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Third Circuit Concurring Opinion Supports Trademark Licensees' Retention of Rights in Bankruptcy Cases

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The concurring opinion in a recent Third Circuit Court of Appeals case[8] suggests that trademark licensees may be able to retain their rights in bankruptcy cases, even if licensors reject the license agreements. The majority did not consider whether the licensee could retain its rights. Instead, the majority held that the trademark license was not an executory contract; therefore, it could not be rejected under the Bankruptcy Code. The majority opinion applies narrowly to circumstances involving perpetual, exclusive, and royalty-free trademark licenses.

The concurring opinion, however, has a potentially broader application. Based on the concurring opinion, trademark licensees can argue that despite intentionally excluding trademarks from the Bankruptcy Code definition of "intellectual property," Congress intended for bankruptcy courts to exercise equitable powers in cases involving rejection of trademark license agreements. The *In re Exide* opinions warrant careful examination by both licensors and licensees. The concurrence forewarns licensors that filing for bankruptcy may not guarantee that they will be able to reject executory trademark licenses. Licensees may cite the concurring opinion to support arguments for retaining their trademark license rights after their licensors file for bankruptcy.

The Parties' Trademark License Agreement

Exide Technologies ("Exide") manufactured and sold industrial batteries. In 1991, Exide sold substantially all of its industrial battery business to Yuasa Battery (America), Inc., which is now known as EnerSys Delaware, Inc. ("EnerSys"). The sale agreement provided EnerSys with a perpetual, exclusive, royalty-free license to use Exide's eponymous trademark—Exide—for its newly-acquired industrial battery business. Exide retained its trademark for use outside of the industrial battery business, however.

In 2000, Exide decided to re-enter the North American industrial battery market. By that time, EnerSys had paid in full for all of the purchased assets. Nevertheless, Exide made several attempts to reacquire

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[8] *In re Exide Techs*., 607 F.3d 957 (3d Cir. 2010).

the trademark from EnerSys because Exide wanted to unify its corporate image by producing all its products under a single name and trademark. EnerSys, however, refused to relinquish its trademark rights. Ultimately, Exide purchased another battery business and was forced to compete in the market against EnerSys' products, which bore Exide's own trademark.

Bankruptcy Case and Lower Courts' Rulings

After filing for bankruptcy in 2002, Exide sought to reject the trademark license agreement under Section 365(a) of the Bankruptcy Code. Rejection allows a bankrupt debtor to terminate the rights and obligations of "executory contracts." Generally, a contract is executory if material obligations remain unperformed by both parties to the contract. Exide argued that the trademark license agreement was executory because, although EnerSys had no remaining monetary obligations (*i.e.*, the license agreement was fully paid and royalty-free), both parties continued to have unperformed obligations. Exide further argued that because the trademark license agreement was an executory contract, Exide could reject the agreement and be released from the agreement's restrictions. Thus, by rejecting the trademark license agreement, Exide could restore its trademark rights for use in the industrial battery business, allowing it to sell batteries under the Exide mark. Both the Bankruptcy and District Courts determined that the license agreement was executory and allowed Exide to reject it. Therefore, those courts' decisions potentially denied EnerSys the use of the Exide trademark, although that use was critical to EnerSys' business.

Third Circuit Majority Opinion

On appeal, the Third Circuit reversed. Specifically, the Third Circuit concluded that the license agreement was not an executory contract because all material obligations had already been performed and none of the remaining obligations were sufficiently material to make the license agreement executory. So, in the majority opinion, which is the binding portion of the *Exide* decision, the court merely determined whether the trademark license agreement was an executory contract. Therefore, that opinion likely only applies to the limited situation in which a trademark license is perpetual, exclusive, and royalty-free.

Third Circuit Concurring Opinion

Unlike the majority opinion, Judge Thomas L. Ambro's nonbinding concurring opinion applies much more broadly. Judge Ambro agreed with the result, but wrote that the majority should have corrected the Bankruptcy Court's statement that rejection left EnerSys without the right to use the Exide trademark. Before the Bankruptcy Court, EnerSys asserted that if the license agreement was an executory contract, and if it was rejected, EnerSys could still retain its rights under the agreement pursuant to Section 365(n) of the Bankruptcy Code. Section 365(n) allows an "intellectual property" licensee to retain its rights for the remaining term of the agreement, even if the licensor-debtor rejects the license agreement.

Congress added Section 365(n) to the Bankruptcy Code in 1994 in response to a 1985 Supreme Court decision[9] which held that a bankrupt licensor could deny the licensee its rights under a license agreement through rejection, thereby putting the licensee out of business. Notably, the *Lubrizol* court acknowledged that allowing the licensor to reject the license agreement could have a chilling effect on parties' willingness to contract with businesses experiencing financial difficulty. Although Congress provided protection for intellectual property licensees under Section 365(n), it intentionally omitted trademarks from the Code's definition of intellectual property. Therefore, the *Exide* Bankruptcy Court determined that

[9] *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), *cert. denied*, 475 U.S. 1057 (1985).

Section 365(n) did not apply because trademarks are not intellectual property under the Bankruptcy Code. Based on that determination, the Bankruptcy Court reasoned that Exide's rejection of the license precluded EnerSys' continuing use of the trademark.

Legislative history explains why Congress intentionally omitted executory trademark, trade name and service mark licenses from the Bankruptcy Code definition of "intellectual property." Congress recognized that trademarks differed from other forms of intellectual property (such as patents and copyrights) because, to prevent loss of their trademark rights, trademark licensors must control the quality of products or services the licensee sells. In other words, one can argue that trademark licensors should not be saddled with an undesirable licensee through the operation of Section 365(n).

Judge Ambro, a former bankruptcy attorney prior to his appointment to the bench, acknowledged the argument that Section 365(n) does not apply to trademark license agreements because of the licensor's quality control requirements. But, he observed that legislative history also demonstrates that Congress intended for bankruptcy courts to exercise equitable powers to prevent the harsh result of allowing licensors to unilaterally terminate licensees' rights through rejection. Judge Ambro, therefore, concluded that the Bankruptcy and District Courts should have used their "equitable powers to give Exide a fresh start without stripping EnerSys of its fairly procured trademark rights."

Despite the concurring opinion's lack of precedential effect, it could have significant repercussions. The effect of a rejected trademark license agreement has the potential to be the most important issue in a bankruptcy case, both from a licensor's and a licensee's perspective. For example, trademarks are often at the core of franchisor-franchisee relationships. If the franchisor files for bankruptcy, the franchisee may lose its business if it is precluded from retaining its rights to the franchisor's trademark. Conversely, whether a trademark licensor can extricate itself from an exclusive license agreement, allowing the licensor to make the trademark available for sale, may, at the outset, determine whether filing for bankruptcy is a viable strategy.

Conclusion

The Exide opinions provide trademark licensees with two possible arguments that may allow them to retain their rights under a license agreement: (1) the agreement is not an executory contract because it is a perpetual, exclusive and royalty-free license with no material unperformed obligations; and (2) Congress intended for bankruptcy courts to exercise equitable powers to give licensor-debtors a fresh start without stripping licensees of their fairly procured trademark rights. The concurring opinion could be troublesome for licensors contemplating bankruptcy. Yet, if retaining a trademark license agreement would doom a licensor's reorganization efforts, the licensor-debtor could wield the equitable powers shield to its benefit. The licensor-debtor could argue that the court should exercise its equitable powers to permit rejection of the agreement in order to allow the debtor to reorganize and pay its creditors. Depending on the factual circumstances, the Exide concurring opinion provides potential support for both licensors and licensees in bankruptcy cases involving executory trademark license agreements.