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A Reminder Of The Limits Of Section 365(n) Protection

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A recent decision by the U.S. Bankruptcy Court for the District of New Hampshire serves as a good reminder that, although helpful, Bankruptcy Code Section 365(n)'s protection for intellectual property licensees definitely has its limits. That's especially true for a commercial agreement whose central purpose is something other than as a technology license. Since we don't get many Section 365(n) cases, let's examine this one more closely.

Distribution And License Rights

In In re Tempnology LLC, the debtor had entered into a co-marketing and distribution agreement with Mission Product Holdings Inc. ("Mission") for the sale and distribution of certain cooling material products developed by the debtor. The agreement granted Mission "exclusive distribution rights" in the United States and an opportunity to obtain similar rights in other countries. The debtor agreed not to "license or sell" the products involved to others during the term of the agreement. In another section of the agreement, the debtor agreed not to take actions that would "directly or indirectly frustrate its exclusivity obligations" and agreed to enforce the debtor's "intellectual property rights and contractual rights against third parties."

Another section of the agreement addressed intellectual property. "Intellectual property rights" were defined to include, among others, the debtor's copyrights, patentable and unpatentable inventions, discoveries, designs, technology, trademarks and trade secrets. In addition, the debtor granted Mission the following "nonexclusive license":

Excluding those elements of the CC Property consisting of Marks, Domain Names, [the debtor] hereby grants to [Mission] and its agents and contractors a non-exclusive, irrevocable, royalty-free, fully paid-up, perpetual, worldwide, fully-transferable license, with the right to sublicense (through multiple tiers), use, reproduce, modify, and create derivative work based on and otherwise freely exploit the CC Property in any manner for the benefit of [Mission], its licensees and other third parties.

The "CC property" covered all products developed or provided by the debtor and all IP rights with respect to those products. The debtor also granted Mission "a non-exclusive, non-transferable, limited license ... to use its Coolcore trademark and logo (as well as any other Marks licensed hereunder) for the limited purpose of performing its obligations hereunder" during the agreement's term. If the agreement were terminated, it would trigger a two-year wind-down period during which Mission would retain the right to purchase, distribute and sell the relevant products, including use of the trademark rights.

Feeling Rejected

On Sept. 1, 2015, the debtor filed a Chapter 11 bankruptcy case and the next day moved to reject the agreement. The court approved the rejection subject to Mission's election to retain its rights under Section 365(n). With a sale also taking place, the debtor then filed a second motion seeking a determination that Mission's Section 365(n) rights were limited only to the grant of the nonexclusive license and not the exclusive distribution rights or the trademark license. Mission argued that Section 365(n) also extended to its exclusive distribution rights because Section 365(n)(1)(B) permits a licensee to enforce "any exclusivity provision of such contract." Citing to the In re Crumbs Bake Shop case, Mission also argued that under Section 365(n) and the court's equitable authority, it should be allowed to use the debtor's trademarks during the remainder of the wind-down period expiring in July 2016.

The Court Rules Mission's Section 365(n) Rights are Limited

In issuing its decision, the court ruled in favor of the debtor and did not accept either of Mission's arguments.

First, the court concluded that the exclusivity and other protections of Section 365(n) extend only to the intellectual property rights in the agreement. The court held that the exclusive distribution rights granted to Mission were not a right to intellectual property, even if the products were patented. Instead, they were unrelated to the nonexclusive license, which gave Mission the right, directly or through sublicensees,to exploit the underlying intellectual property free of distribution of the debtor's products. Although the nonexclusive license was protected under Section 365(n), the distribution rights were not. As a result, the court held that the exclusive distribution rights did not survive rejection of the agreement.

Second, with respect to the trademark license, the court declined to follow the In re Crumbs Bake Shop case and instead held that Bankruptcy Code Section 101(35A)'s definition of "intellectual property" does not include trademarks. The court ruled that Section 365(n) therefore does not protect Mission's trademark license post-rejection.

A Few Observations

The In re Tempnology LLC decision is interesting for what it does and does not do.

- The court's holding that Section 365(n) extends only to nontrademark IP license rights, and not to exclusive rights to distribute products, serves as a good reminder that Section 365(n) protection is limited principally to the continued right to use intellectual property.

- The court's rejection of the In re Crumbs Bake Shop case applying Section 365(n) to trademarks is not a surprise. The overwhelming majority of cases likewise hold that the absence of trademarks in Section 101(35A)'s definition of "intellectual property" means no Section 365(n) protection for trademarks.

- The Tempnology court applied the seminal 1985 decision that led to the adoption of Section 365(n), Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc., 756 F.2d 1043 (4th Cir. 1985), to hold rejection of the agreement meant that Mission lost both the exclusive distribution rights and any continued rights to the trademark license.

- However, given circuit-level decisions over the last few years involving trademarks and bankruptcy, it's interesting that the Tempnology court did not mention in particular the Seventh Circuit's 2012 decision in Sunbeam Products Inc. v. Chicago American Manufacturing LLC, 686 F.3d 382 (7th Cir. 2012). In Sunbeam, the Seventh Circuit expressly rejected the Lubrizol decision and its analysis of the effects of rejection. The Sunbeam court permitted a nondebtor trademark licensee to continue using licensed trademarks after the underlying trademark license had been rejected, holding that rejection is a breach by the debtor and does not terminate rights of the nonbreaching party.

- Perhaps the Tempnology court had no interest in following Sunbeam over Lubrizol and perhaps Mission chose not to advance Sunbeam's analysis for other reasons. In any event, if the Tempnology court had followed Sunbeam's analysis of the impact of rejection (and, for our purposes, if courts in the future decide to follow Sunbeam), the result might have been different.

- On another note, in this case the core IP rights apparently involved patented products, not copyrighted works. When the products at issue are copyrighted works, however, the licensee might be able to argue that exclusive distribution rights are part of the licensed intellectual property rights. The Copyright Act, specifically 17 U.S.C. Section 106(3), includes among the exclusive rights of the copyright owner (subject to being licensed) the right to "distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending." It's not a certainty, but a licensee granted the exclusive right to distribute copyrighted works might be able to argue that its exclusive distribution rights are part of IP (copyright) rights protected under Section 365(n).

Conclusion

The Tempnology decision underscores the limits of Section 365(n), particularly in commercial agreements with essentially only a backup IP license. The decision has been appealed so it's possible we may get an opinion in the months ahead from an appellate court. With Section 365(n) decisions about as rare as hen's teeth, be sure to stayed tuned.

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Robert Eisenbach is of counsel in Cooley's San Francisco office. He testified before the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 on intellectual property licenses, their treatment in bankruptcy cases, and potential reforms.

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