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Protecting IP Rights in Pandemic-Era Bankruptcies

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The number of bankruptcy filings in the U.S. is rising, which is not surprising given the economic uncertainty caused by Covid-19. Several of the largest recent filings include Neiman Marcus, Hertz, J.C. Penney, Chinos (J.Crew), Latam Airlines, Frontier Communications, Diamond Offshore Drilling, Centric Brands, CEC Entertainment (Chuck E. Cheese), and Quorum Health.

These filings cut across a variety of industries, including apparel and brand design and production, apparel retail and dining, travel, entertainment, and energy. Experts at the Federal Reserve and other institutions estimate coronavirus-related bankruptcies could rise by 200,000. Given the ongoing Covid-19 spikes and recent retractions of reopening plans nationwide, it would not be surprising to see these estimates rise.

Any number of issues may arise in many of the current and future bankruptcy cases that will involve stakeholders' rights pertaining to intellectual property, including patents, trademarks, copyrights and trade secrets. In 2019 alone, the U.S. Patent & Trademark Office granted over 370,000 new patents, the most ever in one year. It also registered 400,000 trademarks.

Whether you or your company is an intellectual property owner or a licensee of intellectual property, or both, planning for bankruptcy issues is prudent in these turbulent times and requires taking several steps to protect your rights. The first step is to determine whether your intellectual property agreement, if any, is an "executory contract."

Executory Contracts in Bankruptcy

Section 365 of the United States Bankruptcy Code—11 U.S.C. §101 et. seq.—describes parties' rights with what are referred to as "executory contracts." Despite the code's definitional section that contains approximately 85 separately defined terms, the term "executory contracts" is undefined.

Courts have grappled with whether or not a particular agreement is an executory contract and what the rights are of parties to those contracts. The majority of courts rely upon the meaning described in an oft-cited law review article that describes an executory contract as one under which the obligations of both parties are so underperformed that a failure of either one to perform would constitute a material breach.

One must also keep in mind that once an agreement is determined to be executory in nature, not all executory contracts are treated equally in bankruptcy: this is so even within the subset of intellectual property agreements (e.g., exclusive versus non-exclusive licenses). For purposes of this article, the authors are assuming that the intellectual property agreements are executory in nature, thus triggering the various provisions set forth in 11 U.S.C. § 365, as discussed below.

Additionally, there are numerous subparts of 11 U.S.C. § 365 that pertain to executory contracts generally, including intellectual property agreements. This article deals only generally with licensee and licensor rights as they pertain to intellectual property agreements that are deemed executory contracts in the context of a bankruptcy case. The article does not cover in detail all of those provisions that affect executory contracts generally, including those that also affect intellectual property agreements (e.g., the timing of when certain actions must be taken by the parties once a bankruptcy case is filed (11 U.S.C. § 365(d)), or under what conditions a debtor in bankruptcy may assume and/or assign to another party an intellectual property agreement (e.g., 11 U.S.C. § 365(b)(1)-(3)).

The second step involves determining which type of intellectual property you are dealing with because, under the Bankruptcy Code, not all are treated equally.

Patents, Copyrights, Trade Secrets, and Bankruptcy Code

Patents often come to mind when people hear the term intellectual property: they are perhaps the best-known. However, copyrights and trade secrets are equally powerful in different ways than patents, and may last decades longer. Under the Bankruptcy Code, all three are treated similarly, so we will do the same here. Trademarks, oddly absent from the code's definition of the term "intellectual property," are discussed separately below.

In 1988, Congress added a new Section (11 U.S.C. § 365(n)) to the Bankruptcy Code that specifically addressed intellectual property, and by definition excluded trademarks. The new code section was a reaction to court decisions that left unclear whether the licensee of a patent, copyright, or trade secret could continue using those rights if the owner filed for bankruptcy.

If the owner of a patent, copyright, or trade secret files for bankruptcy, the Bankruptcy Code provides the licensor two options regarding any license agreements: assume them or reject them. "Assumption" means that the owner (or trustee) will treat the license as ongoing, essentially as if nothing has changed. The licensee can continue to use those rights provided it continues to pay royalties.

However, Section 365(n) of the code is invoked if the owner of a patent, copyright, or trade secret "rejects" the license agreement in bankruptcy. "Rejection" is akin to breaching the contract. Under 11 U.S.C. § 365(n), when a patent, copyright, or trade secret licensor in bankruptcy "rejects" the license agreement, the licensee also has two options: treat the license as terminated or retain its rights and continue to use the intellectual property provided royalties are paid, assuming the license requires royalties.

If, in contrast, the licensee files for bankruptcy, it may not have the ability to continue using the licensed patent, copyright, or trade secret, i.e., "assume" the license agreement. For example, if non-bankruptcy law excuses the licensor from accepting from or rendering performance to an entity other than the licensee, regardless of any contractual provisions that restrict the assignment of rights (11 U.S.C. § 365(c)(1)), and the licensor does not consent to such assumption or assignment.

Trademarks

While many business owners are now concerned about whether they will get paid for goods and services provided, trademark licensees face a different dilemma: can they continue to use the trademarks they license if the owner/licensor files for bankruptcy or you suspect it might soon. Here's what you need to know and three steps you can take now to minimize the risk of losing your trademark rights.

Most businesses rely on trademarks to distinguish their goods and services. Many own their trademarks outright, but others license their trademark rights from the owner or licensor. The Walt Disney Company is the world's largest trademark licensor, pulling in more than $50 billion in licensed product sales in 2015, including license fees paid by others that use its trademarks. While Disney appears financially sound, other trademark licensors may not be in such enviable financial shape, especially this year.

In fact, it is highly likely that a certain number of trademark owners/licensors may seek protection under the bankruptcy laws. What is a trademark licensee to do?

First, review your trademark license agreement. While not common, some trademark licenses include language that addresses bankruptcy, often in or near the termination provision(s). For example, "in the event that either party makes an assignment for the benefit of creditors, or files a petition in bankruptcy (whether voluntary or involuntary) or for reorganization, or becomes insolvent or unable to pay its debts as they become due, then the other party may terminate this Agreement immediately upon giving notice to the other."

In this example, the licensee would have the right, but not the requirement, to terminate the license agreement, stop paying the license fee, and also stop using the trademark. Assuming, however, that the licensee does not want to terminate the license and wants to continue using the trademark (or no language in the license agreement addresses bankruptcy at all), the licensee should go to step number two.

Second, look to the U.S. Supreme Court's recent decision in a case called *Mission Product Holdings, Inc. v. Tempnology, LLC*. Why? Because, strangely, trademarks are not included in the Bankruptcy Code's definition of "intellectual property." Section 365(n) of the code gives most "intellectual property" (patent, copyright, and trade secret) licensees the option to terminate their licenses or continue performing under them for the duration, and any extensions, even after the licensor files for bankruptcy protection and rejects the license agreement.

Trademark licensees are not included in the Code's definition of "intellectual property." The Supreme Court's decision in *Mission Product* clarified that trademark licensees (a non-exclusive trademark license), despite lacking express language in the Bankruptcy Code, must now be treated similarly to other licensees whose contracts are rejected in bankruptcy. In

other words, trademark licensees now have the option to continue using the licensed trademark (and paying the license fee) or treat the license as terminated, even if the owner/licensor rejects the license in the bankruptcy. It is the licensee's option.

However, keep in mind that while the licensor/debtor may not rescind the license if the licensee elects to continue using the licensed trademark, the licensor/debtor's rejection means two things: it permits the licensor/debtor to stop performing its remaining obligations under the license agreement and allows the licensee a claim for damages. While not directly addressed in the *Mission Product* case, similar to 11 U.S.C. § 365(n), a trademark licensee's obligation to make ongoing royalty payments will continue unabated.

Third, consider making an offer to buy the trademark from the owner or the bankruptcy trustee administering the dissolution or reorganization. In all cases, the schedules filed together with, or following, the filing of a bankruptcy petition are required to include a list of all of the debtor's property, including intellectual property such as trademarks and registrations. Even if the debtor fails to properly list its trademark, as a licensee you know that trademark rights are in fact owned by the debtor. Depending on the type of bankruptcy and the severity of debt, the trademark may be for sale.

The present value of the future license payments is one estimate of the trademark's value. Make sure to involve your trademark lawyer too because you must make certain that you acquire all of the trademark rights, registrations and goodwill. The purchase agreement need not be complicated, but it does need to be done right since the previous owner may soon no longer exist to correct anything missed. Finally, the trademark licensee must be mindful of additional Bankruptcy Code provisions that govern the sale of property in bankruptcy (e.g., 11 U.S.C. §363), and that any prospective sale will be subject to "higher and better offers." In the event a trademark licensee wishes to purchase the trademark, it should be careful to structure the offer with an eye toward discouraging competing offers.