No. 17-1657

In the Supreme Court of the United States

MISSION PRODUCT HOLDINGS, INC., PETITIONER,

v.

TEMPNOLOGY, LLC, N/K/A OLD COLD LLC,
RESPONDENT.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF OF THE INTELLECTUAL PROPERTY OWNERS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF NEITHER PARTY

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QUESTION PRESENTED

Whether, under §365 of the Bankruptcy Code, a debtor-licensor's "rejection" of a license agreement—which "constitutes a breach of such contract," 11 U.S.C. §365(g)—terminates rights of the licensee that would survive the licensor's breach under applicable non-bankruptcy law.

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INTEREST OF THE *AMICUS CURIAE*

Amicus curiae Intellectual Property Owners Association (IPO) is an international trade association representing companies and individuals across all industries and fields of technology who own or are otherwise interested in intellectual property rights.[1] IPO's membership includes about 200 companies and over 12,000 individuals who are involved in the association, either through their companies or as inventor, author, executive, law firm, or attorney members. Founded in 1972, IPO represents the interests of owners of intellectual property before Congress and the United States Patent and Trademark Office (USPTO). IPO's members include both licensors and licensees of trademarks and other intellectual property, across various industries and fields. IPO has filed *amicus* briefs in this Court and other courts on significant issues of intellectual property law. The members of IPO's Board of Directors, which approved the filing of this brief, are listed in the Appendix.[2]

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[1] No counsel for a party authored this brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than the amicus curiae or its counsel made a monetary contribution to its preparation or submission. Both parties have consented to the filing of this brief.

[2] IPO procedures require approval of positions in briefs by a two-thirds majority of directors present and voting.

STATEMENT

This case concerns a split of circuit authority about application of the Bankruptcy Code, 11 U.S.C. § 365, to trademark licenses. Three circuits have weighed in, taking two different approaches:

1. In the decision below, the First Circuit held that if a debtor-licensor "rejects" a trademark license under section 365(a), the licensee loses its rights. This "categorical approach," in the court of appeals' words, leaves trademark licensees "unprotected from court-approved rejection." Pet. App. 27a. In holding so, the court observed that section 365(n) allows a licensee of "intellectual property" a choice when facing rejection: it can treat the license as terminated and bring a claim for pre-petition damages, or it can retain its rights under the license. *Id.* at 10a-11a. However, the court then noted that 11 U.S.C. § 101(35A), which defines "intellectual property" for the Bankruptcy Code, does not include trademarks. *Id.* at 20a. Thus, the court held, trademark licensees do not have this same choice. See *id.* at 20a-27a. If a trademark license is rejected, the licensee's only option is a pre-petition damages claim. *See id.*

In the court of appeals' view, anything other than this bright-line rule would either contradict the Bankruptcy Code or inject uncertainty. *Id.* at 21a, 26a. The court also reasoned that, because trademark law requires a licensor to exercise quality control over the licensee's goods or services, allowing a licensee to continue using the mark would unduly burden the bankruptcy estate. *Id.* at 23a-24a.

Judge Torruella dissented. *Id.* at 29a-34a. He "disagree[d] with the majority's bright-line rule," *id.* at 29a, finding problematic both the majority's statutory interpretation and its policy reasoning. *See id.* at 30a-33a. His dissenting opinion urges an equitable, case-by-case approach for trademark licenses. *Id.* at 34a.

2. The Fourth Circuit follows the same rule as the court of appeals here. See *Lubrizol Enters., Inc.* v. *Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). *Lubrizol* held that rejection of a patent license under section 365(a) categorically terminates the licensee's rights. *Id.* at 1048. Congress abrogated *Lubrizol* three years later—at least as to patent licenses and other non-trademark licenses—when it enacted section 365(n). But because section 365(n) does not cover trademarks, *Lubrizol* seemingly remains good Fourth Circuit law in a trademark case like this one.

3. The Seventh Circuit takes the opposite approach. See *Sunbeam Prods., Inc.* v. *Chicago Am. Mfg., LLC*, 686 F.3d 372 (7th Cir. 2012). In *Sunbeam*, the Seventh Circuit held that rejection of a trademark license under section 365(a) has no impact on the licensee's right to continue using the mark. *Id.* at 377. Looking to the language of section 365(g), the court observed that rejection of a contract "constitutes a breach of such contract." *Id.* at 376. Thus, although rejection frees the debtor-licensor from performing its contractual obligations, the licensee's rights under the contract remain in place. *Id.*

SUMMARY OF THE ARGUMENT

For the considerable costs it imposes, the rule adopted below provides little benefit. It puts a serious burden on current and future trademark licensees, requiring them to bear the risk of their licensors' potential bankruptcy in exchange for nothing more than a pre-petition damages claim unlikely to ever be paid. The court of appeals' bright-line rule benefits only the small minority of trademark licensors who eventually file for bankruptcy and then choose to reject their license agreements under 11 U.S.C. § 365(a).

For everyone else—including the overwhelming majority of trademark licensors who never go bankrupt or never end up rejecting a license under section 365(a)—the court of appeals' rule creates little but costs and inefficiencies. It makes trademark licenses more difficult and expensive to negotiate, adding unnecessary roadblocks to economically efficient deals that the law should generally incentivize. Worse still, the court of appeals does this on a thin legal foundation. Its analysis misconstrues trademark law, incorrectly assuming that a licensor's obligation to conduct "quality control" over a licensee will necessarily create an undue burden for the bankruptcy estate. The court sides with *Lubrizol*—a stale decision Congress expressly rejected when it enacted section 365(n) in 1988—and does so by making flawed assumptions about Congress' intent. And its decision potentially creates unreasonable results, both in the specific situation where a license covers multiple forms of intellectual property and in the more general sense of incentivizing the strategic use of bankruptcy to revoke otherwise irrevocable trademark licenses.

These problems stand out because the court did not need to adopt *any* bright-line rule. Congress flagged the intersection between trademark licenses and section 365 as an issue requiring "more extensive study" and "development of equitable treatment . . . by bankruptcy courts." The court of appeals' holding short circuits that equitable development, saddling bankruptcy courts with an inflexible rule that will inevitably produce unjust results.

Until Congress acts, the best rule is not any categorical one, but an equitable approach that considers the facts of each case. The dissenting opinion below urges such an approach, and IPO largely agrees. In IPO's view, bankruptcy courts should start with the Seventh Circuit's *Sunbeam* rule as a presumption—*i.e.*, by presuming that the licensee may elect to continue using the licensed mark. But IPO acknowledges that this result will not always make sense, and sometimes this presumption must cede to other considerations. In those cases, the bankruptcy court should have discretion to craft whatever process or judgment it determines will best serve the equities, taking into account the Bankruptcy Code and its purposes, trademark law, and the terms and context of the parties' license.

ARGUMENT

I. The Court of Appeals' Bright-Line Rule Is Needlessly Restrictive and Problematic.

The court of appeals' "categorical approach" (Pet. App. 27a)—holding that rejection of a trademark license under section 365(a) *always* eliminates the licensee's rights—is troubling. It grafts an inflexible rule onto an area of law that Congress purposefully left open for "more extensive study" and "development of equitable treatment of this situation by bankruptcy courts." S. Rep. No. 100-505, 100th Cong., 2d Sess. 6 (1988). Trademark-licensing issues are highly fact specific. *See id.* at 9 ("[L]icensing arrangements are not generally standardized. Rather, the particular transaction is the product of the circumstances of the licensor, the licensee and other interested parties."); *see also Am. Foods, Inc.* v. *Golden Flake, Inc.*, 312 F.2d 619, 627 (5th Cir. 1963) (noting the "ancient observation that each trade-mark case must be decided upon its own facts"). Yet the decision below adopts an unnecessary "one size fits all" approach, and to no real gain. Neither licensors nor licensees benefit in the long run from this categorical rule.

If adopted by this Court, the court of appeals' rule will add cost and inefficiency to many licensing negotiations, which can already be complicated and expensive. It will do so without indication Congress intended that result, and despite several clear indications to the contrary.

A. Neither Trademark Licensors Nor Licensees Benefit in the Long Run from the Court of Appeals' Rule.

At first blush, the court of appeals' holding appears to unreservedly benefit trademark licensors. It allows them to reclaim unencumbered rights in their trademarks during bankruptcy, regardless of the negative impact this might have on the licensee or the consuming public. In the court's view, this bright-line rule is necessary to give debtor-licensors a "fresh start." Pet. App. 27a. The opinion also suggests—without authority or substantive analysis—that it will reduce "uncertainty and costs on the parties in bankruptcy proceedings." *Id.*

But the court of appeals' rule comes with significant costs. The most obvious ones fall on the licensee, which must bear the risk of the licensor's potential bankruptcy. If a bankrupt licensor rejects a trademark license under section 365(a), the decision below means the licensee's only recourse is a suit for pre-petition damages. *See* 11 U.S.C. §§ 365(g) and 502(g). A pre-petition damages suit will likely net "minimal" recovery, if any. *In re Crumbs Bake Shop, Inc.*, 522 B.R. 766, 772 (Bankr. D.N.J. 2014) ("[M]onetary recoveries primarily benefit the pre-petition and post-petition lenders and administrative claimants. Minimal distributions to general unsecured creditors are the norm."); *accord In re Matusalem*, 158 B.R. 514, 522 (Bankr. S.D. Fla. 1993) ("Rejection, as contemplated by the Debtor, would lead to the filing of a large damage claim pursuant to Section 365(g) and a new round of litigation over the amount of the claim, with the probable result that the Debtor would be unable to pay the claim."). So the licensee stands to lose both its licensed trademark rights and any realistic chance of being made whole. This result "makes bankruptcy more a sword than a shield, putting debtor-licensors in a catbird seat they often do not deserve." Pet. App. 32a-33a (Torruella, J., dissenting) (quoting *In re Exide Techs.*, 607 F.3d 957, 967-968 (3d Cir. 2010) (Ambro, J., concurring)).

The overwhelming majority of trademark licensors will never realize any benefit from the court of appeals' rule. Most trademark licenses do not end with the licensor declaring bankruptcy and rejecting the license. Illustrating the point, this issue has generated only three circuit decisions (one of which, *Lubrizol*, was not even a trademark case). Although the issue is no doubt important, it rests on a factual predicate that does not happen very often—especially when compared to how common trademark-licensing arrangements are. *See, e.g.*, Xuan-Thao N. Nguyen, *Bankrupting Trademarks*, 37 U.C. Davis L. Rev. 1267, 1275-1276 (2004) (explaining that the Lanham Act's enactment in 1946 paved the way for "extensive trademark licensing," which has become a "common practice today").

Meanwhile, the court's categorical rule adds transactional costs and inefficiencies to potentially every negotiation for a trademark license—regardless of whether the licensor ever ends up in bankruptcy. In general, parties enter a trademark license when it creates some sort of net efficiency. *See*, *e.g.*, *In re XHM Corp.*, 647 F.3d 690, 696 (7th Cir. 2010); Kayvan Ghaffari, *The End to an Era of Neglect: The Need for Effective Protection of Trademark Licenses*, 87 S. Cal. L. Rev. 1053, 1067-68 (2014). Parties should generally be incentivized to reach these efficient arrangements, which can benefit not only the parties but the consuming public at large. *See* Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83

Tex. L. Rev. 1031, 1041 (2005) ("Further, if one postulates that transactions involving intellectual property are costless, society as a whole should benefit, since the owners of intellectual property rights will license those rights to others whenever it is economically efficient to do so."). The decision below has the opposite effect. It forces the potential licensee to consider the ramifications, however distant, of the licensor's possible bankruptcy. And the licensee must consider those ramifications even if the licensor assures its financial stability. Financial circumstances can change quickly, and a rational licensee might not want to risk the consequences of categorical license rejection on mere assurances about the licensor's then-current financial situation.

With the court of appeals' rule, even the vague threat of licensor bankruptcy could chill or derail an otherwise desirable and efficient licensing arrangement. This result is particularly troubling because the licensee is often the one investing most of the capital to produce the licensed goods or services—investments that directly benefit the licensor. *See* 15 U.S.C. §§ 1055 and 1127 (establishing that when a "related company," including a licensee, uses a registered mark or a mark with a pending application for registration, that use inures to the registrant or applicant's benefit); Restatement (Third) of Unfair Competition § 33 cmt. b (1995) (same rule for common law marks). Counterintuitively, then, the licensee in many cases ends up bearing both its own investment risk *and* the risk that the licensor goes bankrupt.

If this Court affirms, the rule adopted here will give many potential licensees and their counsel reason to hesitate. This impacts the licensors, too, adding hurdles to deals that can already be complicated and expensive to complete. *See Sands, Taylor & Wood* v. *Quaker Oats Co.*, 34 F.3d 1340, 1351 (7th Cir. 1994) (emphasizing that licensing negotiations can be "protracted," "expensive," and often "unsuccessful"). And even if these hurdles do not derail the deal completely, the licensee might demand more advantageous terms—for example, a lower royalty rate—to compensate for the risks created by the court of appeals' rule. Or the licensee might insist on an independent audit of the licensor's financial records. Either result harms licensors, who might take little solace in whatever sense of comfort the court of appeals' rule provides. After all, bankruptcy is not the end goal of any rational licensor.

The court of appeals accepts these transactional costs because, in its view, anything but a categorical rule will "increase[] uncertainty and costs on the parties in bankruptcy proceedings." Pet. App. 27a. It is not clear, though, that the court's categorical rule will make bankruptcy proceedings any more efficient. It might just shift the fight into a "new round of litigation" over the licensee's pre-petition damages claim and the debtor's ability to pay it. *See Matusalem*, 158 B.R. at 522. And even accepting *arguendo* the court's premise, its opinion gives no reason to explain why the law should categorically favor more efficient bankruptcy proceedings over more efficient licensing negotiations. "All creditors, to some extent, assume the risk of [the debtor's] bankruptcy." *In re Jartran, Inc.*, 732 F.2d 584, 590 (7th Cir. 1984). The same cannot be said of trademark licensees, who may in many situations reasonably expect that the licensor's financial status will have no bearing on the licensee's ability to continue using the mark. *See* Part I.B, *infra*.

These concerns about the costs of categorical license rejection are not new. Congress itself expressed them when it enacted section 365(n), abrogating the same absolute rule from *Lubrizol* that the court of appeals adopted here. Congress cited the "instability" and "chilling" effects of *Lubrizol*, emphasizing the need for "dependability" and "flexibility" in intellectual property licensing. S. Rep. No. 100-505 at 3-4. Although that legislation did not cover trademarks—there was no pressing need, as *Lubrizol* was a patent case—similar policy concerns apply in the trademark space. *See id.* at 3 ("[*Lubrizol*] threaten[s] an end to the system of licensing of intellectual property . . . that has evolved over many years to the mutual benefit of both the licensor and the licensee and to the country's indirect benefits."); *id.* at 4 (noting the "unique role" of intellectual property in "technological and economic development"); *id.* at 12 (emphasizing the pivotal role of licensing in the "development and commercialization" of products and services).

In its petition-stage briefing, respondent addressed these congressional concerns by making policy distinctions between trademarks and other forms of intellectual property (particularly patents and copyrights). See Opp. 10-11. Yet despite respondent's claim to the contrary, trademarks too play a pivotal role in "encouraging or rewarding innovation." *Id.* at

10. Were it not for trademarks, sellers would have little economic incentive to improve the quality of their offerings, as poor quality would be untraceable to its source. 1 J. Thomas McCarthy, *McCarthy on Trademarks & Unfair Competition* § 2:4 (5th ed. 2018). "Consumers would be unable to recognize high-or low-quality brands, so sales would tend to go to manufacturers who reduced their price by cutting corners on quality. The result would be a race to produce inferior products, rather than competition to produce better ones." *Id.* (quoting Richard Craswell, FTC Office of Policy Planning, *Trademarks, Consumer Information & Barriers to Competition* 7 (1979)).

In the long run, the court of appeals' rule will create costs and inefficiencies outweighing any benefits to licensors or the bankruptcy process. Were it clear Congress intended that result, the decision below might stand on solid ground. But that is far from clear, and if anything, the statutory text and history suggest just the opposite. *See* Part I.D, *infra*.

B. The Court of Appeals Relied on Misguided Concerns About a Licensor's Quality-Control Obligations.

The decision below rests heavily—if not entirely—on one premise: that allowing a trademark licensee to retain its licensed rights will unacceptably burden the bankruptcy estate because the debtor-licensor must exercise quality control over the licensee's goods or services. *See* Pet. App. 22a-27a. This premise drove the majority's rejection of *Sunbeam*, ***see** id.* at 27a, and its rejection of the dissenting opinion's equitable, case-by-case approach, *see id.* at 26a. But the majority's premise is faulty. It misinterprets trademark law, overstating and overgeneralizing what it means for a licensor to conduct quality control under a trademark license.

When a trademark owner licenses its mark to others, it has a duty to ensure consistent quality. 3 McCarthy, *supra*, § 18:42. This does not necessarily mean "high" quality—the quality simply must be consistent. *Id.* § 18:55 ("[C]ustomers are entitled to assume that the nature and quality of goods and services sold under the mark at all licensed outlets will be consistent and predictable."). Licensing without quality control is known as "naked licensing" and, in certain situations, can cause the mark to lose its significance as a source identifier. *Id.* § 18:48. If this happens, a court may deem the owner to have abandoned the mark. *I.*; *accord Patsy's Italian Rest., Inc.* v. *Banas*, 658 F.3d 254, 264 (2d Cir. 2011).

"[O]nly minimal quality control" is typically needed to avoid these consequences. *Kentucky Fried Chicken Corp.* v. *Diversified Packaging Corp.*, 549 F.2d 368, 387 (5th Cir. 1977). As a practical matter, "[c]ourts will generally find abandonment through naked licensing only in extreme cases in which the trademark owner exercises no control whatsoever." *Paleteria La Michoacana, Inc.* v. *Productos Lacteos Tocumbo S.A. DE C.V.*, 188 F. Supp. 3d 22, 92 (D.D.C. 2016). Absent a "significant deviation" from the licensor's quality standards, the licensor generally will not lose its mark. *TMT N. Am., Inc.* v. *Magic Touch GmbH*, 124 F.3d 876, 886 (7th Cir. 1997). And as a corollary, courts uniformly hold that abandonment by naked licensing requires a "stringent" showing of proof. *E.g.*, *Doeblers' Penn. Hybrids, Inc.* v. *Doebler*, 442 F.3d 812, 824 (3d Cir. 2006); *Tumblebus Inc.* v. *Cranmer*, 399 F.3d 754, 765 (6th Cir. 2005); *Creative Gifts, Inc.* v. *UFO*, 235 F.3d 540, 548 (10th Cir. 2000); *TMT N. Am.*, 124 F.3d at 884 (7th Cir. 1997); *Taco Cabana Int'l, Inc.* v. *Two Pesos, Inc.*, 932 F.2d 1113, 1121 (5th Cir. 1991), *aff'd* 505 U.S. 762 (1992).

Just as important, adequate quality control "varies with the circumstances." *Edwin K. Williams & Co.* v. *Edwin K. Williams & Co.-E.*, 542 F.2d 1053, 1060 (9th Cir. 1976). There is no black-letter rule requiring any particular type or level of control. *See Eva's Bridal Ltd.* v. *Halanick Enters.*, Inc., 639 F.3d 788, 791 (7th Cir. 2011) ("How much authority is enough can't be answered generally; the nature of the business, and customers' expectations, both matter."). The agreement's terms are highly relevant, as courts might be "reluctant to interfere with reasonable quality control arrangements agreed to by the parties." 3 McCarthy, *supra*, § 18:48. Another important consideration is the type of goods or services being licensed—to give one example, consumers may expect greater quality consistency from a restaurant franchise[3] than they expect from licensed merchandise for their favorite sports team.[4]

These considerations are far from exhaustive. The dispositive question is whether the licensee's use of the mark would "deceive[]" consumers because of "variant quality standards." *Taco Cabana*, 932 F.3d at 1121. This question does not "elevate form over substance." *Id.* It requires courts to examine "the expectations that the licensee's use of the mark creates in consumers and the supervision that is reasonably necessary to insure that those expectations are not endangered." Restatement (Third) of Unfair Competition § 33 & cmt. c (endorsing a "flexible" quality-control standard "responsive to the particular facts of each case").

With these principles in mind, the court of appeals' decision is difficult to defend. It treats quality control as an invariably demanding burden requiring significant affirmative conduct from every licensor.

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[3] Franchisors often offer a "complete method of doing business," controlling the franchisee's real-estate premises and supplying the franchisee's products. David M. Jenkins, *Licenses, Trademarks, and Bankruptcy, Oh My!: Trademark Licensing and the Perils of Licensor Bankruptcy*, 25 J. Marshall L. Rev. 143, 143 n.1 (1991).

[4] The National Football League, for example, has granted licenses "allowing [team] logo[s] to be used by *hundreds* of manufacturers, distributors, sponsors, etc. in connection with their respective business operations." *Bouchat* v. *Baltimore Ravens Ltd. P'ship*, 619 F.3d 301, 313 (4th Cir. 2010) (emphasis added). It would not be feasible for the NFL to ensure perfectly consistent quality across these hundreds of licensees, and there is no reason to think consumers expect that level of control.

See Pet. App. 24a-27a. It overstates the typically "minimal" quality control required by trademark law. *Kentucky Fried Chicken*, 549 F.2d at 387, while also overgeneralizing the case-by-case question of what it means to conduct adequate quality control. In doing so, the court's analysis rests on speculation, stating without authority that (1) the quality-control obligation "will likely often be greater than normal" in bankruptcy because the licensor and licensee might be "at odds" with each other; (2) regardless of whether the licensor and licensee are actually at odds with each other, "in all cases there will be some burden;" and (3) it will usually be impossible to know "how great the burden will prove to be" because it will depend on the acts of the licensee. Pet. App. 26a.

This speculative reasoning is problematic for at least two reasons. First, it fails to recognize that "there are already incentives for licensees to maintain the licensor's quality control provisions" even where the licensor files a bankruptcy petition. Jenkins, 25 J. Marshall L. Rev. at 163-64 ("[T]he mechanism of market forces and the anti-fraud laws make it highly unlikely that licensees will abandon the quality standards to which they originally agreed."). Second, and more importantly, it disregards numerous cases where courts declined to find abandonment by naked licensing *even though* the licensor exercised little (or no) actual control over the licensee. Abandonment requires more than just a lack of action by the licensor—it requires consumer deception arising from variant quality. *See Exxon Corp.* v. *Oxxford Clothes, Inc.*, 109 F.3d 1070, 1079-80 (5th Cir. 1997) ("[I]f a trademark has not ceased to function as an indicator of origin there is no reason to believe that the public will be misled; under these circumstances, neither the express declaration of Congress's intent in [15 U.S.C.] § 1127(2) nor the corollary policy considerations which underlie the doctrine of naked licensing warrant a finding that the trademark owner has forfeited his rights in the mark.").

For example, a licensor may avoid abandonment where it merely approves samples of the licensed goods before entering the licensing agreement, so long as the licensee agrees to maintain the same level of quality during the life of the license. *See Glow Indus., Inc.* v. *Lopez*, 273 F. Supp. 2d 1095, 1110 (C.D. Cal. 2003); *Embedded Moments, Inc.* v. *Int'l Silver Co.*, 648 F. Supp. 187, 194 (E.D.N.Y. 1986). Likewise, abandonment is unlikely if the licensor justifiably relies on its licensee's established expertise to maintain quality based on the parties' previous dealings, *see Transgo, Inc.* v. *Ajac Transmission Parts Corp.*, 768 F.2d 1001, 1017-1018 (9th Cir. 1985), the licensee's lengthy experience in a particular industry, see *Syntex Labs., Inc.* v. *Norwich Pharmacal Co.*, 315 F. Supp. 45, 56 (S.D.N.Y. 1970), or the absence of consumer complaints regarding the quality of the licensed product, *see Land O'Lakes Creameries, Inc.* v. *Oconomowoc Canning Co.*, 330 F.2d 667, 670 (7th Cir. 1964). A licensor may also rely on its licensee to maintain quality where a special relationship exists between the two. *See Hokto Kinoko Co.* v. *Concord Farms, Inc.*, 738 F.3d 1085, 1098 (9th Cir. 2013) (licensee was a wholly owned subsidiary of the licensor); *Doeblers' Penn.*, 442 F.3d at 824 (licensee and licensor were family members); *Stock Pot Rest.,* *Inc.* v. *Stockpot, Inc.*, 737 F.2d 1576, 1580 (Fed. Cir. 1984) (licensee worked as licensor's "right hand" employee).

"Since the implementation of the Lanham Act, courts have adopted an increasingly broad interpretation of quality control and accepted almost any evidence to declare licensing valid." Irene Calboli, *The Sunset of "Quality Control" in Modern Trademark Licensing*, 57 Am. U. L. Rev. 341, 389 (2007). The court of appeals' rule disregards this, heavily emphasizing concerns about a duty that often imposes minimal burden on the licensor. Those concerns form too slender a reed on which to base a categorical rule with such serious consequences.

C. The Court of Appeals' Rule Creates Potentially Unreasonable Results.

Though not addressed by the court of appeals or in the parties' petition-stage briefing, the decision below leads to potentially unreasonable results. One of these results arises in the not-uncommon situation where a licensed asset is both a trademark *and* a copyrighted work. *See* 1 McCarthy, *supra*, § 6:17.50 ("[T]here is no reason why a given work cannot be the subject of both trademark and copyright protection."). Pictures and designs, for example, can receive both trademark and copyright protection. *Id.* § 6:18. This dual protection may extend to logos,[5] the design of physical products[6] and their packaging,[7] periodical covers,[8] and fictional characters[9]—to name just a few examples.

The court of appeals' rule creates a conflict for these dual-protected assets. If a debtor-licensor rejects a license for a dual-protected asset under section 365(a), the licensee would then have the statutory option to

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[5] *See*, *e.g.*, *Jada Toys, Inc.* v. *Mattel, Inc.*, 518 F.3d 628, 632-634, 637 (9th Cir. 2008) (reversing and remanding for consideration of claims for trademark and copyright infringement of HOT WHEELS logos); *City of Carlsbad* v. *Shah*, 850 F. Supp. 2d 1087, 1100, 1111 (S.D. Cal. 2012) (finding trademark and copyright protection for a city's logo).

[6] *See*, *e.g.*, *Kurt S. Adler, Inc.*, v. *World Bazaars, Inc.*, 897 F. Supp. 92, 95-97 (S.D.N.Y. 1995) (finding trademark and copyright protection for design of Christmas tree ornament); *Animal Fair, Inc.* v. *Amfesco Indus., Inc.*, 620 F. Supp. 175, 186-188, 190-191 (D. Minn. 1985), *aff'd*, 794 F.2d 678 (8th Cir. 1986) (same result; design of novelty slipper).

[7] *See*, *e.g.*, *Carol Cable Co.* v. *Grand Auto, Inc.*, 4 U.S.P.Q.2d 1056, 1061-62 (N.D. Cal. 1987) (finding trademark and copyright protection for packaging of battery-booster cables)

[8] *See*, *e.g.*, *Reader's Digest Ass'n, Inc.* v. *Conservative Digest, Inc.*, 821 F.2d 800, 803-06 (D.C. Cir. 1987) (affirming trademark and copyright protection for *Reader's Digest* magazine cover).

[9] *See*, *e.g.*, *Warner Bros. Entm't, Inc.* v. *X One X Prods.*, 840 F.3d 971, 975-76, 979-80 (8th Cir. 2016) (affirming trademark and copyright protection for characters from *Gone With the Wind*, *The Wizard of Oz*, and *Tom and Jerry*); *Walt Disney Co.* v. *Powell*, 698 F. Supp. 10, 11-13 (D.D.C. 1988), *aff'd in relevant part*, 897 F.2d 565 (D.C. Cir. 1990) (same result; Mickey Mouse and Minnie Mouse).

"retain its rights , , , under [the license]." 11 U.S.C. § 365(n)(1)(B). This is because copyrights are one of the enumerated forms of "intellectual property" in section 101(35A). Yet under the court of appeals' rule, that same licensee would simultaneously be *prohibited* from retaining its licensed rights, because the asset is also a trademark. Any commercial use of the asset would be subject to a claim of trademark infringement by the (former) licensor, even though the licensee retains a continuing copyright license for the exact same asset. This result would render the licensee's section 365(n) election basically meaningless.

Another unreasonable result stems from the potentially bad incentives created by the decision below. Many trademark licenses—including the one in this case—are irrevocable. *E.g.*, Pet. App. 121a; *see also* Raymond T. Nimmer & Jeff C. Dodd, *Modern Licensing Law* § 9:17 (2018) (noting common situations in which licenses are "irrevocable or perpetual"). As the Seventh Circuit noted in *Sunbeam*, a licensor cannot revoke an irrevocable license simply by breaching its own obligations. *See* 686 F.3d at 376. The decision here creates an escape hatch, allowing a licensor to revoke an otherwise irrevocable license by filing for bankruptcy and then rejecting the license agreement under section 365(a). If affirmed, the decision could incentivize bankruptcy proceedings for licensors who enter a license and then later regret it, increasing the bankruptcy courts' caseload while also "stripping innocent licensee[s] of rights central to the operations of their ongoing business." S. Rep. No. 100-505 at 4.

This incentive is quite real. In *Lubrizol*, for example, the debtor-licensor rejected the license under section 365(a) precisely because it hoped to "facilitate sale or [future] licensing of the technology unhindered by the restrictive provisions in the [existing] license." 756 F.2d at 1045. Other cases reflect similar strategic bankruptcy filings to escape trademark licenses.[10] Congress alluded to this incentive when it rejected *Lubrizol* by enacting section 365(n). *See* S. Rep. No. 100-505 at 2-3 ("[S]ince rejection results in valuable rights apparently reverting to the bankruptcy estate—rights which the bankruptcy estate otherwise would have to share with the licensee—rejection will nearly always be arguably beneficial to the bankruptcy estate."); *see also* 133 Cong. Rec. S11651-01 (1987) (statement of Sen. DeConcini: "[T]he licensor can obtain a much higher royalty if he enters into an exclusive license with another party . . . even though such a decision could effectively doom the licensee's business. . . . This is the kind of scenario this legislation is designed to prevent.").

[10] *See*, *e.g.*, *In re SIMA Int'l, Inc.*, No. 17-21761 (JJT), 2018 WL 2293705, at *10 n.29 (Bankr. D. Conn. May 17, 2018) (emphasizing that the debtor-licensor sought Chapter 11 reorganization after "continuously [seeking], prepetition, to avoid or otherwise terminate . . . the License Agreement" through a non-bankruptcy litigation and then through arbitration); *Matusalem*, 158 B.R. at 522 (finding that the debtor-licensor had filed for Chapter 11 reorganization with the "ineluctably clear" purpose of terminating a sub-franchise agreement that it had been unable to terminate through prior, non-bankruptcy litigation).

Respondent's brief in opposition suggests that this worrying incentive is all part of Chapter 11's "fundamental rehabilitative nature." Opp. 9-10, 13. It is true, of course, that bankruptcy proceedings can allow a debtor to discharge certain burdens. But rejecting a license agreement "is not 'the functional equivalent of a rescission'" or an avoiding power, which the Bankruptcy Code allows in some other contexts. *Sunbeam*, 686 F.3d at 377 (quoting *Thompkins* v. *Lil' Joe Records, Inc.*, 476 F.3d 1294, 1306 (11th Cir. 2007), and citing 11 U.S.C. § 544-551 as examples). In most cases, categorical rejection of a trademark license will negatively impact the licensee far more than it will benefit the debtor-licensor by reducing any real quality-control burden. *See* Part I.B, *supra*. And in those rarer cases where this calculus comes out the other way, the case-by-case approach IPO recommends below will allow the bankruptcy court to weigh those equities and craft appropriate solutions. *See* Part II, *infra*.

D. The Court of Appeals Relied on Incorrect Assumptions—Disproved by the Statutory Text and the Legislative History—About Congress' Intent.

The court of appeals' opinion appears to suggest that Congress would endorse its bright-line rule. *See* Pet. App. 22a. It emphasizes that Congress' "principal aim" in allowing rejection of executory contracts under section 365(a) is to "release the debtor's estate from burdensome obligations that can impede a successful reorganization." *Id.* (quoting *NLRB* v. *Bildisco & Bildisco*, 465 U.S. 513, 528 (1984)). Although that is true, the court's resulting inference—that a trademark owner's quality-control obligation will necessarily impede a successful reorganization (*see* Pet. App. 23a-27a)—is not. *See* Part I.B, *supra*.

Nothing in section 365(n)'s text or history suggests that Congress agreed with that inference. To the contrary, Congress expressly declined to opine on the issue when it amended the statute to reject *Lubrizol*. *See* S. Rep. No. 100-505 at 6 (explaining that trademark licenses and the quality-control rule "could not be addressed without more extensive study," and that those issues were "beyond the scope of this legislation").[11] Had Congress intended a bright-line rule for trademarks, it could have easily enacted one. *See*, *e.g.*, *SAS Inst., Inc.* v. *Iancu*, 138 S. Ct. 1348, 1356 (2018) ("[I]f Congress wanted to adopt the [respondent's] approach it knew exactly how to do so."). Instead, it left trademarks out of section 365(n) entirely, gave a clear and explicit reason for that decision, and invited "equitable treatment of the situation by bankruptcy courts." S. Rep. No. 100-505 at 6.

Despite all this, the decision below concludes that Congress did *not* intend to allow equitable treatment of this situation. *See* Pet. App. 24a-26a (suggesting

[11] A statutory change is an alternative way to set forth how trademark licenses are handled in bankruptcy, however the congressional record expressly left the handling of trademark licenses subject to current law and for the courts to apply.

that Congress wants bankruptcy courts to exercise their equitable powers only in specific, statutorily enumerated situations). This reasoning sweeps aside Congress' express invitation for bankruptcy courts to treat the issue equitably until further congressional action. It also disregards that bankruptcy courts have broad equitable powers, which they may freely exercise so long as the Bankruptcy Code contains no "specific prohibition" against a particular action. *Law* v. *Siegel*, 571 U.S. 415, 421 (2014); *see* 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."). This only makes sense—Congress could not realistically legislate every possible fact pattern, so the courts must have discretion to reach fair results by relying on precedent, expertise, and experience.

"[I]t is not the role of the courts to legislate . . . through the creation of bright-line rules in the face of congressional intent." Pet. App. 33a (Torruella, J., dissenting). The court of appeals did just that. Its categorical rule creates unnecessary costs, inefficiencies, and potentially unreasonable results—none of which Congress intended.

II. Until Congress Acts, the Best Rule for Trademark Licenses Is an Equitable, Case-by-Case Approach with a Presumption in Favor of the Licensee's Rights.

At some point, Congress might enact legislation addressing rejection of trademark licenses under section 365. Until then, any bright-line rule is inappropriate and unnecessary. Instead, IPO recommends that this Court adopt an equitable, case-by-case approach like the one urged by Judge Torruella's dissenting opinion. *See* Pet. App. 29a-34a. As explained below, IPO suggests one key addition: bankruptcy courts should start by presuming that, in most cases, it will be equitable to allow the licensee to continue using the mark. But if the court finds that result inequitable in a particular case, it should have broad discretion to craft a different solution.

A. Courts Should Start with *Sunbeam*'s Rule as a Presumption, but Then Consider Whether Case-Specific Factors Overcome That Presumption.

Because Congress has yet to legislate the issue, the dissent below correctly explains that courts should view rejection of a trademark license "through the broader lens of section 365." Pet. App. 32a. Under the general provision in section 365(g), rejection of a trademark license merely "constitutes a breach of such contract," 11 U.S.C. § 365(g), the effect of which is to free the debtor-licensor from its contractual obligations. But that still leaves unanswered the key question: what happens to the licensee's contractual rights (*i.e.*, its right to continue using the mark)?

Sunbeam provides a helpful, though incomplete, answer. As that decision explains, a licensor outside of bankruptcy obviously cannot use its own breach to "terminate [the] licensee's right[s]." *Sunbeam*, 686 F.3d at 376. In IPO's view, this basic principle should be the starting point. Because rejection is a breach, 11 U.S.C. § 365(g), the law should presume that rejection does *not* terminate the licensee's rights—the same as with any other breach.

Sunbeam was content to stop there. *See* 686 F.3d at 376-77. However, IPO acknowledges that the situation is more nuanced than *Sunbeam* suggests. A licensor in bankruptcy has different legal rights than a licensor outside bankruptcy. Congress authorized rejection precisely because it can sometimes relieve the bankruptcy estate from "burdensome obligations that can impede a successful reorganization." *Bildisco*, 465 U.S. at 528. Although usually unlikely, *see* Part I.B, *supra*, some licensing arrangements may require a level or type of quality control that impedes the debtor-licensor from successfully reorganizing. *Sunbeam* does not work in those situations.

IPO thus recommends an equitable approach that starts with *Sunbeam* but adds one more step. Bankruptcy courts should presume that, in most cases, it is appropriate to allow the licensee to continue using the mark (*i.e.*, the *Sunbeam* rule). But courts should then consider whether any case-specific factors compel a different conclusion. This factor-based analysis should focus on determining the actual burden to the bankruptcy estate, if any, of conducting quality control over the licensee. Although not exhaustive or mandatory, the following factors might be relevant to answering that question:

- The terms of the license agreement, particularly the specified quality-control obligations and responsibilities of each party. *See* pp. 15-17, *supra*.

- The type of goods or services offered under the license, and how that may affect consumers' expectations for quality consistency. *See* p. 15-17, *supra*.

- Evidence of variant quality and consumer deception, if any. See p. 17, *supra*.

- The nature of the parties' relationship, including the context in which they entered into the license and whether they have any special relationship. *See* pp. 17-18, *supra*.

- The length and history of the licensing relationship, including the history of actual quality-control efforts by the licensor and of quality compliance by the licensee. *See* pp. 17-18, *supra*.

- Whether the licensee is well-established in the industry, and relatedly, whether the licensor can justifiably rely on the licensee's established expertise to maintain quality. *See* pp. 17-18, *supra*.

- Whether the licensed mark is also protected by copyright law and covered by a copyright license. If so, termination could lead to unreasonable results. *See* Part I.C, *supra*.

- Whether the licensee is the only party using the mark. If so, terminating the license could result in abandonment of the mark. *See* 15 U.S.C. § 1117 (establishing that a mark is abandoned if "its use has been discontinued with intent not to resume such use").

- Whether the license covers any non-trademark intellectual property used in conjunction with the licensed mark (for example, patented products sold under the mark). If so, termination of the trademark license could mislead consumers, as the licensee would have to sell the patented product under a different mark.

- Any other prejudice to the licensee if it could no longer use the mark.

- Any other prejudice or benefit to creditors or other interested parties. For example, if the licensee pays a royalty, continuing the license could benefit the bankruptcy estate and facilitate future distributions to creditors.

- The amount of investment and expense the licensee has made to build and develop the brand equity associated with the licensed trademarks.

If these factors (or whatever others the court might consider) lead to the conclusion that continuing the license would unreasonably burden the bankruptcy estate, the court should terminate the licensee's rights.

The licensee may then bring a pre-petition damages claim under section 365(g).

B. The Approach Urged Here Strikes the Best Balance Between Various Interests.

Unlike the decision below (which categorically favors licensors) or the Seventh Circuit's approach in *Sunbeam* (which categorically favors licensees), IPO's suggested approach attempts to strike a balance. It avoids the unnecessary costs and inefficiencies of the court of appeals' rule—plus the serious harm that rule can inflict on licensees—while still paying mind to the debtor-licensor's interests and potential burdens. It also respects the various and sometimes competing purposes of bankruptcy law, trademark law, and contract law, all of which intersect in this type of case. *Compare* Pet. App. 27a (maj. op.) (emphasizing Chapter 11's goals of facilitating distribution to creditors while protecting the debtor's "fresh start options"), *with id.* at 34a (Torruella, J., dissenting) (emphasizing the need to consider "the terms of the Agreement[] and non-bankruptcy law").

IPO's approach also comports best with Congress' intent. It tracks Congress' purposeful decision not to legislate trademark licenses with the 1988 statutory amendment, instead inviting "more extensive study" and "development of equitable treatment." S. Rep. No. 100-505 at 6. It considers the negative economic effects and potentially unreasonable results arising from categorical license rejection, *see* Parts I.A and I.C, *supra*, but also acknowledges that trademark licenses "depend to a large extent on control of the quality of the products or services." S. Rep. No. 100-505 at 6.

Finally, the approach urged here reflects the nuanced contours of trademark law's quality-control obligation. *See* Part I.B, *supra*. It favors protecting the licensee—which usually makes sense given the licensor's often "minimal" burdens, *Kentucky Fried Chicken*, 549 F.2d at 387—while still allowing bankruptcy courts ample room to reach a different result if the equities call for it.

CONCLUSION

The court of appeals' judgment should be reversed and the case remanded for further proceedings.

Respectfully submitted,

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APPENDIX

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