

## Seventh Circuit Upholds Use Of Trademark By Licensee Following Rejection Of Trademark License Under Section 365 Of The Bankruptcy Code

On July 9, 2012, in Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC,<sup>1</sup> the United States Court of Appeals for the Seventh Circuit held that a trademark licensee retained the right to use licensed trademarks following the rejection of the license by a debtor licensor under section 365 of the Bankruptcy Code.

In the context of U.S. bankruptcy proceedings, a debtor has the power to reject onerous contracts under section 365 of the Bankruptcy Code. This power includes the ability of debtor licensors to reject licenses of intellectual property granted by the debtor prior to its bankruptcy filing and has been held to terminate the rights of licensees to use such intellectual property following rejection.<sup>2</sup> Section 365(n) of the Bankruptcy Code, however, preserves the ability of licensees of rejected “intellectual property” contracts, including patent, copyright and trade secret licensees, to retain their rights under such contracts following rejection. The protections afforded to licensees under rejected trademark licenses has been more uncertain. The Sunbeam decision clarified that, in the Seventh Circuit, licensees under rejected trademark licenses retain their rights under the license following rejection of the license by a debtor licensor.

### Background

Lakewood Engineering & Manufacturing Co. (“Lakewood”) made and sold a variety of consumer products. In 2008, Lakewood contracted with Chicago American Manufacturing, LLC (“CAM”) to manufacture box fans (such contract, the “License”). The License authorized CAM to practice Lakewood’s patents, which related to the fans to be manufactured, and to put Lakewood’s trademarks on the completed fans. Lakewood was to take orders from retailers such as Sears, Walmart and Ace Hardware, and CAM would ship directly to these customers on Lakewood’s instructions. Because Lakewood was in financial

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<sup>1</sup> Sunbeam Products, Inc. v. Chicago American Manufacturing, No. 11-3920, 2012 U.S. App. LEXIS 13883 (7th Cir. July 9, 2012). This decision will be referred to herein as the “Sunbeam.”

<sup>2</sup> See, e.g., Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4<sup>th</sup> Cir. 1985).

distress, CAM was reluctant to invest the money necessary to gear up for production—and to make about 1.2 million fans that Lakewood estimated it would require during the 2009 cooling season—without assured payment. Lakewood provided that assurance by authorizing CAM to sell the 2009 run of box fans for its own account if Lakewood did not purchase them.

In February 2009, three months into the CAM License, creditors commenced an involuntary bankruptcy proceeding against Lakewood. A trustee (the “Trustee”) was appointed in Lakewood’s bankruptcy case and Lakewood’s assets were sold to Sunbeam Products, Inc., doing business as Jarden Consumer Solutions (“Sunbeam”). Sunbeam did not want CAM competing with Sunbeam products, and the Trustee rejected the executory portion of the License under section 365 of the Bankruptcy Code. When CAM continued to manufacture and sell Lakewood-branded fans, Sunbeam and the Trustee brought an adversary proceeding against CAM seeking, among other things, damages for trademark infringement and an injunction.

In the Bankruptcy Court, Sunbeam and the Trustee argued, among other things, that the rejection of the License deprived CAM of the ability to use the Lakewood trademarks going forward. The Bankruptcy Court noted that, while section 365(n) of the Bankruptcy Code permits continued use of certain intellectual property following rejection, the Bankruptcy Code definition of “intellectual property” does not include trademarks and, accordingly, did not protect CAM’s right to use the Lakewood trademarks following rejection of the License. The Bankruptcy Court instead relied on legislative history suggesting that bankruptcy courts fashion equitable remedies when trademark licenses are rejected in holding that CAM retained the right to use the Lakewood trademarks following the rejection of the License.

### **The Court of Appeals’ Decision**

On direct appeal from the Bankruptcy Court, the Seventh Circuit affirmed the Bankruptcy Court’s holding that CAM retained the right to use the Lakewood trademarks following the rejection of the License, although on different grounds.

The Court of Appeals agreed with the Bankruptcy Court that section 365(n) of the Bankruptcy Code does not address trademark licenses, but disagreed with the Bankruptcy Court’s decision to allow CAM to continue using the trademarks on equitable grounds, as the appeals court concluded that a bankruptcy court cannot override a licensee’s rights, or lack thereof, under the Bankruptcy Code based on individual notions of equity.

The seminal case considering the protection of intellectual property licensees following rejection is Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985), a decision where the Fourth Circuit held that, upon rejection, a licensee loses its patent, copyright and trademark license rights going forward. The Lubrizol decision spurred the adoption of section 365(n) of the Bankruptcy Code, which protects

patent, trade secret and copyright licensees, but does not expressly protect trademark licensees.

The Seventh Circuit did not view this omission in the Bankruptcy Code as dispositive. Rather, to determine whether CAM retained the right to use the Lakewood trademarks following rejection of the License, the Court looked to section 365(g) of the Bankruptcy Code, which articulates the consequences of rejection generally and states that rejection constitutes a “breach” of the rejected contract. Because rejection of a contract is a breach of that contract and because no provision of the Bankruptcy Code specifically addresses whether a trademark licensee retains the right to use the trademark following rejection of a license by a debtor licensor, the Seventh Circuit looked to the rights of intellectual property licensees following breach by licensors under applicable nonbankruptcy law. The Court found that, under applicable nonbankruptcy law, the breach of a license by a licensor would convert “unfulfilled obligations” to damages but would not automatically cause the other contractual rights of the licensee to “vaporize.” The Court noted that CAM specifically bargained for the right to sell fans under the Lakewood trademarks as security for any failure by Lakewood to pay for such fans. Accordingly, the Court held that CAM retained the right to use the Lakewood trademarks as contemplated under its contract even following the rejection of the License.<sup>3</sup>

### **Implications**

The Sunbeam decision clarifies that, in the Seventh Circuit, licensees under rejected trademark licenses retain their rights under the license following rejection of the license by a debtor licensor.

The opinion conflicts with Lubrizol<sup>4</sup> and with lower court decisions in other Circuits holding that the rejection of a trademark license by a debtor licensor terminates the licensee’s ability to use the trademark. The opinion also could arguably put trademark licensees in a better position than licensees of other intellectual property, who, upon rejection, have to elect whether to retain the license under Bankruptcy Code 365(n), which election would be subject to all of the limitations thereunder.

The decision may also have implications for the law of rejection of executory contracts generally. The Court of Appeals was adamant that a rejection of an executory contract is a “breach” of such contract and that, except where there is clear statutory authority to the contrary, the rights of a counterparty to a rejected contract are the same as such counterparty would have outside of bankruptcy under applicable nonbankruptcy law.

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<sup>3</sup> The Court noted that the opinion was circulated to all Seventh Circuit active judges and that no judge favored a hearing *en banc*.

<sup>4</sup> Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985).

This position is in tension with case law treating rejection analogously to termination or rescission of the rejected contract. It remains to be seen whether other courts will adopt a similar reading of parties' rights under rejected contracts.

If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under "Bankruptcy and Restructuring" or "Intellectual Property" in the "Practices" section of our website ([www.clearygottlieb.com](http://www.clearygottlieb.com)).

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