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Avery Minor
Boston College Law School, avery.minor@bc.edu

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SURVIVAL OF THE TRADEMARK LICENSE: *IN RE TEMPNOLOGY* AND CONTRACT REJECTION IN BANKRUPTCY

Abstract: On January 12, 2018, the United States Court of Appeals for the First Circuit held, in *In re Tempnology*, that forcing specific performance of a trademark license after a contract rejection in a bankruptcy case would be contrary to the plain-language of Section 365(n) of the Bankruptcy Code and conflict with the goal of providing debtors with a "fresh start." In so doing, the First Circuit joined the Fourth Circuit in a split with the Seventh Circuit, which has characterized a contract rejection as a breach in the context of non-bankruptcy law, therefore not extinguishing any trademark license rights. This Comment argues that the Seventh Circuit approach is the correct one as it takes legislative intent into consideration, does not impede a debtor's ability to have a fresh start, and will likely not have any detrimental economic effects.

INTRODUCTION

Trademarks make up the largest branch of registered intellectual property, surpassing patents and copyrights.[1] They are influential in driving technological improvements and are often considered a corporation's most valuable asset.[2] Trademarks also benefit the consumer as they designate responsibility to owners, incentivizing them to offer consistently high quality goods to the public.[3] Trademark licensing to third parties offers trademark owners the opportunity to earn extra revenue and expand their market reach.[4] In the context of a

[1] WORLD INTELLECTUAL PROP. ORG., WORLD INTELLECTUAL PROPERTY REPORT: BRANDS—REPUTATION AND IMAGE IN THE GLOBAL MARKETPLACE 9 (2013). This is due, in no small part, to the increased prevalence and reach of the Internet, which has placed high value and importance on brand recognition and reputation—two values that are protected and perpetuated through trademark registration. *Id.* at 10.

[2] Scott W. Putney, *Bankruptcy Code v. Lanham Act and Controlled Licensing*, 80 TRADEMARK REP. 140, 157 (1990); *see* Xuan-Thao N. Nguyen, *Bankrupting Trademarks*, 37 U.C. DAVIS L. REV. 1267, 1274 (2004) (explaining the value of trademarks for large corporations and using the valuation of the Marlboro mark at $44.6 billion and the Coca-Cola mark at $43 billion as examples).

[3] J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 2:4 (5th ed. 2018). Trademark owners are incentivized to maintain high quality goods because of the potential for increased profits as a result of repeat customers willing to pay higher prices for quality assurances and reduced search costs. William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 270 (1987); Ned Snow, *Free Speech and Disparaging Trademarks*, 57 B.C. L. REV. 1639, 1667–70 (2016).

[4] Nguyen, *supra* note 2, at 1276–77. A trademark license grants the licensee the right to use the trademark, typically in a specific location where the third party operates and for particular products or services. *Id.* at 1275.

Chapter 11 bankruptcy, however, the fate of a trademark license can be uncertain.[5]

When an entity files for Chapter 11 bankruptcy, the U.S. Bankruptcy Code (the "Code") permits the debtor to divest itself of certain burdensome contracts and licenses with reduced consequences, aiding its financial recovery.[6] With court approval, a debtor may accept or reject any executory contract, which are contracts under which both parties have an outstanding obligation to perform.[7] A debtor that rejects an executory contract is liable for damages for breach of that contract but is not bound by its terms.[8] An exception to this rule is that when the debtor has licensed its intellectual property to a third party, the licensee has the option of retaining its right to use the license.[9] Courts are split, however, on whether the licensee has the right to retain a *trademark* license, as trademarks are not included in the Code's definition of intellectual property.[10]

In 2018, in *In re Tempnology* (*Tempnology III*), the First Circuit joined the Fourth Circuit in holding that requiring specific performance of a trademark license would be contrary to the purpose of contract rejection in bankruptcy—providing a fresh start for the debtor.[11] The First Circuit established a bright-

[5] *See In re* Tempnology, LLC (*Tempnology III*), 879 F.3d 389, 404 (1st Cir. 2018) (creating a circuit split by declining to follow the Seventh Circuit decision and holding that trademark licenses may be rejected until Congress decides differently); Kayvan Ghaffari, *The End to an Era of Neglect: The Need for Effective Protection of Trademark Licenses*, 87 S. CAL. L. REV. 1053, 1056 (2014) ("[T]rademarks remain in a precarious situation with no formal statutory protection and no consistent judicial protection.").

[6] 11 U.S.C. § 365(a) (2012); *see* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 531–32 (1984) (detailing the consequences of rejecting an executory contract, including prioritization of creditor claims and continuing responsibilities of both parties). A debtor is the person or entity that files for bankruptcy. 11 U.S.C. § 101(13). Section 507(a) of the Bankruptcy Code divides creditor claims into ten different categories and ranks them based on which need to be paid first. 11 U.S.C. § 507(a).

[7] *Tempnology III*, 879 F.3d at 395. Performance of an executory contract like a lease would involve the lessor's provision of the leased property and the lessee's payment for the use of that property. Laura B. Bartell, *Revisiting Rejection: Secured Party Interests in Leases and Executory Contracts*, 103 DICK. L. REV. 497, 504–05 (1999). Contract rejection is the debtor's (or trustee's) ability to breach a contract entered into pre-bankruptcy. Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 230 (1989).

[8] 11 U.S.C. § 365(g); *Tempnology III*, 879 F.3d at 392.

[9] 11 U.S.C. § 365(n)(1); *Tempnology III*, 879 F.3d at 392.

[10] *Tempnology III*, 879 F.3d at 395; *see* 11 U.S.C. § 101(35A) (listing trade secrets, patented inventions and designs, patent applications, plant varieties, and works of authorship protected under federal copyright law with no mention of trademarks); *Tempnology III*, 879 F.3d at 395 (declining to follow the Seventh Circuit and First Circuit BAP by holding that the trademark license is terminated upon Licensee's contract rejection); Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 378 (7th Cir. 2012) (interpreting the case in the context of non-bankruptcy law and holding that the license survives a contract rejection).

[11] *See Tempnology III*, 879 F.3d at 404 (favoring the Fourth Circuit's categorical approach that would extinguish trademark license rights upon contract rejection); Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) (holding that licensee could seek money damages but would not be able to retain its contract rights post-rejection). Specific performance is a court-ordered remedy that requires a party in breach to perform a contractual promise when damages would not

line rule that a trademark license does not survive contract rejection in Chapter 11 bankruptcy.[12] This decision created a split with the Seventh Circuit, which has held that specific performance of a trademark license can be compelled because contract rejection is synonymous with a breach of contract under the Code, giving rise to a damages claim but not terminating a licensee's rights.[13]

Part I of this Comment gives an overview of bankruptcy and trademark law, in addition to detailing the facts and history of *Tempnology III*.[14] Part II examines the legal framework of trademark license survival in Chapter 11 bankruptcy, from *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.* in the Fourth Circuit in 1985, to *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC* in the Seventh Circuit in 2015, to *In re Sima International, Inc.* in the Bankruptcy Court for the District of Connecticut in 2018, the only case that has been decided since the *Tempnology III* decision.[15] Finally, Part III posits that the *Lubrizol* approach the First Circuit adopted in *Tempnology III* is problematic in many ways and concludes that the Fourth Circuit's interpretation in *Sunbeam* is the correct one.[16]

I. TRADEMARK, BANKRUPTCY, AND TEMPNOLOGY BASICS

Section A of this Part discusses fundamental concepts of trademarks and trademark licensing.[17] Section B of this Part discusses the significance of § 365(n) of the Code.[18] Section C of this Part examines the facts and procedural history of *Tempnology III*, from its origins in the Bankruptcy Court to its current status in the Supreme Court.[19]

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be adequate. Alan Schwartz, *The Case for Specific Performance*, 89 YALE. L.J. 271, 271–72 (1979). Specific performance may be awarded when damages are difficult to compute due to the uniqueness of a product or piece of land. *Id.* at 272–73.

[12] *See Tempnology III,* 879 F.3d at 402 (noting that the survival of a trademark license after contract rejection would force the debtor to monitor the quality of goods sold through the licensee, running counter to the goal of a "fresh start" and the ability to be freed "from any continuing performance obligations").

[13] *See Sunbeam*, 686 F.3d at 377 (explaining that in a non-bankruptcy context, a licensor's breach of contract does not affect the licensee's ability to use the trademark).

[14] *See infra notes* 17–41and accompanying text.

[15] *See infra notes* 42–66 and accompanying text.

[16] *See infra notes* 67–87 and accompanying text.

[17] *See infra notes* 20–24 and accompanying text.

[18] *See infra notes* 25–31 and accompanying text.

[19] *See infra notes* 32–40 and accompanying text.

A. Trademark and Licensing Basics

A trademark is an identifiable mark, name, or symbol that differentiates goods from a certain producer and indicates their origin.[20] Trademark licensing is a common, lucrative arrangement for businesses wishing to broaden their market audience and diversify their revenue sources.[21] Trademark owners can license their trademarks by contracting with a third party to use the mark in connection with certain goods or services, typically in exchange for royalties.[22] The owner, or licensor, continues to hold possession of the trademark, but the licensees retain the right to use it and affix it on their own goods.[23] In the U.S. alone, licensing royalties paid to trademark owners generated $7.3 billion in revenue in 2014.[24]

B. Bankruptcy and § 365(n) Basics

Chapter 11 of the Code, commonly known as reorganization bankruptcy, allows businesses to maintain operations while paying off creditors.[25] Chapter 11 affords debtors a fresh start by allowing them to discharge certain unpaid debts, freeing them from some of their pre-bankruptcy obligations.[26]

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[20] *See* 15 U.S.C. § 1127 (2012) (describing a trademark as "any word, name, symbol, or device, or any combination thereof," used in commerce to "identify and distinguish . . . goods . . . from those manufactured or sold by others and to indicate the source of the goods").

[21] David M. Jenkins, Note, *Licenses, Trademarks, and Bankruptcy, Oh My!: Trademark Licensing and the Perils of Licensor Bankruptcy*, 25 J. MARSHALL L. REV. 143, 145 (1991). Licensing agreements continue to grow in popularity, in part because of "changes in product manufacturing, the internalization of trade, and the shift towards a service economy." Irene Calboli, *The Sunset of "Quality Control" in Modern Trademark Licensing*, 57 AM. U. L. REV. 341, 343 (2007).

[22] *See* Jenkins, *supra* note 21, at 144 (giving examples of trademark licensors such as a business that licenses trademarks to manufacturers to supplement its own product with collateral goods); Xuan-Thao Nguyen, *Selling It First, Stealing It Later: The Trouble with Trademarks in Corporate Transactions in Bankruptcy*, 44 GONZ. L. REV. 1, 4–6 (2008) (detailing the characteristics of a typical trademark license agreement).

[23] Nguyen, *supra* note 22, at 4; Jenkins, *supra* note 21, at 145.

[24] INT'L LICENSING INDUS. MERCHANDISERS' ASS'N, LIMA GLOBAL LICENSING INDUSTRY SURVEY 2015 REPORT 15 (2015).

[25] Alessandra Allegretto, Note, *Overcoming Creditor Misfortune Creatively: Structured Dismissals in Chapter 11 Bankruptcies*, 36 J.L. & COM. 239, 239–41 (2018). It is called reorganization bankruptcy because a debtor develops a plan to restructure their business to maintain operations but repay creditors in the long run. *Id*. at 239. Chapter 11 bankruptcy filing involves three relevant legal consequences: (1) the creation of an estate comprised of all of the debtor's property; (2) the installation of a fiduciary, often the existing management, to manage the estate and act as a "debtor in possession"; and (3) the triggering of an automatic stay to protect the debtor from collection proceedings. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 978–79 (2017). The combination of these three actions seeks to ensure that the debtor maintains business operations and accounts for creditor interests in order to maximize the outcome for all parties. *Id.*

[26] DPWN Holdings (USA) Inc. v. United Air Lines, Inc., 747 F.3d 145, 150 (2d Cir. 2014); *see* Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1393–1424 (1985) (examining the strengths and weaknesses of bankruptcy's fresh start policy).

In 1985, the Fourth Circuit held in *Lubrizol* that a technology licensor could unilaterally reject a contract, stripping the licensees of their intellectual property rights through no fault of their own.[27] In response to technology and investor community concern that, under this holding, a licensor's bankruptcy could void almost any license, Congress passed the Intellectual Property Bankruptcy Protection Act of 1988 (the "Act"), codified at 11 U.S.C. § 365(n).[28] Under § 365(n), a licensee may either treat the rejection as a termination of the agreement or retain its rights under the agreement as they were enforced immediately prior to the bankruptcy's commencement.[29] Should the licensees elect to retain their intellectual property license, they must continue to make royalty payments for as long as they continue to exercise those rights, or until the contract expires.[30] The provision covers patents and copyrights, but Congress notably excluded trademarks because it believed that the issue needed more extensive study.[31]

C. Factual and Procedural History of In re Tempnology

Tempnology, LLC (the "Debtor") was a company that developed and manufactured athletic products and fabrics designed to stay cool during use.[32] It supported its business with a substantial portfolio of intellectual properties.[33] In 2012, Mission Product Holdings, Inc. (the "Licensee") and Debtor executed a Co-Marketing and Distribution Agreement (the "Agreement") that, among

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[27] *See Lubrizol*, 756 F.2d at 1045, 1048 (allowing termination of licensee's right to utilize patented technology despite the lack of independent action on their part warranting the loss).

[28] *See* S. REP. NO. 100-105, 3200–02 (1988) (detailing the reasoning for the passage of § 365, including "certain recent court decisions interpreting that § 365 has imposed a burden on American technological development that was never intended"); *see also* Philip L. Lu, Note, *Trademarked for Death? A Licensee's Trademark Rights After an Executory Contract Is Rejected in Bankruptcy*, 67 VAND. L. REV. 1431, 1439 (2014) (discussing the codification and significance of the Intellectual Property Licenses in Bankruptcy Act).

[29] James M. Wilton & Andrew G. Devore, *Trademark Licensing in the Shadow of Bankruptcy*, 68 BUS. LAW. 739, 751 (2013); *see* 11 U.S.C. § 365(n) (listing the licensee's options should the licensor reject an executory contract).

[30] Wilton & Devore, *supra* note 29, at 751–52. This provision represents an attempt to balance the needs of the debtor-licensor and the licensee, because the debtor's ability to restart may depend on the income it derives from royalty payments. *Id.* at 771. In exchange, the debtor is liberated from any continuing affirmative obligations under the license, like enforcement of quality control, but is still bound by passive obligations such as exclusivity clauses. Lu, *supra* note 28, at 1440, 1456.

[31] *See* 11 U.S.C. § 101(35A) (detailing the statutory definition of intellectual property); *see also* Jenkins *supra* note 21, at 148–49 (discussing Congress's deliberate choice to exclude trademarks from § 365(n) protection). The Senate Report acknowledged that quality control is an essential part of trademark license relationships and determined that the legislature's lack of data made the bankruptcy courts more qualified to explore the matter. S. REP. NO. 100-105, 3204 (1988).

[32] *In re* Tempnology, LLC (*Tempnology I*), 541 B.R. 1, 2 (Bankr. D. N.H. 2015). These products included athletic accessories such as socks, towels, and headbands. *Tempnology III*, 879 F.3d at 392.

[33] *Tempnology III*, 879 F.3d at 392. The portfolio consisted of "two issued patents, four pending patents, research studies, and a multitude of registered and pending trademarks." *Id.*

other things, granted Licensee a limited license to use Debtor's trademark and logo for the term of the Agreement.[34] In 2015, after suffering multi-million dollar losses for two consecutive years, Debtor filed a petition for Chapter 11 bankruptcy and exercised its § 365(a) right to reject seventeen of its contracts, including the Agreement with Licensee.[35] Licensee objected, seeking to retain its trademark license and exclusive distribution rights under § 365(n).[36]

In 2015, in *In re Tempnology* (*Tempnology I*), the Bankruptcy Court for the District of New Hampshire considered, among other things, whether Licensee's election to preserve its rights under § 365(n) extended to the trademark license.[37] The court found that the trademark license was unprotected from rejection due to Congress's decision to leave trademarks off the definitional list of intellectual properties.[38] Licensee appealed to the Bankruptcy Appellate Panel for the First Circuit (the "First Circuit BAP"), arguing that when Congress omitted trademarks from the definition of intellectual property it intended to allow courts to determine the issue on a case-by-case basis.[39] The First Circuit BAP held that, though Licensee's trademark license was not protected by § 365(n), it still had the right to use the license under a different sec-

[34] *Id.* at 393. The license forbade Licensee from using the trademarks in a manner contrary to the terms of the Agreement and gave Debtor the right to monitor usage of the marks. *Id.* Mission's business involves advertising and selling "innovative sports technologies." *In re* Tempnology, LLC (*Tempnology II*), 559 B.R. 809, 811 (B.A.P. 1st Cir. 2016). The agreement was for a term of two years with option for renewal. *Tempnology I*, 541 B.R. at 3.

[35] *Tempnology III*, 879 F.3d at 393–94; *see* 11 U.S.C. § 365(a) (allowing the trustee to continue or reject executory contracts on behalf of the debtor). With the court's approval, § 365(a) allows a debtor to exercise his or her business judgment in rejecting an executory contract where the contract's required performance may harm the recovering company. *Tempnology III*, 879 F.3d at 394. In this case, Debtor argued that the Agreement should be rejected because the exclusive distribution rights granted to Licensee impeded its ability to profit from alternative marketing and distribution partnerships. *Id.*

[36] *Tempnology III*, 879 F.3d at 394; *see* 11 U.S.C. § 365(n) (limiting a debtor's ability to terminate intellectual property licenses that it has granted to third parties).

[37] 11 U.S.C § 365(n); *Tempnology I*, 541 B.R. at 2. Debtor conceded in a prior motion that under the Agreement, Licensee retained its nonexclusive, perpetual license to other, non-trademark intellectual properties. *Tempnology III*, 879 F.3d at 394.

[38] *Tempnology I*, 541 B.R. at 7–8. The court applied the maxim of *expressio unius est exclusio alterious*, meaning "the expression of one thing is the exclusion of other things," and found that Congress's omission of trademarks from the intellectual property definition implied that it had not intended for them to be regarded as analogous. *Id.* (citing U.S. v. Hernandez-Ferrer, 599 F.3d 63, 67–68 (1st Cir. 2010)).

[39] *Tempnology II*, 559 B.R. at 821.

tion of the Code.[40] Debtor appealed to the Court of Appeals for the First Circuit and the majority reversed the First Circuit BAP's decision.[41]

II. Chronology and Discussion of the Circuit Split

The First Circuit's 2018 decision in *In re Tempnology* (*Tempnology III*) establishes a clear rift with the Seventh Circuit as to whether trademark licensees are protected in the event of a contract rejection in bankruptcy.[42] The Third and Eighth Circuits also had the opportunity to examine the different approaches, but declined to address the issue because the contracts in the respective cases were considered non-executory and the Code does not provide for non-executory contract rejection.[43]

Section A of this Part details the cases leading up to *Tempnology III*.[44] Section B examines the *Tempnology III* decision itself.[45] Section C discusses *In re Sima International, Inc.*, the only case to examine the issue after *Tempnology III*.[46]

*A. Pre-*Tempnology III *Chronology*

The two cases most clearly representing the circuit split are the Fourth Circuit's decision in 1985 in *Lubrizol Enterprises, Inc. v. Richmond Metal Fin-*

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[40] *Id.* at 821–23. This section is 11 U.S.C. § 365(g), which deems the effect of rejection to be a breach of contract. 11 U.S.C § 365(g); *Tempnology II*, 559 B.R. at 822–23. The First Circuit BAP agreed with the bankruptcy court that § 365(n) does not protect Licensee's trademark rights, but because of § 365(g), Debtor's breach of a trademark agreement in bankruptcy did not automatically terminate Licensee's rights. *Tempnology II*, 559 B.R. at 822–23.

[41] *Tempnology III*, 879 F.3d at 404.

[42] *Compare In re* Tempnology, LLC (*Tempnology III*), 879 F.3d 389, 395 (1st Cir. 2018) (declining to follow the Seventh Circuit and the First Circuit BAP, holding that the trademark license does not survive Licensee's contract rejection), *with* Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 378 (7th Cir. 2012) (interpreting the case in the context of non-bankruptcy law and holding that the license will survive a contract rejection).

[43] *See* 11 U.S.C. § 365(a) (2012) (allowing the trustee to reject executory contracts on behalf of the debtor); *In re* Interstate Bakeries Corp., 751 F.3d 955, 966 n.2 (8th Cir. 2014) (declining to address whether a trademark license survives contract rejection because of the non-executory nature of the agreement); *In re* Exide Techs., 607 F.3d 957, 964 (3d Cir. 2010) (holding that the agreement was not executory, therefore it cannot be rejected). In 2010, in a concurring opinion in *In re Exide Technologies*, Judge Thomas Ambro commented on Congress's legislative intent in § 365(n), stating that courts should not through negative inference treat a rejection of a trademark license as synonymous with the extinguishment of the licensee's trademark rights. *Exide*, 607 F.3d at 967 (Ambro, J., concurring); *see also* Keith Waters, Sunbeam *and Its Impact on the Rejection of Trademark Licenses in Bankruptcy*, 65 ALA. L. REV. 833, 839–40 (2013) (detailing Judge Ambro's rationale in his concurrence in *Exide Technologies* and its significance in the context of § 365(n), positing that this concurrence was significant in shaping the argument for including trademarks in the definition of intellectual property).

[44] *See infra* notes 47–55 and accompanying text.

[45] *See infra* notes 56–62 and accompanying text.

[46] *See infra* notes 63–66 and accompanying text.

ishers, Inc., which both the bankruptcy court and the First Circuit followed in their decisions, and the Seventh Circuit's decision in 2012 in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, which the First Circuit BAP followed.[47]

In *Lubrizol*, Richmond Metal Finishers filed a Chapter 11 bankruptcy petition and sought to reject a contract licensing the use of its patented metal coating process to Lubrizol.[48] The Fourth Circuit approved the contract rejection, holding that allowing specific performance of a technology license would be contrary to the purpose of contract rejection in bankruptcy, so the correct remedy was damages.[49] The court acknowledged that the decision could detrimentally affect a licensor's willingness to enter into a contract with potentially financially unstable parties, but found that such equitable considerations were irrelevant in light of Congress' decision to allow executory contract rejection.[50]

In 2012, after the passage of § 365(n), the Seventh Circuit clarified in *Sunbeam* that the statute's omission of trademarks was because of the need for further study of the issue and was not meant as an approval of *Lubrizol*.[51] In *Sunbeam*, Lakewood Engineering and Manufacturing licensed its patents and trademarks for box fans to Chicago American Manufacturing ("CAM"), but later declared bankruptcy and sold its assets to Sunbeam Consumer Products, who rejected the existing licensing agreement.[52] CAM continued to sell the fans post-rejection, so Sunbeam sued for infringement.[53] The court held that

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[47] *See Sunbeam*, 686 F.3d at 378 (holding that a license survives a contract rejection because it should be interpreted in the context of non-bankruptcy law); Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985) (holding that licensee would not be able to retain its contract rights post-rejection but could seek monetary damages). Congress passed § 365(n) in direct response to the outcry the Fourth Circuit's 1985 *Lubrizol* holding created, and the Seventh Circuit, in 2015 in *Sunbeam*, sought to clarify that Congress did not intend to codify *Lubrizol* by excluding trademarks from the statutory definition of intellectual property, despite the inference by a few bankruptcy judges. *Sunbeam*, 686 F.3d at 376; Lu, *supra* note 28 and accompanying text.

[48] *Lubrizol*, 756 F.2d at 1045. Richmond Metal Finishers sought to reject the contract to sell and license the metal coating technology free from the limitations imposed by the existing licensing contract with Lubrizol. *Id.*

[49] *Id.* at 1048. The court in *Tempnology III* expanded on this idea by detailing the considerable costs to a debtor that arise from maintaining a trademark, including monitoring usage in order to maintain quality and develop goodwill. *Tempnology III*, 879 F.3d at 402.

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

[51] *Sunbeam*, 686 F.3d at 375. The court mentioned that although Congress had not prioritized trademark licensing as a topic of study since the passage of § 365(n), it did not change its original intent. *Id.*

[52] *Id.* at 374. The original contract provided that Lakewood would be the entity taking orders from big retailers like Walmart, and CAM would directly ship the products to those customers. *Id.* Lakewood authorized CAM to sell the fans outside of this arrangement if they did not sell the full inventory amount. *Id.* After a court-appointed trustee made the decision to sell the business to Sunbeam, Sunbeam rejected the licensing contract because it did not want to sell fans in competition with CAM or buy out its remaining inventory. *Id.*

[53] *Id.*

under § 365(g), a licensor's decision to reject a contract is a breach of the contract, but does not terminate the licensee's rights.[54] The court also took note of uniform scholarly criticism of the *Lubrizol* decision.[55]

B. The Tempnology III *Ruling*

The First Circuit's decision in *Tempnology III* effectively resurrected the *Lubrizol* reasoning that had fallen into disfavor since *Sunbeam*.[56] The First Circuit adopted a bright-line rule that contract rejection terminates a licensee's right to use the previously licensed trademarks.[57]

The majority in *Tempnology III* explicitly declined to follow the *Sunbeam* approach, though Judge Juan R. Torruella tracked the Seventh Circuit decision closely in his dissent.[58] The court reasoned that the First Circuit BAP's approach, modeled after *Sunbeam*, would undercut Debtor's ability to have a fresh start by forcing it to perform costly executory obligations arising from the continuance of the license, including quality control monitoring.[59] Should a trademark owner fail to exercise sufficient quality control, it could become a

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[54] *See* 11 U.S.C § 365(g) (characterizing debtor contract rejection as a breach of contract); *Sunbeam*, 686 F.3d at 376 (explaining that in any context, including bankruptcy, a licensor's breach of contract does not affect the licensee's ability to use the trademark).

[55] *Sunbeam*, 686 F.3d at 377; *see, e.g.*, Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection*,*"* 59 U. COLO. L. REV. 845, 916–18 (1988) (determining that *Lubrizol* confused contract rejection with an avoidance power and incorrectly allowed the executory nature of the contract to control the issue); John J. Fry, *The Rejection of Executory Contracts Under the Intellectual Property Bankruptcy Protection Act of 1988*, 37 CLEV. ST. L. REV. 621, 625–26, 640 (1989) (characterizing rejection as a breach of contract and the Act as a success because it corrected the negative aspects of the *Lubrizol* decision by protecting the licensee in the event of contract rejection); Jay Lawrence Westbrook, *The Commission's Recommendations Concerning the Treatment of Bankruptcy Contracts*, 5 AM. BANKR. INST. L. REV. 463, 470–71 (1997) (stating that contract rejection should be analyzed in the context of non-bankruptcy law and *Lubrizol* was incorrect to use rejection as an avoiding power).

[56] *See Tempnology III*, 879 F.3d at 404 (allowing a trademark license to be terminated upon a licensee's contract rejection, similarly to *Lubrizol*); *see, e.g.*, *In re* Crumbs Bake Shop, Inc., 522 B.R. 766, 770–71 (Bankr. D.N.J. 2014) (finding that the *Lubrizol* decision was unpersuasive and allowing licensees to continue using trademarks despite contract rejection).

[57] *Tempnology III*, 879 F.3d at 404.

[58] *See id.* (arguing that *Sunbeam* incorrectly failed to take into consideration the residual enforcement burdens for which debtors would be responsible should they be unable to reject a licensing contract). The majority criticized the dissent's "equitable remedy" approach for giving too much deference to Congress's legislative intent when it drafted § 365(n). *Id.* at 403. According to Judge Torruella, "the Senate Committee report explains that the purposeful omission of trademarks was not designed to leave trademark licenses unprotected," but to allow further study, and therefore the effect of Debtor's contract rejection on Licensee's trademark license should be guided by the terms of the Agreement and non-bankruptcy law. *Id.* at 405–07 (Torruella, J., dissenting).

[59] *Id.* at 403 (majority opinion). The court stated that Congress's principal goal in allowing contract rejection was to free debtors of seemingly onerous legal commitments that could hinder their ability to restart. *Id.* at 402. An example of such a commitment is a trademark licensor's continuing obligation to monitor the quality of its trademarks, including usage by any licensees, to safeguard against public deception. *Id.*; Waters, *supra* note 43, at 844.

"naked license," resulting in abandonment and the subsequent loss of trademark rights.[60]

In June 2018, Licensee filed a petition for writ of certiorari to the Supreme Court, posing two questions, the first being whether a debtor's rejection of a license agreement extinguishes the licensee's rights.[61] On October 26, 2018, the Supreme Court granted the petition for writ of certiorari only for the first question.[62]

*C. Post-*Tempnology III

Only the Bankruptcy Court for the District of Connecticut, in 2018 in *In re SIMA International, Inc.*, has examined the effects and relevance of the *Tempnology III* decision.[63] In its opinion, the court detailed the history of the circuit split, eventually following the reasoning of *Sunbeam* and deciding that contract rejection does not revoke a licensee's right to use a trademark license.[64] The court focused on the plain language reading of the statute the Seventh Circuit advanced in *Sunbeam*, and it criticized the First Circuit for ignoring Congress's intent to rebalance both licensors' and licensees' intellectual property rights.[65] Whether the Second Circuit will weigh in on the issue is uncertain, as neither party has filed an appeal, but the court's firm renunciation

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[60] Waters, *supra* note 43, at 844. Under the doctrine of naked licensing, if a trademark owner licenses a trademark but fails to enforce any sort of quality control over its use, a court may deem the trademark abandoned. *Id.* When a trademark is abandoned, the owner can no longer bring an infringement action for unauthorized use. *See* FreecycleSunnyvale v. Freecycle Network, 626 F.3d 509, 515–16, 520 (9th Cir. 2010) (holding that defendant-licensor did not maintain express or actual control over plaintiff's quality control measures and was unreasonable in depending on them, therefore resulting in naked licensing and trademark abandonment). After abandonment, a mark is returned to the public domain where anyone can use it. Jonathan B. Schwartz, *Less Is More: Why a Preponderance Standard Should Be Enough for Trademark Abandonment*, 42 U.C. DAVIS L. REV. 1345, 1353 (2009).

[61] Petition for a Writ of Certiorari, Mission Prod. Holdings, Inc. v. Tempnology, LLC, No. 17-1657 (U.S. Jun. 12, 2018), 2018 WL 2967405 at *i.

[62] *Tempnology III*, 879 F.3d at 404 (1st Cir. 2018), *cert. granted*, 139 S. Ct. 397 (U.S. Oct. 26, 2018). The question that the Supreme Court rejected was "Whether an exclusive right to sell certain products practicing a patent in a particular geographic territory is a 'right to intellectual property' within the meaning of § 365(n) of the Bankruptcy Code." Petition for a Writ of Certiorari, *supra note* 61, at *i.

[63] *See In re* SIMA, Int'l, Inc., No. 17-21761, 2018 WL 2293705, at *7–8 (Bankr. D. Conn. May 17, 2018) (summarizing the *Tempnology III* holding and dissent and explicitly disagreeing with the majority's statutory construction and deference to *Lubrizol*).

[64] *Id.* at *4–8. Starting with *Lubrizol* and detailing all significant court decisions up to the present, the court acknowledged the value of reviewing the history of § 365(n) before evaluating it in the context of the current case. *Id.* Writing for the majority, Judge James Tancredi also noted, similarly to *Sunbeam*, that the court was "not alone in concluding that [the *Lubrizol*] reasoning is flawed." *Id.* at 4.

[65] *See id.* at *7–8 (criticizing the First Circuit for ignoring Congress's intent and resurrecting the *Lubrizol* reasoning).

of the reasoning in *Tempnology III* only serves to deepen the divide, running contrary to the constitutional goal of uniformity in bankruptcy law.[66]

III. THE FIRST CIRCUIT'S PROBLEMATIC HOLDING

The First Circuit's 2018 decision in *In re Tempnology* (*Tempnology III*) encourages the use of § 365 as an offensive rather than a defensive technique, gifting debtors an enviable ability to reject contracts at their discretion.[67] Section A of this Part details how *Tempnology III* misinterpreted legislative intent in the omission of trademarks in § 365(n).[68] Section B of this Part explains why the concern expressed in *Tempnology III* regarding the costs of trademark quality control is outdated and unfounded.[69] Section C of this Part discusses why weakened trademark protections as promoted by the decision will have negative economic effects.[70]

A. The Misinterpretation of a Legislative Omission

The Supreme Court has long emphasized that the plain text reading of a statute should control, unless such interpretation is clearly contrary to the drafters' intent.[71] As evidenced by the Senate Report discussing the passage of § 365(n), Congress did not include trademarks in the definition of intellectual property because the topic required more extensive study, not because it believed that contract rejection should terminate trademark license rights.[72] The

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[66] *See* U.S. CONST. art. I, § 8, cl. 4. (Congress has the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States"); Cent. Va. Cmty. Coll. v. Katz, 546 U.S. 356, 369 (2006) (detailing the history of the Bankruptcy Clause and noting the absence of extensive debate over the text that demonstrated the general consensus for the necessity of a uniform bankruptcy system).

[67] *See In re* Tempnology, LLC (*Tempnology III*), 879 F.3d 389, 404 (1st Cir. 2018) (declining to protect trademark licenses from contract rejection in bankruptcy in order to preserve a debtor's fresh start opportunities); *In re* Exide Techs., 607 F.3d at 967–68 (Ambro, J., concurring) (describing the use of bankruptcy as "a sword [rather] than a shield"). Judge Ambro used the phrase "catbird seat" to describe the position in which debtors find themselves as a result of the Fourth Circuit's rationale in its 1985 decision in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc. Id.*

[68] *See infra* notes 71–74 and accompanying text.

[69] *See infra* notes 75–80 and accompanying text.

[70] *See infra* notes 81–87 and accompanying text.

[71] *See* U.S. v. Ron Pair Enters., 489 U.S. 235, 242 (1989) (citing Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982)) ("In such cases, the intention of the drafters, rather than the strict language, controls."); U.S. v. James, 478 U.S. 597, 606 (1986) (citing Consumer Prod. Comm'n v. GTE Sylvania, Inc. 447 U.S. 102, 108 (1980)) ("In the absence of a 'clearly expressed legislative intention to the contrary,' the language of the statute itself 'must ordinarily be regarded as conclusive'"); Blum v. Stenson, 465 U.S. 886, 896 (1984) ("Where . . . resolution of a question of federal law turns on a statute and the intention of Congress, we look first to the statutory language and then to the legislative history if the statutory language is unclear.").

[72] *See* S. REP. NO. 100-105, *supra* note 31 (determining that bankruptcy courts were more qualified to explore the issue). Section 365(n)'s legislative history suggests Congress recognized that the

Fourth Circuit's 1985 decision in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, the case that spurred enough concern for Congress to enact § 365(n), did not involve trademarks, so it follows that trademarks were not a focal point of the statute.[73] There is no hidden meaning behind the omission of trademarks from § 365(n), and the First Circuit's dismissal of the Senate's clear intentions is atypical.[74]

B. Trademark Quality Control Does Not Hinder a Fresh Start

One of the court's main concerns in *Tempnology III* was that allowing licensees to maintain their trademark rights after contract rejection would undercut the debtor's ability to recover due to the costs associated with trademark quality control.[75] If trademark owners cannot afford to monitor their licenses for quality control, they risk losing the trademark altogether.[76] Courts already recognize the burden that licensors face in controlling the quality of their licensed trademarks and have minimized the level of control necessary to prevent abandonment.[77] The norm today is to allow many different forms of quality control, including delegating the responsibility to the licensees themselves.[78] It is unlikely that licensees, who often build their businesses around the value and goodwill derived from a trademark, would destroy that public trust and

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necessity of monitoring trademark usage for quality control is a characteristic not shared by other forms of intellectual property, and the legislators were not comfortable burdening debtors with this cost. Waters, *supra* note 43, at 838; Ghaffari, *supra* note 5, at 1064–65.

[73] *See* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc*.,* 756 F.2d, 1039, 1045 (4th Cir. 1985) (deciding on a patent, not trademark, license to utilize a "metal coating process technology").

[74] *See* U.S. v. Am. Trucking Ass'ns, 310 U.S. 534, 542 (1940) ("In the interpretation of statutes, the function of the courts is easily stated. It is to construe the language so as to give effect to the intent of Congress."); *Tempnology III*, 879 F.3d at 403 (stating that the dissent incorrectly afforded the Senate Report deference normally reserved for an actual statute); *cf. Tempnology III*, 879 F.3d at 406 (Torruella, J., dissenting) (questioning why Congress would have explicitly stated that further study was necessary in the Senate Report if it meant for *Lubrizol* to apply to trademarks, and noting that because Congress has declined to provide further guidance on the issue, the majority's bright-line judicial rule infringes congressional intent).

[75] *Tempnology III*, 879 F.3d at 403–04. As the court notes, trademark quality control is a necessary responsibility of trademark licensing. *Id.*

[76] *Id.*; *see* FreecycleSunnyvale v. Freecyle Network, 626 F.3d 509, 515–16, 520 (9th Cir. 2010) (holding that lack of control over a trademark may result in naked licensing and abandonment of the trademark); Waters, *supra* note 43, at 844 (discussing naked licensing and the risk that trademark owners may lose their trademark rights as a result of it).

[77] Waters, *supra* note 43, at 844; *see, e.g.*, Ky. Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368, 387 (5th. Cir. 1977) (acknowledging the significant burden that a party faces in establishing abandonment).

[78] Nguyen, *supra* note 2, at 1312–13. A licensee typically has a higher level of expertise than a licensor in maintaining trademark quality standards, and delegation maximizes economic efficiency for both parties by disposing of the necessity for on-site licensor inspections. Laura Jelinek, *Equity for Brand Equity: The Case for Protecting Trademark Licensees in Licensor Bankruptcies*, 40 AIPLA Q.J. 365, 389–91 (2012).

risk the loss of customers by selling goods of a lesser quality.[79] Because licensees are incentivized to enforce the mark's quality control for fear of losing their own customers, trademark owners will not be burdened by quality control costs, rendering the concern moot.[80]

C. Weakening Trademark Protections Will Have Detrimental Economic Effects

The *Tempnology III* decision could have detrimental economic and financial effects on licensors, current and potential licensees, and consumers.[81] It is a basic economic principle that a potential trademark licensee is less willing to pay a high price for a trademark license that could be stripped during bankruptcy than for one that is fully protected.[82] As a result, the reduced willingness of licensees to pay a premium undercuts a licensor's potential profits and jeopardizes the licensing regime.[83] In addition, if a licensee's businesses are built around a trademark license, a contract rejection may force them to renegotiate terms in an unfavorable manner or lose their rights altogether.[84] This risk could both devalue the licensor's mark and negatively affect the licensee's reputation.[85] Not only is this detrimental to the licensee, it also harms the debtor whose estate would lose potential value from profits and goodwill benefits from the trademark, decreasing the eventual payout to creditors.[86] Finally, if a contract rejection removes a trademark from the market, economic efficiency

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[79] *See* Nguyen, *supra* note 2, at 1313 (hypothesizing that licensees would not sell products of low quality if they have already invested their own time in promulgating the goodwill of the trademark); Jelinek, *supra* note 78, at 392 (claiming that if licensees lowered the quality of their products, they would disappoint customers who would possibly stop purchasing those products altogether).

[80] *See* Jelinek, *supra* note 78, at 392 (stating that a licensee will likely not need any external pressure to maintain the contractual quality standard of a trademark license).

[81] *See* Ghaffari, *supra* note 5, at 1067–68 (detailing the potential consequences of contract rejection on trademark licensees and licensors, including "devaluing the mark and losing its goodwill"); Jelinek, *supra* note 78, at 397 (commenting on the issues for consumers if trademarks are removed from the market, including increased search costs); Nguyen, *supra* note 2, at 1310–11 (describing the issues that a licensee may face if a licensor files for bankruptcy, including being forced to unfavorably renegotiate terms of the license).

[82] Nicholas W. Quesenberry, *Risky Business: How the Economic Impact of the Risk of Debtor Default Mandates Application of the Presumptive-Contract Interest Rate in the Case of a Cramdown Plan Against a Secured Creditor with a Lien on Personal Property in Chapter 13*, 22 J. BANKR. L. & PRAC. 2 ART. 5 (2013) ("It is manifest that any disinterested buyer would be willing to pay less for a riskier, less stable income stream and more for a more stable and reliable one.").

[83] *See id.* (applying Quesenberry's economic theory to the trademark licensing scheme means that a potential licensee would be less willing to invest in a trademark license that could be stripped in bankruptcy because it would be considered a risky and unstable income stream).

[84] Nguyen, *supra* note 2, at 1310–11; Darren W. Saunders, *Should the U.S. Bankruptcy Code Be Amended to Protect Trademark Licensees?*, 94 TRADEMARK REP. 934, 940 (2004).

[85] Nguyen, *supra* note 2, at 1310–11; Saunders, *supra* note 82.

[86] Ghaffari, *supra* note 5, at 1068.

decreases because consumers are unable to rely on the trademark as an indication of high quality and are forced to spend time seeking a substitute.[87]

CONCLUSION

The First Circuit held in *Tempnology III* that contract rejection terminates a licensee's right to use the previously licensed trademarks. This holding resurrected the reasoning in *Lubrizol* that had fallen into disfavor in recent years. The court used its own judgment in holding that the omission of trademarks from the definition of intellectual property was intentional, despite legislative history indicating otherwise. The First Circuit's fear that imposing quality control obligations on Chapter 11 debtors will hinder their ability to recover is unfounded, as courts have continued to relax the level of quality control necessary to avoid trademark abandonment. Lastly, weakening trademark protections by terminating a license not only negatively affects the licensee, but also the debtor-licensor and consumers in general. The Seventh Circuit's *Sunbeam* approach of examining the issue in the context of non-bankruptcy law and allowing the licensee to continue using the trademarks after contract rejection more effectively maintains the integrity of trademarks and promotes economic efficiency for all parties involved.

AVERY MINOR

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[87] Jelinek, *supra* note 78, at 397. Conveniently, the economic justification for protecting trademark licensees mirrors one of the foundational justifications for trademarks: reducing consumer search costs. *Id.* Search costs are reduced (and economic efficiency is increased) when consumers are able to buy a product without having to investigate the quality and reputation every time they wish to repurchase it, which forces firms to create consistent brand quality to retain customers. Landes & Posner, *supra* note 3.