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It's been a long wait, but we finally have a published decision from a U.S. Court of Appeals confirming that a trademark license is not assignable in bankruptcy without the licensor's consent. On July 26, 2011, the U.S. Court of Appeals for the Seventh Circuit **issued that decision in *In re: XMH Corp.*,** by Circuit Judge Richard A. Posner.

The context

The dispute arose in the Chapter 11 bankruptcy of Hartmarx Corporation (later renamed "XMH"). Its subsidiary Simply Blue ("Blue"), also in bankruptcy, sold its assets to two buyers (the "purchasers") in a sale under Section 363 of the Bankruptcy Code (which allows the sale of assets free and clear of liens and other liabilities).

- Among Blue's assets was an executory contract (a contract that had not been performed) with Western Glove Works ("Western"), which Blue sought to assign to the purchasers. Western objected, arguing that the contract could not be assigned because it was a sublicense to Blue of a trademark licensed by Western. The bankruptcy court agreed with Western and XMH appealed.
- That's when things got a little complicated. While XMH's appeal was pending, Blue and the purchasers amended the contract. Under the amendment, title to the contract was left with Blue but the purchasers assumed all of Blue's contractual duties, together with the right to receive all fees to which Blue was otherwise entitled. The bankruptcy court approved the amendment and Western appealed from that decision.
- In the meantime, the district court reversed the bankruptcy court's original decision holding that the contract could not be assigned, effectively allowing the original contract to be assigned. Western appealed the district court's decision bringing the case to the Seventh Circuit.

The Court's decision

The Court looked to Section 365(c)(1) of the Bankruptcy Code, which limits assignment of an executory contract if "applicable law" permits the non-debtor party to the contract to refuse to accept performance from an assignee, regardless of whether the contract prohibits or restricts assignment.

Here, the contract did not prohibit or restrict assignment (but neither did it permit it). Western argued that "applicable law" was trademark law because the contract stated that Western was a licensee of the trademark JAG JEANS.

The Court held that if the contract included a trademark sublicense when XMH attempted to assign the contract, it was not assignable. This was true regardless of whether federal, state, or even Canadian trademark law applied (Western is a Canadian company).

Citing prior decisions and the McCarthy trademark treatise, the Court said: "None of this matters, though, because as far as we've been able to determine, the universal rule is that trademark licenses are not assignable in the absence of a clause expressly authorizing assignment."

After describing how consumers rely on a trademark as an indicator of a good's quality, the Court explained that if a trademark owner (or licensee sublicensing the mark) allows another company to produce the trademarked goods, it will not want the licensee

to be allowed to assign the license (that is, sublicense the trademark) without the owner's consent.

Although the owner will have chosen his licensee because of confidence that he will not degrade the quality of the trademarked product, he can have no similar assurance with respect to some unknown future sublicensee.

Because this is the normal reaction of a trademark owner, it makes sense to make the rule that a trademark license is not assignable without the owner's express permission a rule of contract law—what is called a 'default' rule because it is the rule if the parties do not provide otherwise (as they are allowed to do).

Ultimately, the Seventh Circuit held that although the contract included a trademark sublicense, the sublicense had expired and the parties had not designated the contract, post-expiration, as a trademark sublicense. Further, the Court held that the balance of the contract was only a service agreement and not an implied trademark license.

The Court also refused to go down the "dark path" of whether a contract could be a trademark license for some purposes but not others. With no actual trademark sublicense in existence at the time of assignment, the default rule discussed above did not apply, and the executory contract could be assigned. The Seventh Circuit affirmed the lower courts' decisions approving the assignment of the contract as amended.

Good news for trademark owners

With the Seventh Circuit's *XMH Corp.* decision, we now have two Courts of Appeals (the other being the Ninth Circuit in an unpublished affirmance of a lower court decision) on record holding that trademark licenses are not assignable in bankruptcy absent the consent of the trademark owner or sublicensor.

That said, how the decision is viewed in other circuits, particularly in Delaware and New York where many large Chapter 11 cases are filed, remains to be seen, so stay tuned.

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