Actual or Hypothetical: Determining the Proper Test for Trademark Licensee Rights in Bankruptcy

Laura D. Steele
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INTRODUCTION

Across the country, storefront window displays have become frames for large neon posters that scream: “Going out of business!”; entrances have been adorned with large yellow banners proclaiming in bold letters: “Everything Must Go!” In a matter of weeks, store shelves that were once fully stocked become victims of savage bargain hunters. Eventually, the stores are stripped clean until only the bolted down shelves remain. It is a scene that has unfolded uniformly at myriad retail locations of Sharper Image, Bombay Co., Linens ’n Things, and Circuit City. Today, these stores have become empty shells, serving only as blighted reminders of hard economic times. Yet, even as bargain hunters have snatched up every ionic air cleanser, incense holder, pillow sham, and cell phone charger from these bankrupt retailers, the most valuable asset remains—the store’s brand.

Investors know that while a company may be bankrupt in the sense of its hard assets, significant value remains in the brand itself. For

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4. Rob Walker, Cleaned Sheets, N.Y. TIMES, Aug. 30, 2009, at MM18; A trademark may be valued in several different ways. See Michael J. Freno, Trademark Valuation: Preserving Brand Equity, 97 TRADEMARK REP. 1055 (2007) (explaining valuation of marks for damages calculations and other purposes). While a trademark is legally protectable, the concept of a “brand” is a broader, non-legal characterization of a trademark. Id. at 1056.

Like trademarks, brands can designate the source of a product or service, but they
example, The Sharper Image, which filed for Chapter 11 bankruptcy protection in 2008, is no longer a retail company with stores and retail associates. Instead, The Sharper Image has reincarnated itself as a “global lifestyle brand licensor.” So while a customer can no longer walk into a Sharper Image store and try out the “deluxe shiatsu foot massager,” a customer in search of the “Sharper Image experience” can still buy Sharper Image licensed merchandise at Macy’s, Best Buy, or OfficeMax. Thus, The Sharper Image has reorganized itself from a failed capital-based business, to a more sustainable royalty-driven business that exploits the value of its brand, and its trademark in particular.

Although THE SHARPER IMAGE trademark has found a happy ending in life after bankruptcy, that is not always the case for trademark licensees. Rather, for licensees, the intersection of trademark law and bankruptcy law has largely been a train wreck: The courts are divided over debtor-licensor rights, and Congress has neglected the problem.

As trademark rights become an increasingly valuable asset in going further, conveying information about a particular product or service, the core trademark behind the brand, other trademarks supporting the brand, any family of marks, domain names, sub-brands, product packaging, the manufacturer and its trade name, advertising of the product, distribution of the product, celebrity endorsements, and even the shelf displays at retailers and/or displays on the Internet.


Chapter 11 reorganizations, it is critical for Congress and the courts to clarify how trademarks will be treated in bankruptcy. Resolution is particularly important for trademark licensees seeking to revive their businesses through reorganization. Recent cases demonstrate that Chapter 11 reorganization may not be a viable option for businesses that depend on licensing. Rather, most courts will allow a licensor to strip the bankrupt licensee of its rights, therefore stifling any chance of a licensee’s successful reorganization.

This Comment urges that a trademark licensee should not be stripped of its licensing rights simply because the licensee enters bankruptcy. Instead, where a licensee intends only to continue using an existing license under the terms of the existing agreement with the licensor, the licensee’s use of that license should be uninterrupted during reorganization. This recommendation, contrary to the position of trademark licensors, will not invade the province of trademark owners to control their marks.

To support this recommendation, this Comment examines the statutory frameworks of both trademark law and bankruptcy law, legislative history of the Bankruptcy Code, and cases that illuminate the current circuit split over the rights of a trademark licensee in bankruptcy. Building on these elements, this Comment outlines an analytical approach that strikes a balance between the need for business reorganization and the duty of a trademark licensor to exercise control over its mark.

Accordingly, this Comment proceeds in three parts. Part I provides a brief overview of the purposes of trademark law and bankruptcy law and also explains why these areas of law conflict. Part II introduces In re N.C.P. Marketing Group to explain the two analytical frameworks—the “hypothetical test” and the “actual test”—used by the courts to determine the rights of a trademark licensee in bankruptcy. Part III explains how federal circuit courts have employed these differing approaches—including one court that has attempted an end run around the issue. Finally, this Comment concludes that courts should adopt the actual test to balance the interests of both trademark licensors and debtor-licensees.

PRIMER FOR IDENTIFYING AND DETERMINING VALUE 169 (2005).


A. Trademark Law vs. Bankruptcy Law: Competing Interests

Trademark law and bankruptcy law are both concerned with the “use” of assets.\textsuperscript{12} For example, trademarks are given protection for their use in commerce.\textsuperscript{13} And in bankruptcy, assets are used to pay creditors and as leverage for the debtor’s “fresh start.”\textsuperscript{14} Yet, unlike physical assets, a trademark is not valuable in and of itself. Rather, the value of a trademark depends on the underlying business it symbolizes. This interdependent relationship creates competing interests between the trademark licensor and the debtor-licensee: On one hand, the trademark licensor will seek to protect its mark from any loss of control and ultimate harm to its business by snatching back the license. On the other hand, a debtor-licensee whose business depends on the license will seek to use the license as leverage to keep its business going. Yet, if the licensor strips the licensee of the right to use the mark, the licensor will virtually ensure the failure of the licensee’s bankruptcy reorganization.

Courts that permit a licensor to strip a licensee of its right to use a mark favor the protectionist principles of trademark licensing while entirely frustrating the purpose of bankruptcy reorganization. Instead, Congress and the courts must balance the rights of a trademark owner to protect its mark, and the ability of a business to reorganize.

This Part will first briefly explain the unique purposes of trademark law and bankruptcy law. Second, this Part will explain the existing conflict between these two areas of law.

1. Trademark Law Purpose

A trademark is defined under the Lanham Act as a word, phrase,"
logo, or symbol used in commerce to signify a source, to distinguish the source from competitors, and to prevent confusion in the marketplace.\textsuperscript{15} Accordingly, a trademark owner is given the right to protect its mark against infringement and dilution through blurring and tarnishment.\textsuperscript{16} The Lanham Act also allows the trademark owner to benefit from the goodwill associated with the mark by selling, assigning, or licensing the trademark to a third party.\textsuperscript{17}

\textbf{a. Trademark Licensing}

Modern trademark law has recognized and legitimized the practice of trademark licensing.\textsuperscript{18} Trademark licensing permits the use of a trademark on goods that may not “emanate directly from the trademark owner,”\textsuperscript{19} but rather come from a selected third party—the licensee. The policy behind the legitimization of trademark licensing, as endorsed by Congress, is to expand the national and global value of trademarks in the marketplace. When a licensing agreement is successful, the mark becomes more widely known by consumers, increasing the mark’s corresponding goodwill, and ultimately making the brand more valuable for the mark’s owner. Trademark licensing has proliferated to such an extent that an entire business models have become dependent on

\begin{itemize}
  \item 15. 15 U.S.C. § 1127 (2006) defines a trademark as: any word, symbol, or device or any combination thereof [that is] (1) used by a person or (2) which a person has a bona fide intention to use in commerce and applies to register on the principal register . . . to identify or distinguish his or her goods, including a unique product, from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown. See \textit{The Trade-Mark Cases}, 100 U.S. 82, 94–95 (1879).
  
  \item 16. 15 U.S.C. §§ 1114, 1125(a), 1125(c).
  
  \item 17. “A trade name or mark is merely a symbol of goodwill; it has no independent significance apart from the goodwill it symbolizes . . . [A] trademark cannot be sold or assigned apart from the goodwill it symbolizes.” Marshak v. Green, 746 F.2d 927 (2d Cir. 1984) (setting aside and reversing attachment and auction of a trademark apart from its associated goodwill). \textit{Accord} Berni v. Int’l Gourmet Restaurants, Inc., 838 F.2d 642 (2d Cir. 1988) (noting the “well-established principle” that a “mark is not property that may be assigned ‘in gross’” and that “rights in a trademark cannot be sold apart from a going business.”). \textit{See} 4 J. THOMAS MCCARTHY, \textit{MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION} § 18:2 (4th ed. 2009).
  
  \item 18. KMart Corp. v. Cartier, Inc., 486 U.S. 281, 314–15 (1988). Not until the 1930’s did a trend develop approving of trademark licensing—so long as the licensor controlled the quality of the licensee’s products—on the theory that a trademark might also serve the function of identifying product quality for consumers. And not until the passage of the Lanham Trade-Mark Act in 1946 did that trend become the rule. \textit{Id.} (citations omitted).
  
  \item 19. 4 \textit{MCCARTHY}, \textit{supra} note 17, § 18:39.
\end{itemize}
licensing agreements with trademark owners. However, because the goodwill behind a mark is a volatile commodity based on consumer perception, a trademark owner must continue to exercise control over the use of its mark in commerce.  

b. Licensor Control

A trademark owner who licenses its mark has the duty to ensure a licensee upholds the quality of a given product. A licensor who fails to oversee the quality of its licensee’s products may not only tarnish the mark, but may also lead a court to find the licensor has abandoned the mark. Courts are concerned with control of licensees because of what a mark embodies: it is a guard against consumer confusion and deceit. The courts reason that without oversight a mark connotes nothing and is without value in the marketplace.

In recent years, while courts have begun to ease this control requirement, courts still require that a licensor be able to demonstrate due diligence in supervising the use of its mark by licensees. Accordingly, a licensor’s duty of control necessarily creates strict limits on a licensee’s use of a mark. For example, a licensee must have the express permission of a licensor to sub-license a mark. This restrictive use is required “because the owner of the trademark has an interest in the party to whom the trademark is assigned so that it can maintain the good will, quality, and value of its products and thereby its trademark.” Thus, the identity of a licensee is a critical and material matter under trademark law.

The personal nature of trademark licenses and restrictions on assignability create unique roadblocks for trademark licensees in

20. Id. § 18:42.
21. Id.
24. Id.
26. 4 McCarthy, supra note 17, § 18:43 (stating “[w]ithout specific authorization from the trademark owner, the licensee’s right to use the licensed mark is personal and cannot be sold or assigned to another”).
28. Id.
bankruptcy.\textsuperscript{29} Moreover, the unique nature of a trademark license makes it a virtually irreplaceable commodity. Accordingly, a licensor wields extraordinary power over a licensee: a licensor who chooses to terminate a trademark license can unilaterally destroy a licensee’s business. While trademark law is correct to afford great protection to trademark licensors, those protections may also unnecessarily frustrate the ability of a licensee to use a core asset of its business as leverage to reorganize and preserve its business for its employees, customers, and creditors.

2. Bankruptcy Law Purpose

The purpose of bankruptcy law is twofold: to treat creditors equally according to their legal rights, and to give the honest debtor a fresh start.\textsuperscript{30} That fresh start is made possible through the Bankruptcy Code (the “Code”).

To the layperson, bankruptcy generally means the end of a business—that it must sell off all of its wares and shut its doors forever. This kind of bankruptcy is a Chapter 7 filing under the Code. Chapter 7 essentially creates a “forced sale” or liquidation that converts business assets into cash.\textsuperscript{32} Proceeds from the liquidation are then distributed among creditors according to priority.\textsuperscript{33}

However, bankruptcy may also serve as a means for a business to resuscitate itself—much like The Sharper Image has done. Reorganization is accomplished under Chapter 11 of the Code. Chapter 11 is effectively a system of negotiation among the participants in the

\textsuperscript{29} See \textit{In re} Travelot Co., 286 B.R. 447, 455 (Bankr. S.D. Ga. 2002) (“The grant of a non-exclusive license is ‘an assignment in gross,’ that is, on personal to the assignee and thus not freely assignable to a third party . . . .”).

\textsuperscript{30} See \textit{Local Loan Co. v. Hunt}, 292 U.S. 234, 244 (1934) (“[I]t gives to the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.”). \textit{See also In re Patient Educ. Media, Inc.}, 210 B.R. 237, 241 (Bankr. S.D.N.Y. 1997) (the goal of bankruptcy is to maximize the estate); \textit{In re Central Ark. Broad. Co., Inc.}, 170 B.R. 143, 145 (Bankr. E.D. Ark. 1994) (stating property of the estate includes licenses and business goodwill). Bankruptcy law, however, was not always so merciful. \textit{See}, e.g., 2 \textsc{William Blackstone}, \textsc{Commentaries of the Laws of England} 472 (1766) (stating “[U]nder Roman Law, creditors might cut the debtor’s body into pieces, and each of them take his proportionate share . . . .”) \textit{cited in David G. Epstein et al., Bankruptcy (Including BAPCPA): 21st Century Debtor-Creditor Law} 6 (2d ed. 2006).

\textsuperscript{31} Epstein et al., supra note 30, at 24–26.

\textsuperscript{32} 11 U.S.C. § 704.

\textsuperscript{33} 11 U.S.C. § 726. While the focus of Chapter 11 is reorganization, the Code also allows for the sale of assets. 11 U.S.C. § 363.
bankruptcy. The aim of a Chapter 11 reorganization is to reduce a business’s expenses while allowing the business to keep its doors open so that it may eventually become solvent again.\textsuperscript{34}

\textbf{a. Overview of Chapter 11 Bankruptcy}

Chapter 11 provides several mechanisms that allow a business to reorganize. First, when a business files for Chapter 11 reorganization, the debtor is granted a stay from creditors.\textsuperscript{35} The stay is a valuable shield that prevents creditors from foreclosing on assets and suing the debtor for money owed.\textsuperscript{36} Second, upon filing the debtor becomes a “debt-in-possession” to act as a fiduciary for the debtor’s creditors. The fiduciary then takes control of the debtor’s property—known as the “bankruptcy estate.”\textsuperscript{37} Meanwhile, unlike other kinds of bankruptcy, the business continues operating and using property of the estate according to a reorganization plan.\textsuperscript{38} If a plan is confirmed and the debtor is successful in consummating that plan, then the debtor receives its “fresh start.”\textsuperscript{39}

Because this Comment considers the use of highly personal trademark rights in bankruptcy, it is necessary to develop further the understanding of who controls a business during a Chapter 11 reorganization.

\textbf{b. The Roles of the Debtor-in-Possession and the Chapter 11 Trustee}

In a Chapter 11 reorganization, either a debtor-in-possession or trustee takes the reins of the insolvent business. Under the Code, the debtor-in-possession is essentially the debtor shed of its obligations to its creditors.\textsuperscript{40} When a court determines that a third party must be


\textsuperscript{35} Id. 

\textsuperscript{36} Id.

\textsuperscript{37} 11 U.S.C. § 541.

\textsuperscript{38} 11 U.S.C. § 1108 (providing “[u]nless the court, on request of a part in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor’s business.”); 11 U.S.C. § 1107 (stating “a debtor in possession shall have all the rights . . . of a trustee serving in a case under this chapter”).

\textsuperscript{39} Epstein et al., supra note 30, at 42.

\textsuperscript{40} 11 U.S.C. § 1101(1).
appointed to run the business, the court removes the debtor from control of the business and places control of the business in the hands of a trustee.\textsuperscript{41} While this practice is disfavored among courts, it is necessary in extraordinary circumstances where the current management has committed fraud or is grossly mismanaging the business.\textsuperscript{42} However, the prevailing policy is that a reorganization is likely to be more successful, affordable, and expedient when the party most familiar with the business is in control.\textsuperscript{43}

In the context of trademark licensees in bankruptcy, it is particularly important to understand that a debtor-in-possession has essentially the same rights, powers, and duties as a trustee. As this Comment will explore later, at least one court has attempted to create a loophole by construing the debtor-in-possession to have different rights from those of a trustee.\textsuperscript{44} However, according to legislative history, Congress placed the debtor-in-possession “in the shoes of a trustee in every way.”\textsuperscript{45}

The goal of the debtor-in-possession and the trustee is to maximize the assets available to creditors.\textsuperscript{46} This means the debtor-in-possession will reach to virtually every asset—including real property and ongoing or executory contracts.\textsuperscript{47} In general, intellectual property licenses are

\begin{enumerate}
\item[41.] 11 U.S.C. § 1104(d).
\item[42.] 11 U.S.C. § 1104(a); see, e.g., In re The 1031 Tax Group, Inc., 374 B.R. 78, 85 (Bankr. S.D.N.Y. 2007) (recognizing that the appointment of a Chapter 11 trustee is an “extraordinary remedy”).
\item[44.] \textit{See} In re Footstar, Inc., 323 B.R. 566, 571 (Bankr. S.D.N.Y. 2005) (arguing the terms “trustee” and “debtor-in-possession” have distinct meanings). Nowhere does the Bankruptcy Code define “trustee” as synonymous with “debtor” or “debtor in possession.” Quite the contrary, when the Bankruptcy Code refers to both “trustee” and “debtor” (or “debtor in possession”) in the same statutory provisions, the two terms are invariably invested with quite different meanings.
\item[45.] Id.
\item[47.] \textit{See} 11 U.S.C. § 1104.
\end{enumerate}
defined as executory contracts.48

i. Statutory Controls over Executory Contracts

An executory contract is an agreement in which both parties have ongoing duties to one another. While the Bankruptcy Code does not define the term, the characterization of a contract as “executory” is critical to the determination of each party’s rights to the agreement. Once a court finds that a contract, such as a trademark license, is executory, the agreement is governed by § 365 of the Code. Section 365 requires a debtor to reject, assume, or assign executory contracts.49 A debtor who rejects a contract is freed from obligations under the contract; the other party to the contract is relegated to a claim against the bankruptcy estate.50 Once an executory contract is rejected, it may be resold to another person willing to pay a higher rate.51 A debtor also has the choice to keep the contract through assumption.52 Or a debtor may assume and assign the contract to a third party, subject to certain limitations.53 Unlike assignment, a debtor who only assumes a contract is not placing the contract in the hands of another party. However, the circuit split that has been highlighted by *N.C.P. Marketing Group, Inc. v. BG Star Productions* essentially, and incorrectly, treats the assumption of trademark licenses as if the license is being handed over to a third party.54 Accordingly, this Comment will more fully explain what it means to assume an executory contract.

ii. Assumption of an Executory Contract

A debtor who assumes its contracts is reaffirming those contracts for which it has already paid and may have built its business around. The Code requires that a debtor who seeks to assume an executory contract must first cure any default or breach of the contract that is not related to the debtor’s insolvency or bankruptcy.55 Moreover, the Code invalidates

48. 11 U.S.C. 365(e)(1); Menell, *supra* note 10, at 764–65 (“Trademark licenses are almost always executory because the licensor has continuing quality control obligations and the licensee typically has payment, reporting, marketing, and other continuing performance obligations.”).

49. 11 U.S.C § 365(a), (f).

50. 11 U.S.C § 365(a).


52. *Id*.

53. 11 U.S.C § 365(c)(1), (f).


any contract provisions requiring the forfeiture of the debtor’s rights upon insolvency or bankruptcy.\textsuperscript{56} However, the Code does permit the non-debtor to object to the assumption or assignment of an executory contract in certain situations under § 365(c)(1).

### iii. Objection to Assumption of an Executory Contract by Non-Debtor

Section 365(c)(1) has spurred multiple interpretations in bankruptcy courts, district courts, and appellate courts. Section 365(c)(1) provides:

The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if— (1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor-in-possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (B) such party does not consent to such assumption or assignment.\textsuperscript{57}

According to one scholar, the plain language interpretation of this provision is that “if the estate wanted to assume, but not assign, a contract that is nonassignable in law, the non-debtor could prevent assumption of the contract, thus depriving the debtor of the benefit of the bargain.”\textsuperscript{58} Yet, this harsh interpretation, which forms the basis of the “hypothetical test” used by the majority of circuit courts, misstates Congress’s intent and produces an illogical result.\textsuperscript{59}

As this Comment will further develop, the prevailing interpretation of § 365(c)(1) produces a result that is inconsistent with the intent of the Code. This interpretation provides that while a licensor may not preemptively protect its licensed mark from becoming part of a bankruptcy estate through an \textit{ipso facto} contract clause,\textsuperscript{60} a licensor may still later strip a debtor-licensee of its rights in a license even if the

\textsuperscript{56} 11 U.S.C. § 365(e).
\textsuperscript{57} 11 U.S.C. § 365(c)(1).
\textsuperscript{59} \textit{Id.} at 224.
\textsuperscript{60} See 11 U.S.C. § 365(e).
licensee does not intend to assign the license to a third party.\textsuperscript{61}

If there is no concern that the debtor-licensee will turn the license over to a third party and that the licensor will have to accept performance from another, the protection granted to licensors under this interpretation is unjustified. Further, if the license is a key asset of the bankruptcy estate, stripping the debtor of its benefit frustrates the entire purpose of Chapter 11 reorganization. Instead, this Comment argues that where a debtor has no intent to assign the license, the debtor should be permitted to assume the license.\textsuperscript{62}

While the argument set forth in this Comment offers a logical approach to resolving the circuit split over the question presented in \textit{N.C.P. Marketing Group}, there is a key issue that must be resolved before it can be adopted.\textsuperscript{63} First and foremost, Congress and the courts must treat trademarks as intellectual property and afford trademark licensees their due rights in bankruptcy.

\textbf{B. The Conflict between Trademark Law and Bankruptcy Law}

Congress has failed to adequately secure trademark licensing rights in bankruptcy on two fronts: (1) under the Bankruptcy Code, trademarks are not considered intellectual property; and (2) Congress has not squarely defined the rights of a trademark licensee who is a debtor. The failure to resolve these two key questions has contributed to the existing circuit split over a licensee’s rights to hold onto a

\begin{itemize}
  \item One arguable criticism of the hypothetical approach is that it purchases fidelity to the Bankruptcy Code’s text by sacrificing sound bankruptcy policy . . . [T]he hypothetical test provides a windfall to nondebtor parties to valuable executory contracts: If the debtor is outside of bankruptcy, then the nondebtor does not have the option to renege on its agreement; but if the debtor seeks bankruptcy protection, then the nondebtor obtains the power to reclaim—and resell at the prevailing, potentially higher market rate—the rights it sold to the debtor.
  \item \textit{Id.} See also Cooke, \textit{supra} note 58, at 224.
  \item \textsuperscript{62} See Cooke, \textit{supra} note 58, at 224.
  \item While the majority of lower courts allow the debtor to assume an executory contract when the debtor has shown an intent not to assign the contract...the majority of the circuit courts...disallow assumption of a contract that cannot be assigned under nonbankruptcy law regardless of whether or not the debtor intends to assign it.
  \item \textit{Id.} See \textit{Menell, supra} note 10, at 789 (stating “[t]he weight of scholarly opinion, emphasizing the purpose of the Bankruptcy Code, the tension between subsections (c) and (f), and the apparent intent of Congress as reflected in the legislative history, favors the application of the actual test.”) (citing EPSTEIN ET AL., \textit{BANKRUPTCY}, \S\S 5–15, at 258–59 (1993)).
  \item \textsuperscript{63} \textit{N.C.P. Mktg. Group, Inc.}, 129 S. Ct. at 1578 (2009).
\end{itemize}
1. Trademarks Are Not Intellectual Property

Law students learn that intellectual property consists of three core areas: patents, copyrights, and trademarks. Yet, under the U.S. Bankruptcy Code, trademarks are not intellectual property. Rather, the Code states, “‘intellectual property’ means (A) trade secret; (B) invention, process, design, or plant protected under title 35; (C) patent application; (D) plant variety; (E) work of authorship protected under title 17; or (F) mask work protected under chapter 9 of title 17; to the extent protected by applicable nonbankruptcy law.” While peculiar, Congress made an intentional choice to exclude trademarks, trade names, and service marks as intellectual property in Bankruptcy cases.

The legislative history behind this definition of “intellectual property” reveals a fundamental failure by Congress to recognize the economic significance of trademarks. The Code’s definition of intellectual property came in the wake of Lubrizol Enterprises v. Richmond Metal Finishers, a case decided at the outset of the Information Age in 1984. That Fourth Circuit case held a licensor in bankruptcy could strip a licensee of its right to use licensed technology—a decision that sent license-dependent technology industries into a panic. Computer and biotechnology companies feared this case would allow the bankruptcy court to cut off critical licensing agreements in one fell swoop—and possibly destroy their businesses.

Because of Lubrizol, members of the technology industry forecasted a widespread chilling effect among hi-tech developers if Congress did not intervene. As James Burger, chief counsel for Apple Computer, explained to Congress in 1988, “[Lubrizol] undermines the utility of the

65. Id.
68. Id.
69. See, e.g., The American Bankruptcy Institute Survey: Hearing on S. 1626, S. 1358, S. 1868, and S. 2279 (Bills pertaining to Title 11 of the U.S. Code, the Bankruptcy Code) Before the Senate Subcomm. on Courts, and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. (1989).
license as a business tool.”70 If a licensee cannot be reasonably certain that its license is secure, Burger told Congress, the licensee will not make investments in the license.71 “[A]nything that does not assure the licensee of his rights to a continuing license—assuming he pays the required royalties himself—is counterproductive to licensing in general and, therefore, counterproductive to the best use of assets to further develop the American industrial system.”72

Instead, given the unique nature of intellectual property, Burger and other industry lobbyists argued that the protections afforded to intellectual property licensees should align with those provided real estate lessees.73 Like a lessee, a licensee is given possessory rights that are less than the fee owner’s right, title, and interest in unique property. And like a lessee who pays for the right not to be a trespasser, a licensee pays for the right not to be an infringer. Under the Code, a landlord may not unilaterally oust a tenant until the expiration of the lease.74 Similarly, lobbyists argued a licensor should not be able to unilaterally oust a licensee simply because of a bankruptcy filing.

Congress heeded to these concerns, if only narrowly, by enacting the Intellectual Property Licenses in Bankruptcy Act (“IPLBA”) in 1988.75 Through the IPLBA, Congress sought “to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license.”76

71. Id. at 91.
72. Id.
74. Intellectual Property Contracts in Bankruptcy: Hearing on H.R. 4657 Before the House Subcomm. on Monopolies and Commercial Law of the Comm. on the Judiciary, 100th Cong. 23 (1988) (statement of James Burger, Apple Computer, Inc.). Congressional hearings reveal that had IPBLA been the law at the time of the Lubrizol decision, “Lubrizol would have retained its essential rights at that time, and there would have been a cash flow and a basis on which a reorganization of the licensor could have been accomplished to the benefit of all unsecured creditors.” Id. at 96. Instead, Lubrizol was “stripped of all its rights, to enable the licensor to go out and peddle those rights somewhere else.” Id. at 95.
applicable non-bankruptcy law.’”77 Trademarks, trade names, and service marks were further protected by providing that the licensor had a duty “to permit existing grantees to continue in concert the quality assurance procedures of the licensor.”78 The bill was reviewed and revised by the National Bankruptcy Conference.79 In its revision, the Conference objected to the inclusion of trademarks as “intellectual property”:

[B]y including trademarks, tradenames, and service marks in the definition, the bill appears to bring every retail franchise involving a trademark within the purview of the legislation, thus extending the reach of the bill far beyond what appears necessary. The inclusion of trademarks also raises the thorny issue of continuing quality assurance for trademarks in the midst of bankruptcy, and the bill does not deal with this problem in an adequate way.80

Thus, the Conference suggests exclusion of trademarks, trade names, and service marks is warranted because including them would open a Pandora’s Box of extraneous issues.81 However, the true motivation for the exclusion of these kinds of intellectual property seems to be more a matter of expediency. This inference is supported by the Conference’s own statement that it saw “no such emergency for and [had] no particular interest in, extending such protection to trademarks connected with traditional distributorships and retail businesses at this time.”82 Instead, the Conference argued, “trademarks should be

78. Id.
80. Id. at 261.
82. The American Bankruptcy Institute Survey: Hearing on S. 1626, S. 1358, S. 1868, and S. 2279 (Bills pertaining to Title 11 of the U.S. Code, the Bankruptcy Code) Before the Senate
So, while the technology sector of computer innovators and biotechnology developers brought a compelling case for swift action by Congress, the trademark lobby was swept aside. As a result, trademarks are not afforded the same protections that other forms of intellectual property are given in bankruptcy. Moreover, this lack of protection makes trademark licensees vulnerable to unilateral rejections of their licenses by licensors. This is a perilous risk not only for businesses dependent on a trademark license, but also for such a business’s creditors.

2. Rights of a Trademark Debtor-Licensee

The IPLBA offers a narrow solution to a narrow issue. While the IPLBA was never broadened to include trademarks as intellectual property, it also limited its solution to situations in which the debtor is the licensor of the intellectual property. Since the IPLBA, Congress has failed to provide a clear definition of a debtor-licensee’s rights in bankruptcy. In absence of a clear answer, a split among the circuits has emerged.

Regardless of the narrowness of the issue addressed by the IPLBA, its analysis forms an instructive analytical framework to resolve the existing split among the courts over how to treat trademark licensees in bankruptcy. As Congress recognized in the development of the IPLBA, a licensor does not simply have the right to void an executory contract because of bankruptcy. Rather, by definition of an executory contract, both parties to the agreement have ongoing obligations to each other.

While the current circuit split revolves around the rights of a licensee in bankruptcy, the same reasoning that protects a licensee when its licensor enters bankruptcy should apply: Licensees should not be

Subcomm. on Courts, and Administrative Practice of the S. Comm. on the Judiciary, 100th Cong. 344 (1989).

83. Id. at 345.

84. See supra note 47 for a discussion of executory contracts. See also Jason B. Binford, Supreme Court Passes on Assumption and Assignment of Trademark License Agreements, 28-JUN. AM. BANKR. INST. J. 36, 83 (2009).

By definition, every executory contract subject to § 365 imposes continuing obligations on the part of the nondebtor party. Rather than using the common law of trademarks to resolve the issue, the language of § 365(c)(1) indicates that a court should consider the issue in the limited context of whether the identity of the nondebtor party is significant under the particular facts at issue.

Id.
stripped of their right to use a key asset, the licensing agreement, as leverage for their “fresh start” where there is no risk that a licensor will be forced to accept performance from a third party.

However, the prevailing analysis among courts rejects this argument. Part II will introduce *N.C.P. Marketing Group v. BG Star Productions* to explain the two analytical frameworks used by courts to determine the rights of a trademark licensee in bankruptcy.

**PART II**

**A. In re N.C.P. Marketing Group**

Recently, the Supreme Court denied certiorari to a case that could have provided some certainty for trademark licensees involved in Chapter 11 proceedings. In *N.C.P. Marketing Group*, the Court was asked to consider whether a firm that was a debtor-licensee of the Billy Blanks TAE BO trademark could continue to use the license as a bankruptcy asset. While the Court recognized the paramount importance of resolving this issue, it concluded this was not the proper case to reach that resolution. However, the TAE BO case illuminates the current state of affairs facing trademark licensees in bankruptcy. This Part will address the development of the TAE BO case from the lower courts to the Supreme Court.

1. The Genesis of TAE BO

   In 1976, Billy Blanks was just a guy working out in his garage, blasting the recently released “Rocky” theme song—“Gonna Fly Now.” The champion-fighter imagery inspired Blanks, a martial arts expert, to integrate boxing elements into a new fitness regimen he

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86. *Id.*
87. *Id.* at 1578.

The division in the courts over the meaning of § 365(c)(1) is an important one to resolve for Bankruptcy Courts and for businesses that seek reorganization. This petition for certiorari, however, is not the most suitable case for our resolution of the conflict. Addressing the issue here might first require us to resolve issues that may turn on the correct interpretation of antecedent questions under state law and trademark-protection principles.

88. What is the History of TAE BO Fitness?, http://www.teamtaebo.com/AboutTaeBo.html.
One journalist has described the program as a “fist-pumping, high-flying hybrid of kick boxing and aerobics.” Eventually, Blanks opened a TAE BO studio in Sherman Oaks, California, where he garnered a retinue of devoted celebrities. Their endorsements along with a successful infomercial campaign hawking TAE BO videotapes, featuring Blanks clad in bold colors of muscle-busting LYCRA unitards, created a successful fitness franchise by 1998.

A year later in 1999, Blanks entered into a licensing agreement with N.C.P. Marketing Group (“N.C.P.”) to help him hawk even more tapes. That agreement granted N.C.P. the nonexclusive right to advertise and sell products and services containing Blanks’s TAE BO mark. However, soon after the agreement was made, the relationship deteriorated. N.C.P. later breached the licensing agreement by failing to pay Blanks royalties on the TAE BO trademark. While an arbitrator ordered N.C.P. to pay $2.1 million in royalties, N.C.P. instead filed for Chapter 11 bankruptcy. In that bankruptcy, N.C.P. claimed the TAE BO license as part of the bankruptcy estate. Blanks rejected the license, arguing that under the Lanham Act, the license was not assumable. In October 2004, the U.S. Bankruptcy Court in Nevada agreed with Blanks, finding that N.C.P. did not have permission to assume its licensing rights.

N.C.P. appealed. In 2005, the U.S. District Court for the District of Nevada affirmed the bankruptcy court’s order. The district court held that under federal trademark law, trademarks are personal to the

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91. Id.
94. Id. at 233.
95. Id.
96. Id.
97. Id.
98. Id.
99. Id.
100. Id.
101. Id. at 238.
assignee, and therefore, nonassignable without the consent of the licensor. As such, a trademark license may not be assumed by a debtor-in-possession without the licensor’s consent. The court based its decision upon its interpretation of § 365(c)(1) of the Bankruptcy Code.

B. Assumption of the License

In re N.C.P. Marketing Group asks whether a debtor-in-possession may assume (continue to benefit from) a trademark license held by the debtor before bankruptcy. If so, a debtor-in-possession could continue to receive the benefits of licenses to use the property of the licensor. If not, a licensor could refuse assignment of rights by not consenting to assignment or assumption. Therefore, the outcome hinged on the district court’s understanding of § 365(c)(1).

1. The In re N.C.P. Marketing Group Court’s Interpretation of Bankruptcy Code § 365(c)(1)

The district court in In re N.C.P. Marketing Group first observed that § 365(c)(1) “has been the subject of much controversy between circuits.” Section 365(c)(1) operates as an exception to the rule that a trustee may assume executory contracts, such as the license at issue in this case, if the licensor objects.

As one court has recognized, “[t]he basic policy goal in place in § 365 is attempting to allow the debtor to realize the correct value of its estate, while also providing some protection to the nondebtor contracting party.” Yet, the meaning of this statute has been interpreted under two different views.

a. The Hypothetical Test

The first view strictly interprets the text of the statute by applying the “hypothetical test.” That test asks whether, “hypothetically, without looking to the individual facts of the case, any executory contracts could

102. Id. at 230–38 (“N.C.P. does not have the consent of the Blanks to license to third parties at this time and therefore cannot assume the trademarks under [11 U.S.C. § 365(c)(1)].”).
103. Id. at 230.
104. Id.
105. Id. at 234.
106. Id. at 233.
108. See infra Part III.
be assumed under applicable federal law.”

Thus, § 365(c)(1) ties nonassignability under “applicable law” to both assumption and assignment in bankruptcy. The effect of this analytical framework is that even if the debtor-in-possession has no intent to assign the license to a third party, it still may not assume an executory contract if the nondebtor objects and “applicable law” would bar assignment to a hypothetical third party.

**b. The Actual Test**

The second view, which applies the “actual test,” asks “whether the executory contract at hand, in actuality, can be assumed when applying the applicable federal law.” Under the actual test, assumption by the debtor-in-possession would be permitted and the nondebtor licensor would not be able to object since the licensor would not actually have to accept performance from a third party.

**c. Applicable Federal Law**

Neither Blanks nor N.C.P. contended that the trademark license was an executory contract or that Lanham Act was the appropriate federal law to apply. However, the parties did “dispute whether applicable trademark law would bar assignment to a third party without consent of the assignor.”

To make this determination, the court drew analogies among other forms of intellectual property. The court reasoned that like copyrights and patents, trademarks “are personal and assignable only with the consent of the licensor and therefore unassumable under [§] 365(c)(1).” The court further stated that unique, intangible nature of trademarks warranted even greater protections for trademark licensors than licensors of patents or copyrights. “Trademarks are valuable property rights that allow their owners to protect the good will of their name and products by preventing unwarranted interference and use of

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109. *In re N.C.P. Mktg. Group, Inc.*, 337 B.R. at 234; *Perlman v. Catapult Entm’t, Inc.* (*In re Catapult Entm’t, Inc.*), 165 F.3d 747, 754–55 (9th Cir. 1999) (analyzing whether restrictions under federal patent law prohibit a debtor from either assuming or assigning an executory patent license).


111. *Id.*

112. *Id.* at 235.

113. *Id.*

114. *Id.*

115. *Id.* at 236.
their mark by others.” Thus, because trademark owners must protect both the mark and the underlying business, there must necessarily be absolute control over whether the trademark may be assigned to a third party.

2. Critique of In re N.C.P. Marketing Group

Ultimately, the district court interpreted § 365(c)(1) to require Blanks’s consent in order for N.C.P. to assume the license. Given the acrimonious relationship between the parties, Blanks’s consent was unattainable. Yet, the conclusion reached by the district court was flawed for at least two reasons.

First, in line with the hypothetical test, the court imagines there is a third party to whom the mark will be assigned. However, a debtor-in-possession is not a third party. Rather, the debtor-in-possession is the debtor itself. When the identity of the licensee does not change, the licensor is not being asked to consent to use of its mark by a third party. And if there is no concern for interference by third parties that could harm the licensor’s business or reputation, then concerns of consumer confusion and infringement fall away.

Second, the district court maintains that trademark licensors are entitled to a short leash on their licenses because they must ensure quality control. However, as N.C.P. points out, that is not a primary concern where the goods being marketed and sold come directly from the licensor. As N.C.P. explained, “[t]he goods identified by the licensed mark are [TAE BO] exercise videotapes manufactured from a master tape created by Blanks. The product is genuine, regardless of whether the licensee is N.C.P. or a third party.” Moreover, the trademark licensee also has a vested interest in maintaining the quality of a mark. Not only is this generally a requirement of a licensing agreement, but also the licensee shares an economic interest with the licensor to ensure the success of the mark in the marketplace.

Thus, if there is no risk that a mark would be assigned to a third party, no risk of consumer confusion, and no quality assurance concerns,

116. Id.
117. Id.
118. Id. at 237 (“Because we find that under applicable trademark law, trademarks are personal and non-assignable without the consent of the licensor, the Blanks' trademark would be unassignable as part of the bankruptcy estate of N.C.P. without the Blanks' consent.”).
119. Id. at 236.
the court’s reasoning that N.C.P. must have Blanks’s consent to use an agreement, for which it had already paid and built is business around, is flawed. By inferring facts that did not exist, the court granted near monopolistic protections to trademark licensors and impaired a business from seeking Chapter 11 reorganization.

C. Questions Remain: N.C.P. Marketing Group v. BG Star Productions

N.C.P. continued its fight to the Supreme Court. In 2009, the Court reluctantly denied N.C.P.’s petition for a writ of certiorari. However, Justice Kennedy, joined by Justice Breyer, issued a statement explaining that while the case before the Court was not an appropriate one through which to issue a final determination of a debtor-licensee’s right to assume an executory contract, the issue presented is a critical one.

Justice Kennedy noted in his statement that both the hypothetical and actual tests are imperfect analytical frameworks to determine a debtor-licensee’s right to assume a trademark. For example, Justice Kennedy noted that the hypothetical test results in a windfall to the licensor by allowing it to accomplish something it could not accomplish outside of bankruptcy—namely the ability to resell the license to the debtor “at the prevailing, potentially higher market rate.” Thus, under the hypothetical test, a licensor is able to reap a substantial benefit that comes at the detriment of the licensee.

And although the actual test is more closely aligned with “sound bankruptcy policy,” Justice Kennedy recognized that the actual test also has its shortcomings, primarily that the actual test may stray from the plain text of the law.

While the Court was not prepared to resolve this important issue through N.C.P. Marketing Group, hope remains that given an appropriate case, the Court will provide a resolution. Until then, a distinct split over this issue persists among the circuits.

Part III of this Comment recognizes that while the courts are split

122. Id. (stating “the division in the courts over the meaning of § 365(c)(1) is an important one to resolve for Bankruptcy Courts and for businesses that seek reorganization.”).
123. Id. at 1577–78.
124. Id. at 1577.
125. Id. at 1578.
126. Id.
and no resolution seems imminent from the Supreme Court or from Congress, the interests of trademark law and bankruptcy law can be best served through the analytical framework of the actual test, rather than the hypothetical test.

**PART III**

**A. Conjunction Junction, What Is Your Function: Explaining the Circuit Split**

Whether a court applies the hypothetical or actual test to determine the rights of a trademark debtor-licensee essentially depends on how that court construes the function of the conjunction “or” in § 365(c). As the *In re Footstar* court recognized, “[t]he threshold issue . . . is a question of statutory interpretation—must the word ‘or’ in the statutory language ‘assume or assign’ be read literally, i.e., as a disjunctive, or should it be construed in context as the functional equivalent of the conjunction ‘and.’” While the *In re N.C.P. Marketing Group* court read the provision disjunctively to apply the hypothetical test, the case could have had a different outcome in a circuit that reads the provision conjunctively to apply the actual test. Part III offers a brief overview of the differing statutory interpretations among the circuits.

1. The Hypothetical Test

The Ninth, Third, and Fourth Circuits read § 365(c)(1) disjunctively and apply the hypothetical test. In these circuits, a debtor-licensee who does not have the power to assign a license under the applicable law without the licensor’s consent also may not assume the license even if the debtor has no intent to assign the license.

   **a. The Ninth Circuit: In re Catapult Entertainment**

   The Ninth Circuit applied the hypothetical test in *In re Catapult Entertainment*. In that case, a Chapter 11 debtor proposed to assume

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127. Schoolhouse Rock!: Conjunction Junction (ABC television broadcast 1973), lyrics available at http://www.schoolhouserock.tv/Conjunction.html (stating “And then there’s ‘or’: O-R, when you have a choice like ‘This or that.’”). Generations of children have learned the grammatical function of a conjunction from the famous *Schoolhouse Rock* cartoon “Conjunction Junction.” *Id.* The cartoon uses train cars to illustrate that the function of conjunctions is “[h]ooking up words and phrases and clauses.” But, as the cartoon warns, one must “watch that function.” *Id.*

128. *In re Footstar, Inc.*, 323 B.R. 569 (Bankr. S.D.N.Y. 2005); Perlman v. Catapult Entm’t, Inc. (*In re Catapult Entm’t, Inc.*), 165 F.3d 747, 754 (9th Cir. 1999).

129. *In re Catapult*, 165 F.3d 747.
a patent license as part of its reorganization plan. The licensor objected. The court agreed with the licensor, holding that the debtor-in-possession could not assume an executory contract over the licensor’s objection if applicable law would bar assignment to hypothetical third party, even where a debtor-in-possession has no intention of assigning the contract in question to any such third party.

The court supported its reasoning by arguing that federal patent law made nonexclusive patent licenses personal and nondelegable. That characterization, the court stated, bars a debtor from assuming patent licenses without the licensor’s consent. While the court considered applying the actual test, it quickly jettisoned that test stating the actual test requires an unjustified “judicial rewrite” of the statute: “That the plain language of § 365(c)(1) may be bad policy does not justify a judicial rewrite. And a rewrite is precisely what the actual test requires.”

However, by not permitting Catapult to continue using the license, the licensor doomed its licensee’s business. Without the license, Catapult had no product. With no product, Catapult was no longer an on-going concern and could not successfully complete a Chapter 11 reorganization.

Meanwhile, as the Supreme Court has noted, the licensor was free to sell the crucial license to another, perhaps higher bidder. Catapult demonstrates the Court’s concern that the hypothetical test frustrates the purpose of bankruptcy and gives the licensor powers it would not ordinarily have.

b. The Third Circuit: In re West Electronics

The Catapult court followed In re West Electronics in holding that the hypothetical test applies where a debtor-in-possession seeks to assume an executory contract. However, West did not involve the

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130. Id. at 749.
131. Id.
132. Id. at 754–55.
133. Id. at 750.
134. Id.
135. Id. at 754.
136. Id.
138. Id.
rights of an intellectual property licensee. Rather, the question in *West* was whether the debtor, a defense contractor, could assume its government contract to manufacture military equipment. The court held the debtor could not assume the executory contract without consent from the government because applicable law barred assignment of the contract to a third party. The court recognized that such a bar was necessary to keep the government contractor directly accountable for any breach and to protect the government from having to accept performance from a third party. West argued that the applicable law did not bar assumption by its debtor-in-possession since the debtor-in-possession is the debtor itself and not a third party. The court rejected that argument, stating “the relevant inquiry is not whether [applicable law] would preclude an assignment from West as a debtor to West as a debtor in possession, but whether it would foreclose an assignment by West to another defense contractor.” Therefore, because West could not assign its contract to a hypothetical third party, its debtor-in-possession also had no “legally cognizable” right to assume the contract in its bankruptcy. Through this logic, the *West* court incorrectly construed the meaning of § 365(c) to require the hypothetical test.

While, the *West* court recognized the government had a right to keep its contract out of the hands of a third party, it went a step too far in holding that the debtor and the debtor-in-possession were two distinct entities. Rather, the Code does not view the debtor-in-possession as a third party, but rather as the debtor itself. Further, the Code does not seek to strip a Chapter 11 debtor's rights. Rather, the Code seeks to protect and preserve the rights of the debtor. Without these protections, the debtor would have few incentives to file for Chapter 11 reorganization.

140. *Id.*
141. *Id.* at 82 (citing 41 U.S.C. § 15 (2006)).
142. *Id.* at 83.
143. *Id.*
144. *Id.*
145. *Id.* at 83–84.
146. *Id.* at 84 (Higginbotham, J., concurring in part and dissenting in part) (“I do not believe that a ‘solvent contractor and an insolvent debtor in possession going through bankruptcy,’ . . . are different entities for the purposes of the Non-Assignment Clause.”).
c. The Fourth Circuit: In re Sunterra Corp.

Despite the shortcomings of the hypothetical test, the Fourth Circuit has also applied this analysis to determine the rights of a debtor-licensee. The court in In re Sunterra Corp. employed the plain meaning rule to reject the actual test, and deny Sunterra the right to assume a software license in its bankruptcy. Sunterra, a vacation timeshare operator, held a nonexclusive license to use software for its timesharing business. Sunterra bought the software license for $3.5 million. The company then invested $38 million to design its own unique system to manage timeshare rights at its various resort locations. In 2000, Sunterra filed Chapter 11 bankruptcy and sought to assume its software license. However, like the licensor in Catapult, Sunterra’s licensor filed a motion to have the court reject Sunterra’s license. The court sided with the licensor, reasoning that because the applicable law—copyright law—restricted the transfer of the license, Sunterra could not assume the license without the licensor’s consent.

As in Catapult, the licensor denied the licensee the right to benefit from a contract for which it had already paid and relied upon for its business. Thus, the unforeseen consequence of filing for reorganization was that Sunterra was forced to give up a significant asset of its estate. Moreover, because the court deemed the license to be rejected, the licensor could then later renegotiate the license and demand a higher royalty rate from the licensee. Again, Sunterra illustrates how the hypothetical test often yields a windfall to the licensor at the detriment of the debtor-licensee.

2. The Actual Test: The First Circuit

Under the “actual test” the court must make a case-by-case inquiry
to determine “whether the nondebtor party . . . actually was being ‘forced to accept performance under its executory contract from someone other than the debtor party with whom it originally contracted.” The First Circuit, along with a majority of lower courts, has taken the view that the courts should apply an “actual test” in construing the statutory language so as to permit assumption where the debtor-in-possession has no intention to assign the contract.

The court in Institut Pasteur v. Cambridge Biotech, applied the more logical analysis that first asks whether the debtor is actually trying to impose performance of the contract by a third party upon the licensor before stripping away the debtor-licensee’s rights. In Institut Pasteur, a patent licensor objected to a licensee’s use of its patents in bankruptcy based upon § 365(c). The licensor argued that the licensee’s sale of stock to the licensor’s competitor was a de facto “assignment” of a non-assignable license under patent law. The licensee argued that the licenses were merely assumed into the bankruptcy estate, and that the licenses were “indispensable” to the success of its reorganization. The licensor argued that because of the stock sale, it would effectively be forced to accept performance from a third party, which the applicable patent law prohibited. The licensor further argued that the licensee was pulling a fast one—that while in form the licensee sought only to assume the license, but in reality it was seeking to assign the license to a third party. The court foreclosed that argument, citing another First Circuit case—In re Leroux.

In In re Leroux, the First Circuit rejected the hypothetical test. Instead, the court held that § 365(c) contemplated a pragmatic “case-by-case inquiry” into whether the licensor really would have to accept performance from a third party. Likewise, in Institut Pasteur, the


160. Id. at 490.

161. Id.

162. Id. at 491.

163. Id. at 493.

164. Id.

165. Id. (citing Summit Inv. & Dev. Corp. v. Leroux (In re Leroux), 69 F.3d 608, 612 (1st Cir.1995)).

166. Id.

167. Id.
court applied the actual test and looked to whether the debtor-licensee actually sought to assign the license to a third party. Because the debtor-licensee sought only to continue its business and use the license as it had before its bankruptcy, the court permitted the debtor-licensee to assume the patent licenses.\footnote{168}{Id. at 495 (stating the licensee “remains in all material respects the legal entity with which [the licensor] freely contracted, [the licensor] has not made the required individualized showing that it is or will be deprived of ‘the full benefit of [its] bargain’”).}

Thus, in reaching its decision, the court weighed the potential risk to the licensor in allowing the debtor-licensee to assume the patent license. Finding no risk to the licensor, the court allowed the licensee to continue using a valuable bankruptcy asset essential for its reorganization—allowing the debtor to achieve its “fresh start.”\footnote{169}{Id. at 495.}

\section*{B. An Alternative: In re Footstar}

But, perhaps, as at least one court has recognized, this entire debate over a conjunction is for naught. Instead, as the \textit{In re Footstar} court suggests, § 365(c)(1) should be read even more plainly.

In \textit{Footstar}, the bankruptcy court concluded that use of the term “trustee” in § 365(c)(1) is not a synonym for the term “debtor-in-possession,” as the other circuits have read it to be. Rather, the court argued the terms have distinct meanings so that the prohibition against assignment and assumption under § 365(c)(1) is explicitly limited to situations in which the trustee, not the debtor-in-possession, seeks to assume an executory contract.\footnote{170}{In \textit{In re Footstar, Inc.}, 323 B.R. 566, 573 (Bankr. S.D.N.Y. 2005); see also \textit{In re Aerobox Composite Structures, LLC}, 373 B.R. 135, 140–42 (Bankr. D.N.M. 2007).}

Thus, while the debtor-in-possession could not assign the contract and force the licensor to accept performance from a third party, the debtor-in-possession could still assume the executory contract.\footnote{171}{\textit{In re Footstar}, 323 B.R. at 575.} As the court stated, to construe “trustee” in § 365(c)(1) to mean “debtors” or “debtors in possession” would defy the “plain meaning” of the statute as written by Congress.\footnote{172}{Id. at 570–71.}

However, that is not the intent of Congress and unfortunately, the resolution of this issue is not as simple as the \textit{Footstar} court would like. Congress has clearly stated that in Chapter 11, the debtor-in-possession has the same rights as the trustee.\footnote{173}{11 U.S.C. § 1107(a); H.R. REP. NO. 95-595, at 407 (1977), \textit{reprinted in} 1978 U.S.C.C.A.N. 5963, 6360.}
CONCLUSION

As the rate of Chapter 11 filings increases along with the value of trademark licenses, it is more important than ever that Congress and the courts answer the question of whether a debtor-licensee may assume a nonassignable trademark license.

The prevailing hypothetical test unfairly provides a windfall for licensors while stripping debtor-licensees of trademark rights that are essential to their ability to keep a business going and to reach a successful reorganization under Chapter 11. Not only is this result contrary to the spirit of the Bankruptcy Code, it also provides extraordinary monopolistic powers to trademark licensors. While the Bankruptcy Code has excluded trademarks from the protections given to other forms of intellectual property, Congress has recognized that the rights of intellectual property licensees may not be stripped away simply because of a bankruptcy. This reasoning should be applied to trademark licensees in bankruptcy who seek only to use the license as leverage to obtain a “fresh start.” The actual test, which asks whether in fact a licensor will have to accept performance from a third party, balances the concerns of both bankruptcy law and trademark law.

In absence of congressional action, courts should adopt the actual test to balance the need for business reorganization and the need for a trademark licensor to exercise control over its mark. Under this analytical framework, both debtor-licensees and nondebtor-licensors will reap the benefit of their bargain.

LAURA D. STEELE*

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