When Trademark Rights and Bankruptcy Collide

Article
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Toys “R” Us, Payless, The Limited, Bloomingdale’s, Sears, Shopko.

Almost every month brings news of another large company declaring bankruptcy. But what happens to you if you are currently a business partner to a company that declares bankruptcy? How are your rights affected? This article will address the specific issue of what rights you retain when you license intellectual property from a company that declares bankruptcy. As we well see, the answer depends on the type of intellectual property you license and what the Supreme Court decides to do with trademarks.

Example

Company B, a bedding manufacturer, realizes how popular weighted blankets have become. Company B decides to start selling weighted blankets, but it doesn’t know how to make them. That’s where Zzzz Inc. enters. Zzzz Inc. is the leading designer of weighted blankets with over 25 patented blankets and a well-known “Sleep EaZzzzy” brand. Company B enters into a five-year contract with Zzzz Inc. for the rights to Zzzz Inc.’s patents and the right to manufacture and sell blankets under the already well-known “Sleep EaZzzzy” name. Approximately one year into the five-year license, Zzzz Inc. declares bankruptcy. Zzzz Inc.’s bankruptcy trustee decides the five-year license with Company B is not favorable to Zzzz Inc. and rejects the contract, which effectively terminates the contract with four years remaining. So what happens to Company B? Can it still use Zzzz Inc.’s patents? Can it still sell blankets under the Sleep EaZzzzy trademark?

The short answer is: It depends. Patents, trade secrets, and copyrights are treated differently in a bankruptcy than trademarks.

Patents, Trade Secrets, and Copyrights

Company B would retain its rights to Zzzz Inc.’s patents. In the 1980’s, Congress amended the Bankruptcy Code to ensure that companies who have licensed another company’s intellectual property may continue to do so even if the other business declares bankruptcy. 11 U.S.C. § 365(n). However, when Congress made this change, it defined intellectual property to include patents, trade secrets, and copyrights. Left off of this list, however, was trademarks, which has sparked confusion and discord amongst the lower courts ever since.

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Whether Company B can still use the Sleep EaZzzzy trademark is unclear and currently depends on where the bankruptcy was filed. If the bankruptcy was filed in the First Circuit, which includes states like Maine, Massachusetts, New Hampshire, Puerto Rico, and Rhode Island, then Company B would not have the right to use the Sleep EaZzzzy trademark. The First Circuit has held that a rejection terminates the contract and all continuing rights to use the trademarks. The court reasoned that because the amended Bankruptcy Code does not include "trademarks" as one of the types of intellectual property where usage rights continue and cannot be terminated during bankruptcy by rejecting the license.

However, if the bankruptcy was in the Seventh Circuit, which consists of Illinois, Indiana, and Wisconsin, then Company B could continue to sell products while using the Sleep EaZzzzy trademark. The Seventh Circuit has held that the rejection of a trademark license is a breach of contract, but that it does not eliminate the licensee's continuing trademark rights.

Supreme Court to Resolve Conflict

In February, the Supreme Court heard arguments in *In re Tempnology, LLC*, a case that will address these different approaches and determine what rights a trademark licensee maintains. The Justices' questions during oral arguments indicate that they are balancing two competing theories of rights—the bankrupt licensor's vs. the licensee's. On one hand, the Justices recognized that allowing a licensee to retain its trademark license imposes a burden on the bankrupt licensor to monitor the use of that trademark. On the other hand, the Justices acknowledged that a licensor would not be able to unilaterally revoke its license by breaching its contract outside of bankruptcy. Allowing the licensor to revoke its license would be unfair to the licensee because it would revoke rights that had already been bestowed upon the licensee, and freely negotiated by the parties.

These questions, their answers, and more will be considered as the Supreme Court renders its decision, which will happen before the end of the session at the end of June. When the Supreme Court ultimately renders its decision, it will have permanent consequences for intellectual property rights when one of the party's to a license agreement files for bankruptcy.

If you license intellectual property, the terms that you negotiate for your license should factor in the risks of whether the licensor can terminate the agreement. Because we know how drastic these consequences may be, we will continue monitoring the Supreme Court's decision.