expenses; the licensee may still seek damages from the debtor, but only as a general unsecured creditor. If the licensee elects to retain its rights, the trustee must make the intellectual property available to the licensee. § 365(n)(3)(A).

27. *In re Szombathy*, 1996 Bankr. LEXIS 888, slip op. at 31-32 (Bankr. N.D. Ill. 1996)(citing S. Rep. 100-505) rev’d on other grounds, 1997 U.S. Dist. LEXIS 5168 (N.D. Ill. 1997).

the benefits of a debtor's post-petition labors even if the licensee elects under § 365(n) to retain its license rights; thus, for example, a § 365(n) election will not entitle a patent licensee to any improvements the debtor developed post-petition. Those belong to the debtor.²⁸ In addition, until the license is rejected, a licensee has the right to demand in writing that the debtor continue to perform or at least not to interfere with the licensee's ability to enjoy the license.²⁹

Notably, however, § 365(n) applies only to licenses of "intellectual property" as defined in the Code. The Code defines "intellectual property" in § 101(35A) to include patents, copyrights, trade secrets, and semi-conductor chip mask works—but not trademarks. Congress's concern in enacting § 365(n) was to protect new and unproven start-up companies in the computer software and biotechnology industries, which were heavily dependent on licensing.³⁰ Congress perceived Lubrizol as a direct threat to the growth of these industries; it was concerned that potential licensees would shy away from dealing with financially unsteady startups for fear of having to invest substantial sums to commercialize a product only to lose the licenses upon the licensor's bankruptcy.

The legislative history indicates that, by amending § 365, Congress specifically did not intend to "bring every retail franchise involving a trademark within the purview of the legislation, thus extending the reach of the bill far beyond what appears necessary."³¹ At least part of the reason is the unique legal attributes that distinguish trademarks from the other forms of intellectual property addressed in § 365(n). Unlike owners of copyrights and patents, trademark owners must take affirmative steps to control use of the mark in order to retain their continued

28. *In re Szombathy*, 1997 Bankr. LEXIS 888, slip op. at 9-10 (N.D. Ill. 1997).

29. § 365(n)(4).

30. See *Intellectual Property Contracts in Bankruptcy: Hearings on H.R. 4657 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 100th Cong. 2d Sess. (June 3, 1988), hereinafter "House Hearings" (statement of James Burger, Chief-Counsel-Government, Apple Computer Inc.); *A Bill to Keep Secure the Rights of Intellectual Property Licensors and Licensees Which Come Under the Protection of Title 11 of the United States Code, the Bankruptcy Code: Hearings on S.1626 Before the Subcomm. on Courts and Administrative Practice of the Senate Comm. on the Judiciary*, 100th Cong. 1st Sess. (June 10, 1988), hereinafter "Senate Hearings" (statement of John L. Pickitt, President, Computer and Business Equipment Manufacturers Association).

31. Senate Hearings, statement of George A. Hahn on behalf of the National Bankruptcy Conference at 4. See also, Letter by George A. Hahn on behalf of the National Bankruptcy Conference (July 14, 1988), in *The American Bankruptcy Institute Survey* at 344 ("[t]he Conference supports this legislation on a semi-emergency basis in order to further the activities of American research and development companies in the world race for technological leadership. The Conference sees no such emergency for and has no particular interest in, extending such protection to trademarks connected with traditional distributorships and retail businesses at this time.").

rights. And by exercising control of the mark, the owner's rights potentially may last forever—in contrast to patents and copyrights, which have statutory expiration dates. This quality control requirement is at odds with § 365(n); a continuing obligation on the licensor is contrary to the purpose behind rejection, which is to free the debtor from its obligations under the rejected contract.³²

Thus, Congress's exclusion of trademarks from the definition of "intellectual property" did not mean that Congress ignored the difficulties of trademark licensees.³³ All it means is Congress focused on what it viewed as the more pressing threat at the time: potential damage to technology licensing. Nevertheless, Congress explicitly encouraged the courts to develop and pursue equitable treatment of trademark licenses in the rejection context.³⁴

In the time since 1988, when Congress enacted § 365(n), conventional § 365 analysis apparently continues to prevail in trademark license rejection cases, despite Congress's invitation to the courts to develop rules governing rejection of licenses in debtor bankruptcies.³⁵ In fact, a case decided just last year refused to apply § 365(n) to trademarks even while it applied § 365(n) to closely related copyrights.³⁶

3. Section 365(n) and the Conundrum of "Bundled Rights"

Changes in the economy since 1988 have highlighted certain defects in the scheme set up by § 365(n). Specifically, § 365(n) may have made it more difficult to reorganize a business built in part on intellectual property. In the modern economy, businesses or assets increasingly are made up of bundles of rights, some of them "intellectual property" as defined in the Bankruptcy Code, and others not. These bundles can be composed of some combination of such things as intellectual property licenses, marketing or distribution rights, affinity marketing arrangements, co-branding, trade secrets, patents of business methods or new technology, processes or know-how and software copyrights. Pharmaceutical products are often based on a combination of patents, know-how

32. S. Rep. No. 505, 100th Cong., 2d Sess. (1988). See also, Senate Hearings, *supra* n.30, at 4.

33. To the contrary, the legislative history reflects clear awareness of the problem. See S. Rep., *id.* ("While such rejection [of a trademark license] is of concern because of the interpretation of § 365 by the Lubrizol court and others [citations omitted], such contracts raise issues beyond the scope of this legislation").

34. *Id.*

35. See, e.g., *In re Gucci*, 126 F.3d 380, 394 (2d Cir. 1997); *In re Blackstone Potato Chip Co.*, 109 B.R. 557 (Bankr. D.R.I. 1990). But see *In re Ron Matusalem, Inc.*, 158 B.R. 514 (Bankr. S.D. Fla. 1993), discussed *infra*.

36. *In re Centura Software Corp.*, 281 B.R. 660 (Bankr. N.D. Cal. 2002).

and trademarks. Motion picture rights may entail licenses of copyrights, trademarks, distribution rights and rights of publicity. Website businesses can be composed of software (often copyrighted), trademarks, trade dress, good will, copyrighted content, perhaps a business method patent, and URLs (which, of course, are based upon registration agreements). The business owner might own some of these rights, but others might be licensed and others might be owned but contracted out to third parties.

This increase in properties composed of bundles of rights highlights a potentially enormous gap in § 365(n). Section 365(n) presumes that each intellectual property license is a discrete entity rather than a part of a larger, integrated set of rights, which is inconsistent with the current business environment. The underpinnings of a line of business cannot always be classified simply as “intellectual property” under § 365(n) or not. Often the business is built on both types of property.

Under current law, if a licensor files a Chapter 11 petition and seeks to reject its licenses in order to get lines of business back from its licensees, § 365(n) can lead to a standoff. Through rejection, the debtor-licensor could recover its trademarks and some other contract-based assets, but might not recover the copyright, patent or trade-secret-based part of the business, because the licensees could elect to retain their rights under § 365(n). In conventional contract law, generally one part of a deal cannot remain in place while performance of another part is excused, because related documents that form a single transaction normally are construed together.³⁷ Similarly, a debtor cannot construe the various parts of a transaction as separate agreements in order to assume the favorable portions and reject the unfavorable ones.³⁸

But in a “bundled rights” case, the debtor is not trying to break up a transaction into pieces in order to keep the ones it likes and reject the ones it doesn’t. In such a case, the problem arises because, even though the debtor rejects all parts of the deal, there are different consequences of rejecting different types of contracts: for some (such as patent or copyright licenses), the licensee can keep its rights and for others it cannot. That can leave different parts of the same business in different hands, so that neither party

37. See, e.g., *Donoghue v. IBC USA (Publications), Inc.*, 70 F.3d 206, 212 (1st Cir.1995); *Gordon v. Vincent Youmans, Inc.*, 358 F.2d 261, 263 (2d Cir. 1965); *Stetzer v. Dunkin’ Donuts, Inc.*, 87 F. Supp. 2d 104, 110 (D. Conn. 2000); *Bloor v. Shapiro*, 32 B.R. 993, 999 (S.D.N.Y. 1983); Restatement (Second) of Contracts § 202(2).

38. See, e.g., *In re T&H Diner, Inc.*, 108 B.R. 448 (D.N.J. 1989); *In re Holland*, 25 B.R. 301, 303 (E.D.N.C. 1982) (conditional assignment cannot be rejected separately from lease); *In re The Texstone Venture, Ltd.*, 54 B.R. 54 (Bankr. S.D. Tex. 1985); *Matter of Shelter Dev. Group, Inc.*, 50 B.R. 588 (Bankr. S.D. Fla. 1985) (rejection of lease required rejection of mortgages).

can run the business. As a result, for debtor businesses that hold a bundle of different but related rights, § 365 seems to drive the parties to a situation where the debtor *must* assume the contract, because it may be left with no (or little) advantage from rejection. Of course, that creates real problems for a debtor without the resources to assume the license, or without the ability to find a buyer who will accept an assignment of the license.³⁹

The licensee in such a situation does not have much comfort either, because the licensee has no ready way to keep control of all the assets it needs to carry on its business. It has the ability to keep only some of the pieces. This mutual standoff certainly can provide a powerful incentive for both sides to get together to negotiate a business accommodation. And in a rational world, usually that should happen. But of course the world is not always rational. What happens if the parties cannot agree? What happens if enlightened self-interest does not prevail, or the business needs of the parties cannot be made to coincide?

A case decided in 1993 highlights the problem. In *re Ron Matusalem*⁴⁰ involved a rum business, where the licenses covered know-how, trade secrets and a trademark. Some language in *Matusalem* can be read to suggest that the court in that case believed the licensee could retain its rights in the *trademark* license under § 365(n), even though § 365(n) does not on its face cover trademarks. To date, this case has had very limited influence. In the past year, one court rejected the notion that § 365(n) could apply to trademarks, despite the licensee's reliance on *Matusalem* for the proposition that the licensee could retain its trademark license rights under § 365(n).⁴¹ Because of its unusual facts and the alternative bases for its decision, *Matusalem* may well never be widely accepted. But if its application of § 365(n) to trademarks is followed by other courts, the ramifications for trademark law are potentially enormous.

The *Matusalem* bankruptcy was one of the final rounds of a long-standing family feud. One branch of the family controlled the entities that owned a process for manufacturing rum, together with associated trademarks, and the other branch controlled the entity that, under an exclusive long-term license, manufactured

39. Another issue is the effect of the rule against assignments in gross. Suppose the trademark license is merely one part of a larger set of rights, and the trademark by itself, without the other associated contracts and licenses, cannot, as a practical matter, be used. Rejection could arguably violate the rule against assignments in gross: as a result of the rejection, the debtor would be receiving back a trademark that has no goodwill associated with it—which in turn could mean the trademark is invalid, see 15 U.S.C. § 1060. To the author's knowledge, this issue has not come up so far. It is worth noting, however, that bankruptcy courts have tended to strain to find some kind of goodwill passing along with the trademark. See, e.g., *In re Roman Cleanser, Inc.*, 802 F.2d 207 (6th Cir. 1986).

40. 158 B.R. 514 (Bankr. S.D. Fla. 1993).

41. *In re Centura Software Corp.*, 281 B.R. 660, 971-72 (Bankr. N.D. Cal. 2002).

and sold the rum. The licensor (“Matusa”) had failed in its prebankruptcy attempt to terminate the franchise agreement based on purported breaches by the licensee (“Inc.”); the Eleventh Circuit in 1989 upheld a district court determination that the claimed breaches were not material.⁴² When Matusa later filed a Chapter 11 petition, it sought to reject its licensing arrangement with Inc. In support of its motion, Matusa relied on Lubrizol for the proposition that its rejection could deprive Inc. of all its rights under the agreement.

The opinion begins by rejecting the debtor’s argument that Lubrizol was controlling rather than § 365(n). As the court saw it, “[t]he pertinent Legislative report states: ‘since these matters [relating to 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.’ Thus the ball is back in the Court’s court.”⁴³ The court went on to hold that rejection, and removal of use rights from the licensee, were inappropriate—whether under the debtor’s Lubrizol theory or under § 365(n).

Several factors indicate that the Matusalem court could have refused to permit rejection solely by applying typical rejection analysis. The court believed that the rejection was not an exercise of good faith business judgment, but rather a vendetta, and it questioned Matusa’s ability to reorganize and manage a rum business competently even if rejection were permitted.⁴⁴ The impact on Inc. would have been devastating, which means that a rejection would have had destructive effect on the licensee without any probable benefit to the debtor.⁴⁵ Further, because § 365(n) clearly covered the trade secret aspect of the license (namely the formula and manufacturing process), Inc. could retain some rights anyway, even if the other parts of the license could be rejected. So rejection could well be to no avail because Matusa would be unable to recover the rum business in any event.

42. *Ron Matusalem & Matusalem of Florida, Inc. v. Ron Matusalem, Inc.*, 872 F.2d 1547 (11th Cir. 1989).

43. 158 B.R. at 516.

44. 158 B.R. at 520, 522.

45. The Bankruptcy Court has residual equitable power to disapprove rejection when it believes the nondebtor would be harmed highly disproportionately to any possible minimal benefit to the debtor, and it has exercised that power in trademark cases. See, e.g., *In re Southern California Sound Systems, Inc.*, 69 B.R. 893 (Bankr. S.D. Cal. 1987); *In re Midwest Polychem, Ltd.*, 61 B.R. 559 (Bankr. N.D. Ill. 1986); *In re Petur U.S.A. Instrument Co.*, 35 B.R. 561 (Bankr. W.D. Wash. 1983); *supra* pp. 6-7. These cases (as well as *Matusalem*) also raise the concern that rejection in these circumstances will result in such an enormous unsecured pre-petition claim that it will crowd out all the other creditors from any appreciable chance of a reasonable recovery.

Thus, the court could have rested its opinion that rejection was improper entirely on conventional rejection analysis, without applying § 365(n) to trademarks. Nevertheless, the court said that it would have permitted a § 365(n) election if the trademark license were rejected. The court did not consider the potential impact of its interpretation of § 365(n) upon the Lanham's Act's quality control requirements. Section 365(n) thus may well require further legislative rethinking to remove from a stubborn licensee an effective veto over sale of a business.

The case law thus offers no clear guidance about what happens when a business based on a bundle of related but disparate rights is caught up in a bankruptcy. It remains to be seen whether the issue will be addressed during the recent surge in Chapter 11 filings.

C. Issues Raised by Bankruptcy of a Licensee

When the debtor is a licensee, many of the issues are similar to those raised when the debtor is licensor—but the perspective is markedly different. A licensor whose licensee becomes a Chapter 11 debtor is faced with potential harm to its rights in the licensed property. Because of (among other things) quality control requirements and the danger of possible abandonment or laches, trademark owners are uniquely at risk when a licensee files a petition and the automatic stay comes into effect.

1. Owner's Risks From Licensee Bankruptcy

Although the non-debtor licensor must continue to perform under the license agreement, the automatic stay prevents it from enforcing the license agreement against the debtor without going through the bankruptcy court.⁴⁶ For a trademark owner, this could have adverse consequences since the stay limits the licensor's ability to control its mark. Failure to control a mark may lead (if all the requisite elements are shown) to a finding that the mark may have been abandoned.⁴⁷ Yet, because the automatic stay restricts the licensor's ability to enforce the license against the debtor, unsupervised or nonconforming merchandise might enter the stream of commerce. Thus, beyond the normal concerns of any person who deals with a company that files a bankruptcy petition, the trademark licensor also has the problem—quite literally—of “protecting the franchise.” In addition to the danger of possible

46. It should be noted, though, that the licensor would obtain a first-priority claim for the value of the debtor's obligation to perform post-petition, including the obligation to pay royalties. 11 U.S.C. §§ 503(b), 507(a)(1).

47. See, e.g., *Haymaker Sports, Inc. v. Turian*, 581 F.2d 257 (3d Cir. 1978); *Carl Zeiss Stiftung v. V.E.B. Carl Zeiss, Jena*, 293 F. Supp. 892 (S.D.N.Y. 1968), *aff'd*, 433 F.2d 686 (2d Cir. 1970), *cert. denied*, 403 U.S. 905 (1971).

abandonment-related litigation, the licensor's reputation may be injured if inferior or non-conforming goods are sold bearing the licensor's mark.

The licensor has several ways to protect itself, none of them perfect. The licensor may move in bankruptcy court to compel the debtor to assume or reject the license agreement; alternatively, it may seek to lift the stay so that it may terminate the license. A licensor may want to prevent the licensee from assigning the license to an undesirable assignee in order to force the debtor to give up the license. The first step, however, is to determine whether the license has already been terminated pre-petition.

2. Bankruptcy Code Treatment of License Termination

Whether the license has already terminated is the crucial question. If the license did not terminate pre-petition, then the debtor has power to assume it at some time in the future, and thus to use it until the decision to assume or reject is made. A licensor cannot unilaterally terminate the license post-petition.⁴⁸

The automatic stay does not by itself prevent the termination of a license. If a license is supposed to expire by its own terms, but before the expiration date the licensee files a bankruptcy petition, the automatic stay has no effect: at the end of the license term the license will terminate. In the words of the Seventh Circuit, "[t]he automatic stay does not toll the mere running of time under a contract, and thus it does not prevent automatic termination of the contract."⁴⁹ Similarly, if the contract had already terminated at the petition date, it cannot be revived.⁵⁰ For example, a renewal option that had not been exercised properly before the petition can not be exercised post-petition if the license does not permit it.⁵¹

If, however, the license is not simply expiring, but rather is expiring *if* the licensee does not cure defaults by a certain date, then the license will not terminate even if the licensee did not cure by the prescribed date. In such a case, the intervening bankruptcy petition, and the automatic stay that comes along with it, operate to freeze the parties' rights in their posture as of the moment of

48. See, e.g., *In re Deppe*, 110 B.R. 898, 902 (Bankr. D. Minn. 1990); *In re Quinones Ruiz*, 98 B.R. 636 (Bankr. D.P.R. 1988).

49. *Moody v. Amoco Oil Co.*, 734 F.2d 1200, 1213 (7th Cir.), cert. denied, 469 U.S. 982 (1984). See also *In re Diversified Washes of Vandalia, Inc.*, 147 B.R. 23 (Bankr. S.D. Ohio 1992); *In re Anne Cara Oil Co.*, 32 B.R. 643, 647 (Bankr. D. Mass. 1983); *In re M&E Enters., Inc.*, 23 B.R. 820 (Bankr. S.D. Fla. 1982); *In re Benrus Watch Co.*, 13 B.R. 331 (Bankr. S.D.N.Y. 1981).

50. See, e.g., *City Auto, Inc. v. Exxon Co.*, 806 F. Supp. 567, 569 (E.D. Va. 1992); *In re AGI Software, Inc.*, 199 B.R. 850, 860 (Bankr. D.N.J. 1995); *In re Gainesville P-H Properties, Inc.*, 77 B.R. 285 (Bankr. M.D. Fla. 1987).

51. See *In re Roswog*, 48 B.R. 689 (Bankr. N.D. Pa. 1985).

filing.⁵² So long as the licensee retains any rights under the license whatsoever, the license becomes part of the estate under § 541; it is subject to possible assumption under § 365; and the automatic stay applies under § 362.⁵³ Even an ex parte temporary restraining order enjoining termination, which may ultimately turn out to have been improvidently granted, is enough to make the license part of the estate.⁵⁴ So long as a possibility of cure exists, the stay prevents termination. The converse is also true: if cure is impossible, the licensor may terminate, with bankruptcy court approval.⁵⁵

Because violating the automatic stay may carry contempt-like sanctions, it is advisable for a licensor who believes the license validly terminated pre-petition to seek a declaration of rights from the bankruptcy court, even in relatively clear-cut cases.⁵⁶ If the debtor is continuing to use the licensed property after what the licensor believes was a pre-petition expiration, it will be necessary to seek bankruptcy court relief in any event because the stay prohibits the commencement of any actions against the debtor that could have been brought before the petition.⁵⁷ If the bankruptcy court finds that the license expired before the petition, it may lift the stay to permit the licensor to pursue its remedies in state court, other than collecting a money judgment.⁵⁸

Trademark licenses often are part of a web of interconnected agreements. This is especially so in franchise situations, where a license might be coupled with a real estate lease or with supply contracts or other business arrangements. As a drafting matter, licensor's counsel might be well-advised to provide in each of the related documents that termination of the trademark license automatically terminates the related agreements. Without such a provision, it is possible for a bankruptcy court to decide that the lease, for example, did not terminate even though the license did, as occurred in *In re 717 Grand Street Corp.*,⁵⁹ a case that involved Baskin Robbins and Dunkin' Donuts franchises. The court held

52. See, e.g., *City Auto, Inc. v. Exxon Co.*, 806 F. Supp. 567, 569 (E.D. Va. 1992); *In re Tudor Motor Lodge Assocs., L.P.*, 102 B.R. 936, 951 (Bankr. D.N.J. 1989).

53. See, e.g., *In re Supernatural Foods, LLC*, 268 B.R. 759, 766-98 (Bankr. M.D. La. 2001); *In re ERA Cent. Regional Servs. Inc.*, 39 B.R. 738, 740-41 (Bankr. C.D. Ill. 1984); *In re Vylene Enters.*, 90 F.3d 1472, 1496 (9th Cir. 1986) (all rights in existence on petition date are part of estate).

54. See, e.g., *In re Wills Motors, Inc.*, 133 B.R. 297 (Bankr. S.D.N.Y. 1991).

55. See, e.g., *In re Deppe*, 110 B.R. 898, 904 (Bankr. D. Minn. 1990); *In re Best Film & Video Corp.*, 46 B.R. 861 (Bankr. S.D.N.Y. 1985).

56. See, e.g., *City Auto, Inc. v. Exxon Co.*, 806 F. Supp. 567 (E.D. Va. 1992); *In re 717 Grand Street Corp.*, 259 B.R. 1 (Bankr. E.D.N.Y. 2000).

57. 11 U.S.C. § 362(a).

58. *In re 717 Grand Street Corp.*, 259 B.R. 1, 5-6 (Bankr. E.D.N.Y. 2000)

59. *Id.*

that even though the lease provided that the property could be used only for a Dunkin' Donuts store, the lease was not part of a single indivisible transaction with the license. The court reasoned that the debtor could still assume and assign the lease to some other person who would operate a Dunkin' Donuts store at the location. As a result, the franchisor was able to terminate the license but could not recover the leased property.

3. Motion to Lift Stay to Permit Termination

A licensor may seek to protect itself by moving to lift the automatic stay in order to permit the licensor to terminate the license. The most likely vehicle by which the licensor will seek to have the stay lifted is § 362(d)(1), which authorizes the bankruptcy court to lift the stay "for cause." Although § 362(d)(1) does not define "cause," "cause" includes "lack of adequate protection of an interest in property of such party in interest." What constitutes "adequate protection"? Although not defined in the Code, § 361 sets forth several non-exclusive ways that adequate protection may be provided, such as cash payments, replacement liens or other relief that (in the words of § 361) "will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property." As one court stated, "[o]n a motion for relief from the stay, adequate protection is meant to preserve the status quo of the entity with an interest in the debtor's property during a reasonable length of time. The rights of the creditor are frozen, but not changed."⁶⁰

Trademark licensors typically feel the need to terminate immediately or else gain assurance of compliance when a licensee files a bankruptcy petition because the automatic stay makes enforcement of the license problematic. Until the license is assumed or rejected, the debtor need not comply with its obligations unless ordered to do so. Trademark licensors thus may feel they can never be adequately protected against debtor non-compliance with the terms of the license because the licensor's rights in the trademark are tied to their control over the mark.

As a practical matter, courts usually cut the debtor some slack early in a Chapter 11 case, particularly where the trademark license is the linchpin of the debtor's business. But if as the case wears on, the debtor continues not to comply with the provisions of the license, the licensor's argument that its interest is not being adequately protected and that the mark is being harmed gains credibility. Generally speaking, the bankruptcy courts will accept such an argument if the licensor can demonstrate it is suffering real harm and if the court does not perceive that the desire to terminate is really motivated by the fact that the debtor owes pre-

60. In re Tudor Motor Lodge Assocs., L.P., 102 B.R. 936, 954 (Bankr. D.N.J. 1989).

petition royalty or license payments.⁶¹ As one court put it, “the property in this case, the use of trademarks and service marks, is of such a type that money may never adequately protect the movant. The movant’s reputation to the general public is at stake.”⁶² The licensor in that case obtained the relief from stay it was seeking. But a mere claim for damages for past infringement does not present “cause” that warrants lifting the stay.⁶³

Thus, the court will deny a motion to lift the stay in a case where the court is not convinced that there is a real quality control concern. A licensor’s delays in asserting quality control are particularly damning.⁶⁴ In fact, one district court has held that upon assumption, nonmonetary defaults need not be cured under § 365(b)(2)(D).⁶⁵ This case law underscores for licensors the importance of vigilance and a good paper record of consistent quality control.⁶⁶ It also argues in favor of moving promptly for relief from the stay as soon as there is a hint that the licensee is not complying.

The general rule appears to be that an ongoing injury that casts doubt on the licensee’s ability to cure will justify termination. In other words, the less likely the debtor can cure the breach, the more likely that the harm to the licensor will continue and that the licensor will not be “adequately protected,” leading to relief from the automatic stay. Thus, a licensor who can show an incurable default may receive relief from the stay.⁶⁷

4. Motion to Compel Assumption or Rejection

If the license was still in effect at the petition date, the licensor may seek to compel the debtor to assume or reject it. A motion to compel the debtor to assume or reject an executory contract is precisely what its name says it is. It is basically a mechanism for reducing uncertainty. If the motion is granted, then

61. Inability of the debtor to make *post*-petition payments, however, is an indicium of lack of adequate protection, and may be a basis for lifting the automatic stay to permit termination. See *infra*.

62. In *re* B-K of Kansas, Inc., 69 B.R. 812, 815 (D. Kan. 1989). See also In *re* Tudor Motor Lodge Assocs., L.P., 102 B.R. 936 (Bankr. D.N.J. 1989).

63. In *re* Telegroup, Inc., 237 B.R. 87 (Bankr. D.N.J. 1999).

64. See *Matter of Independent Management Associates, Inc.*, 108 B.R. 456 (D.N.J. 1989).

65. In *re* Claremont Acquisition Corp., Inc., 186 B.R. 977 (C.D. Cal. 1995).

66. Other cases where relief from stay was denied because the court perceived no genuine quality control concern are In *re* Rooster, Inc., 100 B.R. 228 (Bankr. E.D. Pa. 1989); and In *re* Specialty Foods of Pittsburgh, Inc., 91 B.R. 364 (Bankr. W.D. Pa. 1988).

67. See, e.g., In *re* Lee West Enters, Inc., 179 B.R. 204 (Bankr. C.D. Cal. 1995) (closure of auto dealership for extended period); In *re* Ruiz, 98 B.R. 636. (Bankr. D.P.R. 1988) (misbranding of fuel); In *re* Joyner, 55 B.R. 242 (Bankr. M.D. Ga. 1985) (same). But see In *re* Tom Stimus Chrysler-Plymouth, Inc., 134 B.R. 676 (Bankr. M.D. Fla. 1991) (permitting assumption despite closure of auto dealership).

under § 365(d)(2) the court may order the debtor to elect within a court-specified time whether to assume or reject the license. The amount of time given may be short or long, according to the equities of the situation.⁶⁸ Courts do not always grant such motions, especially early in a case, but are more likely to grant the motion upon a showing of lack of adequate protection. In Chapter 7 cases, the trustee must elect to assume or reject executory contracts within 60 days after the petition (or such longer period as the court may order for cause). In Chapter 7, a contract that is not timely assumed is deemed rejected.⁶⁹

The consequences of the choice are the same as set forth above in the discussions of licensor rejection and assumption: if the license is rejected, both parties are freed from performance and the non-debtor party (here the licensor) will gain an unsecured pre-petition claim for damages for breach of contract. If the license is assumed, the debtor must cure past defaults and provide adequate assurance of future performance.

5. Limitations on Licensee's Ability to Assume and Assign

(a) Adequate Assurance

To assume and assign an executory contract, the debtor must provide adequate assurance that the assignee can perform. "Adequate assurance" does not mean ironclad assurance: "the assurance of future performances is adequate if performance is likely (i.e. more probable than not). The degree of assurance necessarily falls considerably short of an absolute guaranty."⁷⁰ Indeed, at least one bankruptcy court has approved giving the debtor a two-year payment plan to cure its defaults under a patent license, finding that the debtor's business prospects were bright enough to adequately assure performance in the future and cure past defaults.⁷¹

(b) Impact of § 363 Procedures Regarding Sales of Estate Property

To assume and assign the license under § 365(f), the debtor-licensee must show that the assignee will comply with the terms of the license. This requirement cannot be circumvented by

68. In *In re New York City Shoes*, 84 B.R. 947 (Bankr. E.D. Pa. 1988), for example, the court determined that rejection was the most likely outcome—but so as not to predetermine the debtor's judgment, the court gave the debtor 10 days in which to decide whether to assume or reject, or else the court would deem the license rejected.

69. 11 U.S.C. § 365(d)(1).

70. In *re Prime Motor Inns, Inc.*, 166 B.R. 993, 997 (Bankr. S.D. Fla. 1994).

71. See *In re Ehrenfried Technologies, Inc.*, 1998 Bankr. LEXIS 804 (Bankr. E.D. Va. 1998).

disguising the assumption and assignment in the garb of a sale of the license under § 363. As one court put it, the debtor “cannot sell the assets of a debtor’s business, including the right to use a trademark, free of the obligations to pay a royalty for the trademark use.”⁷² Assuming and assigning the contract is an absolute precondition to selling a license.⁷³

Courts recognize that assumption and assignment of an intellectual property license is conceptually similar to a sale because a license is not just an executory contract—it is also property of the estate.⁷⁴ Thus, just as a license can be sold only by complying with the rules in § 365 for assumption and assignment, an assumption and assignment must also comply with the rules in § 363 for a sale. As the Third Circuit explained in *Krebs Chrysler-Plymouth, Inc. v. Valley Motors, Inc.*:

Trademarks are property, and franchises are licenses to use such property. Thus, under [state] law, these franchises are interests in property, and as such are property of the estate under [Bankruptcy Code] section 541. They also are covered by section 363, although the procedure for their transfer is delineated by section 365.⁷⁵

Because § 363 applies to sale of a license, once the bankruptcy court grants a licensee’s motion to assume and assign, a disgruntled licensor who wishes to retain the right may try to undo the transfer. Section 363(m) provides that if there is no stay pending appeal, a sale to a good faith purchaser cannot be undone *even if the order approving the sale is reversed on appeal*. Thus, unless some relief other than undoing the sale is available, failing to obtain a stay will ordinarily moot the appeal.⁷⁶

Under § 363(m), an entity can be a “good faith purchaser” even if it knew of the pendency of the appeal. This can often mean that the purchaser’s “good faith” is really the only issue that can lead to effective relief on appeal. However, “good faith” simply means that the winning bidder paid value and was not involved in fraud, collusion or unfair advantage in the bidding process.⁷⁷

(c) Non-assignable Contracts

Under § 365(f), most contracts can be assumed and assigned regardless of whether the contract itself restricts assignment. The

72. *In re Dartmouth Audio, Inc.*, 42 B.R. 871, 875 (Bankr. D.N.H. 1984).

73. *In re Access Beyond Technologies, Inc.*, 237 B.R. 32, 47 (Bankr. D. Del. 1999) (“until [an executory contract] is assumed under section 365, the debtor has nothing to sell under section 363”).

74. See, e.g., *In re Qintex Entertainment, Inc.*, 950 F.2d 1492, 1495 (9th Cir. 1991).

75. 141 F.3d 490, 498 (3d Cir. 1998).

76. *Id.* at 499.

77. *In re Gucci*, 126 F.3d 380, 390 (2d Cir. 1997).

main exception to this rule is set forth in § 365(c)(1), under which the debtor cannot assign a contract if, even in the absence of a contract clause restricting assignment, the other party would not be required to accept performance from someone other than the debtor.⁷⁸ The prototype of such a contract is a personal services contract, where what is bargained for is a specific person's performance. In such cases, the nondebtor party to the contract cannot be forced to accept performance from someone else.

What constitutes a personal service contract is a matter of nuance. Simply reciting in the contract that a specific person's services are being bargained for is not dispositive.⁷⁹ The courts look, instead, to whether the "contracted-for duties involved the exercise of special knowledge, judgment, taste, skill, or ability."⁸⁰ The results of this test are not readily predictable. The Third Circuit held that an automobile dealership could possibly be a personal services contract, depending on how the factual record developed.⁸¹ But one bankruptcy court held that it takes no special skill to run a Burger King franchise,⁸² and another held that choosing patterns for ties to be sold under Bill Blass's name was not an exercise of unique taste or judgment.⁸³

Outside the personal services area, the issue of whether the nondebtor may be excused from accepting an assignee's performance often arises in connection with automobile dealerships, in which rights and duties are heavily subject to state regulation. Under the majority rule, the nondebtor franchisor may be excused by state statute from accepting performance from an assignee of a dealership against the franchisor's will.⁸⁴

Whether a license is assignable is significant for other reasons as well. The circuits are split concerning whether a debtor can

78. § 365(c)(1) provides as follows:

(c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession whether or not such contract, or lease, prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment.

79. See, e.g., *In re Headquarters Dodge, Inc.*, 13 F.3d 674 (3d Cir. 1993).

80. *In re Rooster, Inc.*, 100 B.R. 228, 232 (Bankr. E.D. Pa. 1989). See also, e.g., *In re Sunrise Restaurants, Inc.*, 135 B.R. 149, 153 (Bankr. M.D. Fla. 1991).

81. *Headquarters Dodge*, 13 F.3d 674.

82. *Sunrise Restaurants*, 135 B.R. 149.

83. *Rooster*, 100 B.R. 228.

84. See, e.g., *Pioneer Ford Sales, Inc.*, 729 F.2d 27 (1st Cir. 1984); *In re Claremont Acquisition Corp., Inc.*, 186 B.R. 977 (C.D. Cal. 1995); *In re Van Ness Auto Plaza, Inc.*, 120 B.R. 545 (Bankr. N.D. Cal. 1990). But see *In re Tom Stimus Chrysler-Plymouth, Inc.*, 134 B.R. 676 (Bankr. M.D. Fla. 1991).

assume an executory contract that is not assignable. The language of § 365(c) seems to suggest that a debtor may not do so: “The [debtor] may not assume or assign any executory contract . . . whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if . . . applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor . . .” The Ninth Circuit’s and Third Circuit’s view is that this language requires application of the so-called “hypothetical test”: if hypothetically the debtor could not assign the license without the nondebtor party’s consent, then the debtor cannot assume it either—even if the debtor has no intention of assigning the license, but rather wants to perform under it, as with any other assumed contract.⁸⁵ Applying this test, the Ninth Circuit in *In re Catapult Entertainment* refused to permit the debtor to assume certain nonexclusive patent licenses.

The First Circuit, however, takes a different view. In *Institut Pasteur v. Cambridge Biotech Corp.*,⁸⁶ the First Circuit applied the “actual test”: that the license is not assignable is relevant only if the debtor actually is trying to assign it. Otherwise, the debtor may assume it because no actual assignment is occurring (notwithstanding that for certain purposes the debtor in possession is deemed a distinct legal entity from the prebankruptcy debtor).

The Ninth Circuit has observed in *Catapult* that the weight of lower court authority favors the actual test.⁸⁷ The Ninth and Third Circuits have both said that they believe the Eleventh Circuit follows the hypothetical test, because in *In re James Cable Partners, Inc.*⁸⁸ the Eleventh Circuit said that § 365(c) asks a “hypothetical question.” However, *James Cable* affirmed a district court opinion that rejected the hypothetical test and adopted the actual test,⁸⁹ so it appears the Eleventh Circuit may in fact follow the First Circuit’s rule rather than that of the Ninth and Third Circuits.

The law in the Fourth Circuit apparently remains in flux. On one hand, the Fourth Circuit in 1994 affirmed without opinion a

85. See, e.g., *In re Catapult Entertainment, Inc.*, 165 F.3d 747, 749-50 (9th Cir. 1999); *In re West Elec., Inc.*, 852 F.2d 79, 83 (3d Cir. 1988).

86. 104 F.3d 489, 493 (1st Cir.), cert. denied, 521 U.S. 1120 (1997).

87. *Catapult*, 165 F.3d at 750 n.2. The Ninth Circuit cited to the following cases: *Texaco Inc. v. Louisiana Land and Expl. Co.*, 136 B.R. 658, 668-71 (M.D. La. 1992); *In re GP Express Airlines, Inc.*, 200 B.R. 222, 231-33 (Bankr. D. Neb. 1996); *In re Am. Ship Bldg. Co.*, 164 B.R. 358, 362-63 (Bankr. M.D. Fla. 1994); *In re Fastrax*, 129 B.R. 274, 277 (Bankr. M.D. Fla. 1991); *In re Hartec Enters., Inc.*, 117 B.R. 865, 871-73 (Bankr. W.D. Tex. 1990), vacated on other grounds, 130 B.R. 929 (W.D. Tex. 1991); *In re Cardinal Indus., Inc.*, 116 B.R. 964, 976-82 (Bankr. S.D. Ohio 1990).

88. 27 F.3d 534, 537 (11th Cir. 1994).

89. *In re James Cable Partners, L.P.*, 154 B.R. 813, 815 (M.D.Ga. 1993).

lower court decision applying the hypothetical test.⁹⁰ On the other hand, an opinion issued just this year in the District of Maryland applies the actual test and emphatically rejects the hypothetical test as “unreasonable in light of the drafters’ intentions.”⁹¹

D. Drafting Tips for Avoiding the Adverse Impact of Bankruptcy

It should be clear from the foregoing that there is precious little parties can do in the context of a contract that will blunt the effects of bankruptcy, whether of a licensor or a licensee. The best way to avoid the effects of the Bankruptcy Code is by using a transaction structure that gives the party to be protected some form of interest in the trademark or the license other than simply rights under a contract. However, none of these structural solutions have to date been the subject of reported case law, so the ensuing discussion is based mainly on what makes sense, and on what some attorneys have sought to do.

If a debtor seeks to sell property in which a non-debtor shares an ownership interest, the co-owner has a statutory right of first refusal under § 363(i) of the Bankruptcy Code. Thus, a licensee who is worried that its licensor might file a bankruptcy petition and then seek to transfer the mark might wish to take a fractional ownership interest in the mark to ensure that it will have the right to buy the mark if the licensor becomes a debtor and then tries to sell the mark. (Of course, co-ownership raises other problems, so the risks and benefits of this solution have to be weighed carefully.)

Another possibility is for the party to be protected to take a lien. Depending on the parties’ business needs in the transaction, the lien can secure either side’s performance, and the events of default under the security agreement can be tailored to the parties’ specific concerns.⁹²

A somewhat more complex technique could involve use of a letter of credit, in which the mark is lodged with an intermediary, and would be transferred upon the happening of a specified event. Because a letter of credit issued at the behest of a company that becomes a debtor does not become part of the bankruptcy estate,⁹³ the intermediary could transfer the mark to the beneficiary

90. *In re Catron*, 158 B.R. 629 (E.D. Va. 1993), *aff’d*, 25 F.3d 1038 (4th Cir. 1994).

91. *RCC Technology Corp. v. Sunterra Corp.*, 287 B.R. 864 (D. Md. 2003).

92. The drafting would need to be done with care, though, because a debtor normally can sell property free and clear of liens, and the lien would attach to the proceeds. 11 U.S.C. § 363(f).

93. See, e.g., *Matter of Compton*, 831 F.2d 586, 589 (5th Cir. 1987); *In re Zenith Laboratories, Inc.*, 104 B.R. 667, 672 (Bankr. D.N.J. 1989); *In re M.J. Sales & Dist. Co., Inc.*, 25 B.R. 608 (Bankr. S.D.N.Y. 1982).

without violating the automatic stay. The problem is in constructing the letter of credit in such a way that quality control is maintained. Another technique is to use single-purpose entities. For example, a bankruptcy-remote corporation or limited liability company can be set up to hold and license the mark. Here again, it is necessary to ensure that proper quality control is maintained.

Each of these solutions has its risks, and of course every transaction must be tailored to the specific business needs of the parties. It bears emphasis that, as noted earlier, none of these structural solutions have been the subject of litigation. Consequently, although each solution should, in appropriate circumstances, afford the desired protection, it is impossible to know for certain what will and will not be given effect by a court.

III. ISSUES RELATING TO SECURITY INTERESTS IN INTELLECTUAL PROPERTY

Like all other property of the debtor, trademarks and other forms of intellectual property become part of the bankruptcy estate upon the filing of the petition. As with all other property of the estate, they cannot be the subject of collection efforts due to the automatic stay. Similarly, the debtor may use the intellectual property in the course of its business under § 363(b) even if the intellectual property was pledged to secure an obligation. The secured creditor may, however, seek to ensure that its interests in the collateral are “adequately protected” by bringing a motion under § 363(e), requesting that the court adequately protect its security interest. In fact, § 363 cautions that any use or sale of the collateral by the debtor under § 363 cannot be inconsistent with any adequate-protection relief granted to a creditor.

A. Adequate Protection and Relief From Stay

“Adequate protection” under § 361 is a flexible concept. The essence of adequate protection is that the secured creditor must be protected to the same extent that it would have been absent the bankruptcy.⁹⁴ If the secured creditor has a valid lien, its rights in the lien (or to “adequate protection” in the form of some substitute) are absolute; the bankruptcy court must enforce the lien even if it feels the secured creditor has otherwise behaved inequitably.⁹⁵

The Supreme Court has held that secured creditors have a right to payment out of the value of their security. Unlike unsecured creditors, a secured creditor is theoretically entitled in every case to payment of 100¢ for each dollar it is owed, to the

94. See *In re Craddock-Terry Corp.*, 98 B.R. 250, 253 (Bankr. W.D. Va. 1988).

95. See *In re Empire for Him, Inc.*, 1 F.3d 1156 (11th Cir. 1993).

extent of the value of the collateral.⁹⁶ But that right to payment is “not adequately protected if the security is depreciating during the term of the stay.” Accordingly, if the value of the collateral is declining, the secured creditor will be entitled to “adequate protection” in the form of “cash payments or additional security in the amount of the decline.”⁹⁷ This is a special concern where the collateral is closely tied to goodwill, such as trademarks and customer lists, which can depreciate rapidly in bankruptcy.⁹⁸

What remains unsettled is the date as of which the secured creditor is entitled to adequate protection. Some courts hold that the creditor is entitled to protection of the value of its collateral as of the petition date.⁹⁹ Other courts hold that the right to adequate protection commences from the date “when the creditor would have obtained its state law remedies had bankruptcy not intervened.”¹⁰⁰ The majority rule appears to be that adequate protection runs from the date the creditor first sought relief under § 362 and/or § 363.¹⁰¹ Accordingly, this uncertainty argues in favor of moving for relief from the stay or for adequate protection at the earliest possible date if there is a prospect of the collateral depreciating below the amount of the debt or if this has already happened and the value is continuing to go down. Of course, the court may deny relief from the stay under § 362(d)(1) by conditioning its order on the debtor’s supply of adequate protection to the secured creditor.

B. Valuation Issues for Secured Creditors

The secured creditor’s right to full payment to the extent of its lien, or to adequate protection of that right, shines a spotlight on the value of the intellectual property. If the debt exceeds the value of the property, the creditor will be undersecured, and the portion of the debt that exceeds the value of the property will be treated as unsecured debt.¹⁰² The value of the collateral thus determines how much of a creditor’s claim is secured and how much is not, and can become the focus of litigation. Thus, with a finite amount of resources available in the estate to pay creditors, the debtor and

96. See *United Savings Assn. of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 370 (1988) (secured creditor has right “to have the security applied in payment of the debt upon completion of the reorganization”).

97. *Timbers of Inwood*, 484 U.S. at 370.

98. See, e.g., *Craddock-Terry*, 98 B.R. 250.

99. E.g., *In re Ritz-Carlton of D.C., Inc.*, 98 B.R. 170 (S.D.N.Y. 1988); *In re Craddock-Terry Shoe Corp.*, 98 B.R. 250 (Bankr. W.D. Va. 1988).

100. *In re Deico Electronics, Inc.*, 139 B.R. 945, 947 (B.A.P. 9th Cir. 1992). See also *In re Ahlers*, 794 F.2d 388 (8th Cir. 1986), *rev’d on other grounds*, 485 U.S. 197 (1988).

101. See, e.g., *In re Waverly Textile Processing, Inc.*, 214 B.R. 476, 479 (Bankr. E.D. Va. 1997); *In re Kennedy*, 177 B.R. 967, 973 (Bankr. S.D. Ala. 1995); *In re Best Products Co., Inc.*, 138 B.R. 155, 157-58 (Bankr. S.D.N.Y. 1992) (citing cases).

102. 11 U.S.C. § 506(a).

various unsecured creditors may seek to downgrade as much of the secured creditor's claim as possible to unsecured status.¹⁰³

Valuation also comes into play in determining whether the debtor has equity in the collateral—that is, whether the collateral's value exceeds the debt it secures. Lack of equity in the collateral is one element a movant has to show when seeking to lift the stay under § 362(d)(2). Additionally, the value of the collateral will determine the extent to which adequate protection may be necessary.

In *re Craddock-Terry Shoe Corp.*¹⁰⁴ illustrates nicely several of the valuation issues that may arise. Two secured creditors, Lincoln and Westinghouse, held a security interest in mailing lists, catalogues and four trademarks of a division of the debtor. Lincoln and Westinghouse moved for relief from the stay, citing their concerns about the declining value of the collateral. The court refused to lift the stay under § 362(d)(2) because the collateral would be needed in any reorganization. It did find, however, that absent adequate protection, Lincoln and Westinghouse would be entitled to relief from the stay for cause under § 362(d)(1). Accordingly, the court had to determine how much adequate protection to provide.¹⁰⁵

The parties were very far apart as to the value of the collateral. Both sides used accepted valuation techniques, but they measured different things. The creditors used “going concern value,” namely, “the value of the mailing list in place and in use” by the debtor.¹⁰⁶ This technique yielded a high valuation, because the mailing list and mark were worth more to the debtor than to anyone else. The debtor, in contrast, advocated a “fair market value” approach, under which the collateral would be valued at what a third party would pay for it in an arm's length transaction—a far lower value than its value to the debtor. The court adopted the latter valuation, noting that if the creditors had foreclosed, they could not have realized more than what a third party would pay for it in a market transaction.¹⁰⁷

103. Indeed, in the context of a Chapter 11 reorganization (as distinct from a sale), a persuasive case can be made that a mark has no intrinsic value because its worth is tied directly to the reorganized debtor's ability to operate profitably; its value will be a direct function of projected future performance of the debtor's management. Clearly in the case of a sale of the mark, as distinct from a reorganization without a sale, the value of the mark would be a function of the buyer's perception of the value it adds to a product.

104. 98 B.R. 250 (Bankr. W.D. Va. 1988).

105. This court followed the line of cases that extends adequate protection from the petition date.

106. 98 B.R. at 251.

107. *Id.* at 254-55.

C. Trademarks and Assignments in Gross

Unlike most other assets, there are special statutory restrictions on the form that creation of a security interest in a trademark may take. A mark may not be assigned alone, but only together with the goodwill associated with it.¹⁰⁸ The consequence of taking a trademark “in gross,” without the associated goodwill, is that rights in the mark will be voided.¹⁰⁹ Thus, a lender taking a trademark as collateral must be sure also to take a lien on enough other assets associated with the marked product to ensure that, if a need to foreclose ever arises, the act of foreclosure will not in and of itself destroy the value of the collateral.

The leading case on the issue is *Matter of Roman Cleanser Co.*¹¹⁰ In that case, the debtor had borrowed money from NAC and secured the debt with a lien on, among other things, its “goods, equipment and general intangibles.”¹¹¹ Some time later, NAC released its security interest in the debtor’s vehicles, machinery and equipment. The borrower later filed a bankruptcy petition.

The issue in *Roman Cleanser* was whether NAC’s security interest in the “Roman Cleanser” mark survived after NAC released its security interest on the assets used to create the Roman Cleanser product. The trustee argued that it did not. Because none of the assets needed to create the product were subject to the lien, NAC should not retain a security interest on (and possible future possession of) the mark, as the public could be misled if a transferee of the mark used it on different products.

The Sixth Circuit rejected the contention that “goodwill” must include the machinery needed to manufacture the trademarked product, or at least some tangible asset associated with the product. In the Sixth Circuit’s view, the fact that formulas and customer lists passed together with the mark was enough to meet the “goodwill” requirement, because they would enable a transferee to produce comparable goods. This case thus reflects a very relaxed definition of “goodwill” for purposes of the rule against assignments in gross.¹¹²

108. 15 U.S.C. § 1060.

109. See, e.g., *Marshak v. Green*, 746 F.2d 927 (2d Cir. 1984); *Clark & Freeman Corp. v. Heartland Co. Ltd.*, 811 F. Supp. 137 (S.D.N.Y. 1993).

110. 802 F.2d 207 (6th Cir. 1986).

111. Trademarks are within the category of general intangibles, see U.C.C. § 9-102(42).

112. In cases where the debtor sells the mark (rather than pledging it as collateral), bankruptcy courts have generally strived to find that some goodwill passed with the mark. E.g., *In re Specialty Foods of Pittsburgh, Inc.*, 91 B.R. 364 (W.D. Pa. 1988). See also *Bambu Sales, Inc. v. Sultana Crackers Inc.*, 683 F. Supp. 899 (E.D.N.Y. 1988). Of course, in these cases the sale resulted in money flowing in to the estate. The *Roman Cleanser* case, discussed in the text, is notable because there a secured creditor sought to foreclose and remove an asset from the estate.

IV. JURISDICTIONAL ISSUES: ESCAPING FROM BANKRUPTCY COURT

This article began by noting that bankruptcy law and trademark law are usually different universes, and that they tend to be adjudicated in different courts. Most bankruptcy issues are decided in the first instance in bankruptcy courts, which are primarily concerned with debtor-creditor relations and, where feasible, with rehabilitating the debtor. Trademark cases, on the other hand, tend to be decided in the non-specialized district courts, which are not tethered to any specific substantive field of law. Because each tribunal has its own perspective, the outcome of a trademark dispute may be substantially influenced by the forum in which it is litigated. Obviously, trademark lawyers tend to prefer litigating in the familiar district courts rather than the specialized and unfamiliar bankruptcy courts. This preference can sometimes be accommodated—in certain situations, the Bankruptcy Code not only permits withdrawal of a case from the bankruptcy court to the district court, but affirmatively requires it.

A. Historical Background

As originally enacted, the Bankruptcy Code granted to the bankruptcy courts broad jurisdiction over virtually all aspects of bankruptcy cases. But in the 1982 Northern Pipeline case, the Supreme Court struck down as unconstitutional this broad grant of adjudicative authority, on the ground that bankruptcy judges cannot be empowered to decide cases outside their prescribed sphere because, as non-Article III judges, they lack lifetime tenure.¹¹³ As a result of Northern Pipeline, various bankruptcy-related disputes were cast beyond the power of bankruptcy courts, so that Congress was required to overhaul federal bankruptcy jurisdiction.

Accordingly, Congress amended the Bankruptcy Code in 1984 to confer on the district courts original jurisdiction over bankruptcy matters. At the same time, it enacted 28 U.S.C. § 157, which permits the district courts to refer bankruptcy cases to the bankruptcy court, subject to the district court's ability to withdraw that reference. The result is a system of split jurisdiction, with most bankruptcy cases being decided in bankruptcy court pursuant to standing orders of reference, but with portions of those cases subject to being withdrawn to the district court.

B. Core Versus Non-Core Proceedings

The division of power between bankruptcy court and district court under § 157 turns largely on the distinction between “core”

113. Northern Pipeline Construction Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982).

and “non-core” proceedings. A bankruptcy judge may make final determinations in a “core” proceeding, but in a non-core proceeding that is “otherwise related” to the bankruptcy case, the bankruptcy judge may only submit proposed findings of fact and conclusions of law to the district judge, who then must make a de novo review of the bankruptcy court’s recommendations. Only the district court may make a final determination in a non-core “related” proceeding.¹¹⁴

1. Core Proceedings

Neither Title 28 nor the Bankruptcy Code defines clearly the distinction between core and non-core proceedings, nor have the courts articulated any definitive rule. Section 157(b)(2) does not even attempt to define a core proceeding. Instead, it sets forth a list of various types of proceedings that are “core,” and cautions that “[c]ore proceedings include, but are not limited to,” the items on the list.¹¹⁵ As a general matter, though, a core proceeding is

114. The relevant provisions of § 157 state, in pertinent part:

(b) (1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11 . . . and may enter appropriate orders and judgments subject to review under section 158 of this title.

* * * *

(c) (1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court.

115. The items listed in Section 157 as “core proceedings” are as follows:

- (A) matters concerning the administration of the estate;
- (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12 and 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
- (C) counterclaims by the estate against persons filing claims against the estate;
- (D) orders in respect to obtaining credit;
- (E) orders to turn over property of the estate;
- (F) proceedings to determine, avoid or recover preferences;
- (G) motions to terminate, annul or modify the automatic stay;
- (H) proceedings to determine, avoid or recover fraudulent conveyances;
- (I) determinations as to the dischargeability of particular debts;
- (J) objections to discharge;
- (K) determinations of the validity, extent or priority of liens;
- (L) confirmation of plans;
- (M) orders approving the use or lease of property, including the use of cash collateral;

usually understood as one that has “as its foundation the creation, recognition, or adjudication of rights which would not exist independent of a bankruptcy environment. . . .”¹¹⁶ In practice, though, this test can sometimes be maddeningly difficult to apply. For the trademark practitioner, the key question is whether a trademark litigation can be withdrawn from the bankruptcy court to the district court. The answer will turn on the type of issues at stake in that litigation.

Some issues, like assumption or rejection of a trademark licensing agreement,¹¹⁷ fit squarely within the definition of a core proceeding.¹¹⁸ But some courts that have classified trademark cases as core or non-core have reached some disturbingly dissimilar results and even articulated different tests. Even within a single case, courts have grappled mightily with the core/non-core distinction.

For example, in *In re Vylene Enterprises, Inc.*,¹¹⁹ the debtor-licensee sued its franchisor in bankruptcy court, asserting several claims arising out of termination and non-renewal of its franchise. The franchisor counterclaimed for trademark violations, unfair competition and misappropriation, then moved for a preliminary injunction. Although all the claims in the case were based on non-bankruptcy law, the bankruptcy court held that the case was a core proceeding because deciding the preliminary injunction motion would necessarily determine rights to use property of the bankruptcy estate, namely the trademark.¹²⁰ The district court reversed on a later appeal.¹²¹ In declaring that the entire adversary proceeding was non-core, despite the property rights implicated by the counterclaims, the court said “[t]here is no indication that, in the absence of a bankruptcy proceeding, these

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; and

(O) other proceedings affecting the liquidation of the assets of the estate or adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims.

116. *In re Vylene Enterprises, Inc.*, 122 B.R. 747, 752 (C.D. Cal. 1990), vacated, 90 F.3d 1472 (9th Cir.1996) (quoting *Acolyte Electric Corp. v. City of New York*, 69 B.R. 155, 173 (Bankr. E.D.N.Y. 1986)). See also *In re Wood*, 825 F.2d 90, 97 (5th Cir. 1987) (“a proceeding is core under section 157 if it invokes a substantive right provided by title 11 or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy case”).

117. Assumption and rejection are discussed at pp. 3-5, *supra*.

118. See *In re Turbowind Inc.*, 42 B.R. 579 (S.D. Cal. 1984) (trustee’s motion to reject alleged executory agreement was core proceeding as a matter concerning the administration of the estate, over which bankruptcy court has jurisdiction to render final orders).

119. 63 B.R. 900 (Bankr. C.D. Cal. 1986), vacated, 122 B.R. 747 (C.D. Cal. 1990), vacated, 90 F.3d 1472 (9th Cir. 1996).

120. *Id.* at 905.

121. 122 B.R. 747 (C.D. Cal. 1990). Appeals from bankruptcy courts may be taken to district courts under 28 U.S.C. § 158(a).

claims could not have been brought in state court.”¹²² The claims in the case had nothing to do with bankruptcy law and, in fact, the court observed, “[t]he only apparent connection to the bankruptcy proceeding is that the action was brought by the debtor.”¹²³

On appeal, however, the Ninth Circuit vacated the district court’s ruling and directed reinstatement of the bankruptcy court’s decision.¹²⁴ The Ninth Circuit observed that the franchise agreement and rights flowing from it clearly were within the § 541 definition of “property of the estate.”¹²⁵ Therefore, in the Ninth Circuit’s view, the case was a core proceeding.

But this reasoning is far from unassailable. In the § 157(b) list of disputes that are core proceedings, there is no entry for “disputes” that affect property of the estate. Such a category would, indeed, be so broad as to make almost all bankruptcy-related disputes into core proceedings. The Ninth Circuit and the bankruptcy court in *Vylene* had both premised their decision that the dispute was a core proceeding on the provision in 28 U.S.C. § 157(b)(2)(M) that core proceedings include “orders approving the use or lease of property, including the use of cash collateral.” Section 157(b)(2)(M) appears, however, to have been designed to cover motions to approve a debtor’s use of property during bankruptcy, under § 363(b) or (c). The matters at stake in *Vylene* were entirely different, and the rights in issue there were not based on bankruptcy law at all. The result in *Vylene* thus seems to be something of an anomaly.

In *In re Marr Broadcasting Co., Inc.*,¹²⁶ the court held that a trademark infringement and unfair advertising case brought by a debtor against a competitor was a non-core proceeding. This case views core proceedings mainly in terms of the source of the legal issues at stake, similar to the district court in *Vylene*. In the words of the *Marr* court, “[a] lawsuit to prevent a purportedly unfair advertising practice does not involve the ‘peculiar rights and powers of bankruptcy’ for its existence. It is possible to administer the estate without resolving this controversy.”¹²⁷ Because the defendant competitor was not a creditor of the estate, no debtor-creditor issues were implicated. That meant the case had only a tenuous nexus with bankruptcy, so it could not be deemed a core

122. *Id.* at 753.

123. *Id.*

124. *In re Vylene Enters.*, 90 F. 3d 1472 (9th Cir. 1996).

125. The concept of a bankruptcy “estate” is discussed at p. 2 & n.2, *supra*.

126. 79 B.R. 673 (Bankr. S.D. Tex. 1987).

127. *Id.* at 677.

proceeding.¹²⁸ Marr thus holds that proceedings that could be brought independent of the bankruptcy are not core proceedings.

In *re Nutri/System, Inc.*¹²⁹ highlights that concerns other than the source of the rights at issue can come into play when distinguishing between core and non-core proceedings. The debtor's complaint in *Nutri/System* asserted claims solely for Lanham Act violations and related common law and statutory law, like breach of contract, tortious interference with contract, misappropriation, false advertising and deceptive practices. Nevertheless, despite the absence of any bankruptcy-based claims, the court rejected the defendants' contention that, because the alleged Lanham Act violations were independent of the bankruptcy, the case was not a core proceeding. The key factor, in the court's view, was the fact that the alleged conduct occurred post-petition. As a result, the court held that the case was core because it affected administration of the estate, use of estate property and liquidation of estate assets, which the court felt brought the case within the broad language of §§ 157(b)(2)(A), (M) and (O).¹³⁰

It is plain from just these few cases that although most conventional trademark disputes would be viewed as non-core, that is not necessarily always the case, and there is no bright-line rule to distinguish trademark disputes that are core proceedings from those that are not.

2. "Related to" Cases

Even if a proceeding is not considered "core" under § 157, it still may be within the bankruptcy court's jurisdiction as an "otherwise related proceeding." As noted, bankruptcy courts may hear related proceedings, but cannot determine them. All they may do is make recommendations to the district court, which makes its own decision upon de novo review.¹³¹

A related proceeding is one that can "conceivably have any effect on the estate."¹³² Most trademark-related issues that ultimately involve adjudication of the rights or liabilities of the debtor will fit within this broad definition.

128. Marr implies, however, that had the alleged infringer in fact been a creditor, the proceeding could have been considered core. Thus, even according to Marr, other factors would come into play in determining whether or not an infringement action is core.

129. 159 B.R. 725 (E.D. Penn. 1993).

130. *Id.* at 727.

131. See pp. 28-29, *supra*.

132. *Marr Broadcasting*, 79 B.R. at 678.

C. Withdrawal of Reference

A bankruptcy court's jurisdiction over trademark proceedings, even those categorized as "core," may be terminated under § 157(d) of the Bankruptcy Code. That section permits, and in some cases requires, that the district court withdraw the reference and reassert jurisdiction.¹³³

1. Permissive Withdrawal

Permissive withdrawal is provided for in § 157(d), which permits the district court to withdraw the reference either upon application of a party or on its own motion. But the statutory standard to apply in deciding whether to withdraw the reference is extraordinarily vague: the reference may be withdrawn "for cause shown." The statute does not elaborate on what constitutes "cause." That has been left to the case law.

The case law bases the permissive withdrawal decision on a number of factors: whether the claim or proceeding is core or non-core, whether it is legal or equitable, and considerations of efficiency, prevention of forum shopping, and uniformity in the administration of bankruptcy law.¹³⁴ The core/non-core distinction is especially crucial because bankruptcy judges may not issue final determination in non-core proceedings; only district courts may, upon de novo review of the bankruptcy court's decisions. Thus, efficiency considerations are often tied to the core/non-core classification.¹³⁵ That is not to say that core proceedings cannot be the subject of a withdrawal of the reference. However, "[w]hen a core claim is involved, the other factors must weigh heavily in favor of withdrawing the reference."¹³⁶

2. Mandatory Withdrawal

Section 157(d) also provides that withdrawal is mandatory in certain cases. The district court must withdraw the reference in

133. Section 157(d) provides:

The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

134. *Orion Pictures Corp. v. Showtime Networks, Inc.*, 4 F.3d 1095, 1101 (2d Cir. 1993), cert. denied, 511 U.S. 1026 (1994); *In re Pruitt*, 910 F.2d 1160, 1168 (3d Cir. 1990); *Times Mirror, Inc. v. Las Vegas Sporting News L.L.C.*, No. 98-CV-5768, 1999 WL 179749 (E.D. Pa. Mar. 17, 1999).

135. *Orion Pictures*, 4 F.3d at 1101.

136. *AFCO Credit Corp. v. Iridium LLC*, No. 01 Cir. 3595 (LMM), 2001 WL1658233 (S.D.N.Y. Dec. 26, 2001) (citing *SEC v. Churchill Sec. Inc.*, 233 B.R. 415, 419 (S.D.N.Y.1998)).

cases that require consideration of both the Bankruptcy Code and another federal law regulating activities affecting interstate commerce. This mandatory withdrawal provision obviously comes into play in the trademark arena because trademark disputes in bankruptcy court will often require the court to construe both the Bankruptcy Code and the Lanham Act, which is a federal law regulating activity affecting interstate commerce.

That does not mean, however, that all bankruptcy proceedings in which the Lanham Act is implicated qualify for mandatory withdrawal. First, under the plain words of § 157(d), mandatory withdrawal applies only when consideration of the two federal laws is necessary to resolution of the case. Mere incidental involvement of one statute or another is not enough. Case law is in accord.¹³⁷

Thus, the mere fact that a lawsuit may involve a trademark is not enough for mandatory withdrawal. For that reason, the court in *American Biomaterials Corp. v. University of Florida*¹³⁸ rejected the argument that withdrawal was mandatory where the claims asserted were primarily for breach of an agreement licensing patents and trademarks. “Although portions of the agreement concerned patents and trademarks, the adjudication of this matter depends on principles of common-law contract, not federal patent or trademark law.”¹³⁹ Mandatory withdrawal was inappropriate because the case did not turn on the federal trademark or patent issues.

Second, the courts construing § 157 have, to varying degrees, required that the federal non-bankruptcy issues must be material and substantial before holding withdrawal mandatory.¹⁴⁰ These holdings are based on legislative history indicating that the mandatory withdrawal provision is to be construed narrowly.¹⁴¹

The more troublesome issue is defining which issues are “significant” and “material” for mandatory withdrawal purposes. As with so much else in this area, the courts differ on the issue.

137. See *American Biomaterials Corp. v. University of Florida*, No. 89-4148 (CSF) slip op. at 2 (D.N.J. 1989) (avail. on WESTLAW at 1989 WL 144931). See also *In re McCrory Corp.*, 160 B.R. 502 (S.D.N.Y. 1993). See, e.g., *In re Johns-Manville Corp.*, 63 B.R. 600 (S.D.N.Y. 1986); *In re Contemporary Lithographers, Inc.*, 127 B.R. 122 (M.D.N.C. 1991).

138. No. 89-4148 (CSF) (D.N.J. Nov. 20, 1989) (avail. On WESTLAW at 1989 WL 144931).

139. *American Biomaterials*, slip op. at 1.

140. See, e.g., *In re Houbigant, Inc.*, 185 B.R. 680, 684 (S.D.N.Y. 1995) (“In the absence of particularly complex issues, a case of first impression or a conflict between non-Title XI federal law and the Bankruptcy Code, withdrawal in this case is not mandated.”); *In re White Motor Corp.*, 42 B.R. 693, 705 (N.D. Ohio 1984).

141. See, e.g., *In re Johns-Manville Corp.*, 63 B.R. 600, 602 (S.D.N.Y. 1986); *Times Mirror Magazines, Inc. v. Las Vegas Sporting News, L.L.C.*, No. 98-CV-5768, 1999 WL179749, at n.2 (E.D. Pa. Mar. 17, 1999); *American Biomaterials Corp. v. University of Florida*, 1989 WL 144931 at 1 (D.N.J. 1989).

Burger King Corp. v. B-K of Kansas¹⁴² seems to adopt an approach in which issues are deemed material and substantial if the court *must* consider them to resolve the action. In that case, the non-debtor plaintiff, Burger King, asserted (i) claims seeking to prevent discharge of certain debts and to exclude the franchise from the estate (both bankruptcy-based claims), and (ii) a claim for trademark infringement. The defendant debtor counterclaimed for antitrust and RICO violations (all non-bankruptcy federal law). Because the case presented both bankruptcy and non-bankruptcy federal claims, the court held withdrawal was mandatory. Notably, the court provided few facts beyond describing the mere allegations in the complaint. By not specifically analyzing the precise issues to be decided under the Lanham Act, the Burger King court implies that the presence in a bankruptcy action of *any* infringement claim under the Lanham Act, even a routine “plain vanilla” case, could mandate withdrawal to the district courts.

Such an approach seems different from the Second Circuit rule, which requires mandatory withdrawal only in “cases or issues that would otherwise require a bankruptcy court judge to engage in significant interpretation, as opposed to simple application of federal laws apart from the bankruptcy statutes.”¹⁴³ Because of this more restrictive standard, the bankruptcy court in *In re McCrory Corp.*¹⁴⁴ was required to analyze the degree to which a bankruptcy judge would have to analyze trademark law before mandatory withdrawal would apply. In that case, the plaintiff-debtor brought an adversary proceeding seeking (i) a declaratory judgment that its service mark did not violate the defendant’s rights to the mark; and (ii) cancellation of the defendant’s federal registration, as well as damages.

The defendant moved to withdraw the case to the district court, arguing that because the case raised issues of the registrability of the mark and whether the defendant’s conduct constituted unfair competition, withdrawal was warranted.¹⁴⁵ The plaintiff’s response was that withdrawal would be improper because the issues merely required “straightforward application of fixed legal standards.”¹⁴⁶ Thus, the court was faced head-on with deciding just how much consideration of non-Code federal law was necessary under § 157’s mandatory withdrawal provision.

The McCrory court steered a middle course: “Simple application” of non-bankruptcy federal law to the facts of the case

142. 64 B.R. 728 (D. Kan. 1986).

143. *City of New York v. Exxon Corp.*, 932 F.2d 1020, 1026 (2d Cir. 1991).

144. 160 B.R. 502.

145. *Id.* at 504.

146. *Id.*

did not require withdrawal.¹⁴⁷ The court also rejected the other extreme, and refused to find that withdrawal was mandated only when the meaning of the statute was not settled or where the issue raised was one of first impression. Instead, the court held that withdrawal was mandatory when “significant application of non-bankruptcy federal statutes” is involved.¹⁴⁸

The court adopted a standard under which “matters requiring significant application of non-bankruptcy federal statutes . . . must be removed from the bankruptcy courts,” while cases involving no more than “routine application [of law] to the facts” need not be. But the court appeared to hold that under this standard, no Lanham Act cases are routine:

Interpreting Lanham Act provisions to a given set of facts is, generally, neither simple nor straightforward. In examining a trademark issue, especially one involving “secondary meaning,” a court must familiarize itself with different interpretations and then fashion an appropriate standard. . . . The bankruptcy court would have to determine, among others, the relative rights of [plaintiff] and [defendant] to various marks under trademark law, whether these marks are protectable under the Lanham Act, and if so to what degree protection is needed. Moreover the bankruptcy court would be required to rule on whether the use of similar marks by [plaintiff] creates a likelihood of confusion and constituted unfair competition.¹⁴⁹

The court deemed this dispute to require the kind of “substantial and material” consideration of non-bankruptcy issues which required withdrawal.

From the court’s reasoning, it appears that all but the clearest cases in which infringement is alleged would require withdrawal. Since infringement claims almost always raise issues of rights to use the mark, likelihood of confusion, and/or secondary meaning, under the court’s reasoning these proceedings must be withdrawn. Subsequent case law, however, indicates that straightforward Lanham Act cases do not necessarily warrant mandatory withdrawal.¹⁵⁰

Notably, though, the provision in § 157(d) that the case must raise issues of both bankruptcy and non-bankruptcy federal law has not been strictly applied. The courts seem less concerned with the literal language of § 157(d) than with the underlying purpose of mandatory withdrawal—ensuring that non-bankruptcy law will be determined by district courts rather than bankruptcy courts

147. *Id.*

148. *Id.*

149. *Id.* at 506.

150. *E.g.*, *In re Houbigant, Inc.*, 185 B.R. 680, 684 (S.D.N.Y. 1995).

even where the case presents no bankruptcy issues.¹⁵¹ Under this majority rule, withdrawal could be required whenever a significant question arises under the Lanham Act in a bankruptcy case.

V. CONCLUSION

Bankruptcy can have significant adverse effects on businesses that have dealings with the bankrupt entity. The effects of bankruptcy are pervasive, potentially affecting every aspect of the debtor's business relationships. Because of the unique nature of intellectual property, its owners or users need to be aware of the special problems bankruptcy can create for them—not just in the conduct of business but in the conduct of litigation as well.

151. See, e.g., *In re Contemporary Lithographers, Inc.*, 127 B.R. 122 (M.D.N.C. 1991) (“[T]he court does not believe that controversies concerning federal laws other than Title 11 which arise in Title 11 cases must be excluded from the scope of the mandatory withdrawal provision simply because the proceeding for which withdrawal is sought will not include material Title 11 cases once withdrawn . . . [I]t would make no sense to prevent withdrawal from a bankruptcy court where there is a lack of bankruptcy questions.”).