AMERICAN BANKRUPTCY INSTITUTE

VALCON 2018

Judicial Panel

Wayne P. Weitz, Moderator
Hammond Hanlon Camp LLC; New York

Hon. Kevin J. Carey
U.S. Bankruptcy Court (D. Del.); Wilmington

Hon. Daniel P. Collins
U.S. Bankruptcy Court (D. Ariz.); Phoenix

Hon. David R. Jones
U.S. Bankruptcy Court (S.D. Tex.); Houston

2018

KeyCite Yellow Flag - Negative Treatment
Superseded by Statute as Stated in In re Qimonda AG, E.D.Va., May 7, 2012

756 F.2d 1043
United States Court of Appeals,
Fourth Circuit.

LUBRIZOL ENTERPRISES, INC., Appellee,
v.
RICHMOND METAL FINISHERS, INC., Appellant.
In re RICHMOND METAL FINISHERS, INC., Debtor.

No. 84-1539.
|
Argued Dec. 3, 1984.
|
Decided March 15, 1985.

Synopsis
In Chapter 11 case, debtor moved to reject technology license agreement which debtor claimed was an executory contract. The Bankruptcy Court, 34 B.R. 521, granted motion, and creditor moved for stay pending appeal. The Bankruptcy Court for the Eastern District of Virginia, 36 B.R. 270, denied motion, and creditor appealed. The United States District Court for the Eastern District of Virginia, at Richmond, D. Dortch Warriner, J., 38 B.R. 341, reversed and remanded. Debtor appealed. The Court of Appeals, James Dickson Phillips, Circuit Judge, held that: (1) for purposes of bankruptcy provision relating to rejection of executory contracts, agreement between debtor and another corporation granting nonexclusive license to utilize metal coating process technology was executory as to each of the parties; (2) in finding that debtor's contingent obligations under the agreement were not sufficiently onerous that relief from them would be beneficial, District Court improperly substituted its business judgment for that of the debtor; and (3) District Court misapprehended controlling law in thinking that even by rejecting the agreement the debtor could not deprive nonbankrupt party of all rights to the technology process; in fact, the rejection would leave nonbankrupt party with only a money damages remedy, but no further rights under the agreement to continued use of the process.

Reversed and remanded.

West Headnotes (8)

[1] **Bankruptcy**
Executory Nature in General

Under bankruptcy provision relating to rejection of executory contracts by debtor, a contract is "executory" if performance is due to some extent on both sides. Bankr.Code, 11 U.S.C.A. § 365(a).

51 Cases that cite this headnote

[2] **Bankruptcy**
Executory Nature in General

Contingency of an obligation does not prevent its being executory under bankruptcy provision relating to rejection of executory contracts. Bankr.Code, 11 U.S.C.A. § 365(a).

25 Cases that cite this headnote

[3] **Bankruptcy**
Executory Nature in General

For purposes of bankruptcy provision relating to rejection of executory contracts, contract is not executory as to a party simply because the party is obligated to make payments of money to the other. Bankr.Code, 11 U.S.C.A. § 365(a).

25 Cases that cite this headnote

[4] **Bankruptcy**
Executory Nature in General

For purposes of bankruptcy provision relating to rejection of executory contracts, contract between debtor and another corporation granting nonexclusive license to utilize metal coating process technology was executory as to each of the parties, since debtor had continuing duties of, inter alia, notifying corporation of further licensing of the process and defending infringement suits, and corporation had continuing duties to account and pay royalties for life of the agreement. Bankr.Code, 11 U.S.C.A. § 365(a).

32 Cases that cite this headnote

[5] **Bankruptcy**
"Business Judgment" Test in General

In context of bankruptcy provision relating to rejection of executory contracts, courts addressing question of whether rejection would be advantageous to debtor must start with proposition that debtor's decision is to be accorded the deference mandated by the sound business-judgment rule as generally applied by courts to discretionary action or decisions of corporate directors. Bankr.Code, 11 U.S.C.A. § 365(a).

65 Cases that cite this headnote

[6] **Bankruptcy**
Particular Cases and Issues

Bankruptcy court's factual adjudication whether decision of debtor that rejection of executory contract will be advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, whim or caprice, is reviewable under "clearly erroneous" standard. Bankr.Code, 11 U.S.C.A. § 365(a).

48 Cases that cite this headnote

[7] **Bankruptcy**
Proceedings

In finding that, for purposes of determining propriety of bankruptcy debtor's rejection of executory contract, debtor's contingent obligations under the contract were not sufficiently onerous that relief from them would be beneficial, district court improperly substituted its business judgment for that of the debtor. Bankr.Code, 11 U.S.C.A. §§ 365, 365(a).

19 Cases that cite this headnote

[8] **Bankruptcy**
Grounds for and Objections to Assumption, Rejection, or Assignment

In denying bankruptcy debtor's right to reject executory contract, district court misapprehended controlling law in thinking that even by rejecting the agreement the debtor could not deprive nonbankrupt party of all rights to technology process which was subject of the licensing agreement; in fact, the rejection would leave nonbankrupt party with only a money damages remedy, but no further right under the agreement to continued use of the process. Bankr.Code, 11 U.S.C.A. § 365(a, g).

50 Cases that cite this headnote

Attorneys and Law Firms

***1044** James R. Sheeran, Richmond, Va., for appellant.

Marilyn Shea-Stonum (Jeanne M. Rickett, Jones, Day, Reavis & Pogue, Washington, D.C., Benjamin C. Ackerly, Dennis T. Lewandowski, Richmond, Va., Hunton & Williams, Washington, D.C., on brief), for appellee.

Before PHILLIPS and WILKINSON, Circuit Judges, and BUTZNER, Senior Circuit Judge.

Opinion

JAMES DICKSON PHILLIPS, Circuit Judge:

The question is whether Richmond Metal Finishers (RMF), a bankrupt debtor in possession, should have been allowed to reject as executory a technology licensing agreement with Lubrizol Enterprises (Lubrizol) as licensee. The bankruptcy court approved rejection pursuant to 11 U.S.C. § 365(a), 34 B.R. 521 stay denied 36 B.R. 270; but the district court reversed on the basis that within contemplation of § 365(a), the contract was not executory and, alternatively, that rejection could not reasonably be expected substantially to benefit the bankrupt debtor. 38 B.R. 341. We reverse and remand for entry of judgment in conformity with that entered by the bankruptcy court.

***1045** I

In July of 1982, RMF entered into the contract with Lubrizol that granted Lubrizol a nonexclusive license to utilize a metal coating process technology owned by RMF. RMF owed the following duties to Lubrizol under the agreement: (1) to notify Lubrizol of any patent infringement suit and to defend in such suit; (2) to notify Lubrizol of any other use or licensing of the process, and to reduce royalty payments if a lower royalty rate agreement was reached with another licensee; and (3) to indemnify Lubrizol for losses arising out of any misrepresentation or breach of warranty by RMF. Lubrizol owed RMF reciprocal duties of accounting for and paying royalties for use of the process and of cancelling certain existing indebtedness. The contract provided that Lubrizol would defer use of the process until May 1, 1983, and in fact, Lubrizol has never used the RMF technology.

RMF filed a petition for bankruptcy pursuant to Chapter 11 of the Bankruptcy Code on August 16, 1983. As part of its plan to emerge from bankruptcy, RMF sought, pursuant to § 365(a), to reject the contract with Lubrizol in order to facilitate sale or licensing of the technology unhindered by restrictive provisions in the Lubrizol agreement. On RMF's motion for approval of the rejection, the bankruptcy court properly interpreted § 365 as requiring it to undertake a two-step inquiry to determine the propriety of rejection: first, whether the contract is executory; next, if so, whether its rejection would be advantageous to the bankrupt.

Making that inquiry, the bankruptcy court determined that both tests were satisfied and approved the rejection. But, as indicated, the district court then reversed that determination on the basis that neither test was satisfied and disallowed the rejection. This appeal followed.

II

[1] We conclude initially that, as the bankruptcy court ruled, the technology licensing agreement in this case was an executory contract, within contemplation of 11 U.S.C. § 365(a). Under that provision a contract is executory if performance is due to some extent on both sides. *NLRB v. Bildisco and Bildisco,* 465 U.S. 513, ----, 104 S.Ct. 1188, 1194 n. 6, 79 L.Ed.2d 482 (1984). This court has recently adopted Professor Countryman's more specific test for determining whether a contract is "executory" in the required sense. By that test, a contract is executory if the " 'obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other.' " *Gloria Manufacturing Corp. v. International Ladies' Garment Workers' Union,* 734 F.2d 1020, 1022 (4th Cir.1984) (quoting Countryman, *Executory Contracts in Bankruptcy: Part I,* 57 Minn.L.Rev. 439, 460 (1973). This issue is one of law that may be freely reviewed by successive courts.

Applying that test here, we conclude that the licensing agreement was at the critical time executory. RMF owed Lubrizol the continuing duties of notifying Lubrizol of further licensing of the process and of reducing Lubrizol's royalty rate to meet any more favorable rates granted to subsequent licensees. By their terms, RMF's obligations to give notice and to restrict its right to license its process at royalty rates it desired without lowering Lubrizol's royalty rate extended over the life of the agreement, and remained unperformed. Moreover, RMF owed Lubrizol additional contingent duties of notifying it of suits, defending suits and indemnifying it for certain losses.

The unperformed, continuing core obligations of notice and forbearance in licensing made the contract executory as to RMF. In *Fenix Cattle Co. v. Silver (In re Select-A-Seat Corp.),* 625 F.2d 290, 292 (9th Cir.1980), the court found that an obligation of a debtor to refrain from selling software packages under an exclusive licensing agreement made a contract executory as to the debtor notwithstanding the continuing ***1046** obligation was only one of forbearance. Although the license to Lubrizol was not exclusive, RMF owed the same type of unperformed continuing duty of forbearance arising out of the most favored licensee clause running in favor of Lubrizol. Breach of that duty would clearly constitute a material breach of the agreement.

[2] Moreover, the contract was further executory as to RMF because of the contingent duties that RMF owed of giving notice of and defending infringement suits and of indemnifying Lubrizol for certain losses arising out of the use of the technology. Contingency of an obligation does not prevent its being executory under § 365. *See In re Smith Jones, Inc.,* 26 B.R. 289, 292 (Bankr.D.Minn.1982) (warranty obligations executory as to promisor); *In re O.P.M. Leasing Services, Inc.,*

23 B.R. 104, 117 (Bankr.S.D.N.Y.1982) (obligation to defend infringement suits makes contract executory as to promisor). Until the time has expired during which an event triggering a contingent duty may occur, the contingent obligation represents a continuing duty to stand ready to perform if the contingency occurs. A breach of that duty once it was triggered by the contingency (or presumably, by anticipatory repudiation) would have been material.

Because a contract is not executory within the meaning of § 365(a) unless it is executory as to both parties, it is also necessary to determine whether the licensing agreement was executory as to Lubrizol. *See Bildisco,* 465 U.S. at ----, 104 S.Ct. at 1194 n. 6. We conclude that it was.

[3] Lubrizol owed RMF the unperformed and continuing duty of accounting for and paying royalties for the life of the agreement. It is true that a contract is not executory as to a party simply because the party is obligated to make payments of money to the other party. *See Smith Jones,* 26 B.R. at 292; H.Rep. No. 95-595, 95th Cong., 2d Sess. 347, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5787, 5963, 6303-04. Therefore, if Lubrizol had owed RMF nothing more than a duty to make fixed payments or cancel specified indebtedness under the agreement, the agreement would not be executory as to Lubrizol. However, the promise to account for and pay royalties required that Lubrizol deliver written quarterly sales reports and keep books of account subject to inspection by an independent Certified Public Accountant. This promise goes beyond a mere debt, or promise to pay money, and was at the critical time executory. *See Fenix Cattle,* 625 F.2d at 292. Additionally, subject to certain exceptions, Lubrizol was obligated to keep all license technology in confidence for a number of years.

[4] Since the licensing agreement is executory as to each party, it is executory within the meaning of § 365(a), and the district court erred as a matter of law in reaching a contrary conclusion. *

III

[5] There remains the question whether rejection of the executory contract would be advantageous to the bankrupt. *See Borman's, Inc. v. Allied Supermarkets, Inc.,* 706 F.2d 187, 189 (6th Cir.1983). Courts addressing that question must start with the proposition that the bankrupt's decision upon it is to be accorded the deference mandated by the sound business judgment rule as generally applied by courts to discretionary actions or decisions of corporate directors. *See Bildisco,* 465 U.S. at ----, 104 S.Ct. at 1195 (noting that the business judgment rule is the "traditional" test); *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific Railroad,* 318 U.S. 523, 550, 63 S.Ct. 727, 742, 87 L.Ed. 959 (1943) (applying business ***1047** judgment rule to bankrupt's decision whether to affirm or reject lease); *Control Data Corp. v. Zelman (In re Minges),* 602 F.2d 38, 43 (2d Cir.1979) (applying *Institutional Investors* outside of railroad reorganizations); *Carey v. Mobil Oil Corp. (In re Tilco, Inc.),* 558 F.2d 1369, 1372-73 (10th Cir.1977) (applying *Institutional Investors* to rejection of gas contracts).

As generally formulated and applied in corporate litigation the rule is that courts should defer to-should not interfere with-decisions of corporate directors upon matters entrusted to their business judgment except upon a finding of bad faith or gross abuse of their "business discretion." *See, e.g., Lewis v. Anderson,* 615 F.2d 778, 782 (9th Cir.1979); *Polin v. Conductron Corp.,* 552 F.2d 797, 809 (8th Cir.1977). Transposed to the bankruptcy context, the rule as applied to a bankrupt's decision to reject an executory contract because of perceived business advantage requires that the decision be accepted by courts unless it is shown that the bankrupt's decision was one taken in bad faith or in gross abuse of the bankrupt's retained business discretion.

[6] In bankruptcy litigation the issue is of course first presented for judicial determination when a debtor, having decided that rejection will be beneficial within contemplation of § 365(a), moves for approval of the rejection. The issue thereby presented for first instance judicial determination by the bankruptcy court is whether the decision of the debtor that rejection will be advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice. That issue is one of fact to be decided as such by the bankruptcy court by the normal processes of fact adjudication. And the resulting fact determination by the bankruptcy court is perforce then reviewable up the line under the clearly erroneous standard. *See Minges,* 602 F.2d at 43; *see generally* 1 *Collier on Bankruptcy* ¶ 3.03(8)(b) (L. King 15th ed. 1984).

Here, the bankruptcy judge had before him evidence not rebutted by Lubrizol that the metal coating process subject to the licensing agreement is RMF's principal asset and that sale or licensing of the technology represented the primary potential source of funds by which RMF might emerge from bankruptcy. The testimony of RMF's president, also factually uncontested by Lubrizol, indicated that sale or further licensing of the technology would be facilitated by stripping Lubrizol of its rights in the process and that, correspondingly, continued obligation to Lubrizol under the agreement would hinder RMF's capability to sell or license the technology on more advantageous terms to other potential licensees. On the basis of this evidence the bankruptcy court determined that the debtor's decision to reject was based upon sound business judgment and approved it.

On appeal the district court simply found to the contrary that the debtor's decision to reject did not represent a sound business judgment. The district court's determination rested essentially on two grounds: that RMF's purely contingent obligations under the agreement were not sufficiently onerous that relief from them would constitute a substantial benefit to RMF; and that because rejection could not deprive Lubrizol of all its rights to the technology, rejection could not reasonably be found beneficial. We conclude that in both of these respects the district court's factual findings, at odds with those of the bankruptcy court, were clearly erroneous and cannot stand.

A

[7] In finding that the debtor's contingent obligations were not sufficiently onerous that relief from them would be beneficial, the district court could only have been substituting its business judgment for that of the debtor. There is nothing in the record from which it could be concluded that the debtor's decision on that point could not have been reached by the exercise of sound (though possibly faulty) business judgment in the normal process of evaluating alternative courses of action. If ***1048** that could not be concluded, then the business judgment rule required that the debtor's factual evaluation be accepted by the court, as it had been by the bankruptcy court. *See Schein v. Caesar's World, Inc.,* 491 F.2d 17, 20 (5th Cir.1974).

B

[8] On the second point, we can only conclude that the district court was under a misapprehension of controlling law in thinking that by rejecting the agreement the debtor could not deprive Lubrizol of all rights to the process. Under 11 U.S.C. § 365(g), Lubrizol would be entitled to treat rejection as a breach and seek a money damages remedy; however, it could not seek to retain its contract rights in the technology by specific performance even if that remedy would ordinarily be available upon breach of this type of contract. *See In re Waldron,* 36 B.R. 633, 642 n. 4 (Bankr.S.D.Fla.1984). Even though § 365(g) treats rejection as a breach, the legislative history of § 365(g) makes clear that the purpose of the provision is to provide only a damages remedy for the non-bankrupt party. H.Rep. No. 95-595, 95th Cong., 2d Sess. 349, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5963, 6305. For the same reason, Lubrizol cannot rely on provisions within its agreement with RMF for continued use of the technology by Lubrizol upon breach by RMF. Here again, the statutory "breach" contemplated by § 365(g) controls, and provides only a money damages remedy for the non-bankrupt party. Allowing specific performance would obviously undercut the core purpose of rejection under § 365(a), and that consequence cannot therefore be read into congressional intent.

IV

Lubrizol strongly urges upon us policy concerns in support of the district court's refusal to defer to the debtor's decision to reject or, preliminarily, to treat the contract as executory for § 365(a) purposes. We understand the concerns, but think they cannot control decision here.

It cannot be gainsaid that allowing rejection of such contracts as executory imposes serious burdens upon contracting parties such as Lubrizol. Nor can it be doubted that allowing rejection in this and comparable cases could have a general chilling effect upon the willingness of such parties to contract at all with businesses in possible financial difficulty. But under bankruptcy law such equitable considerations may not be indulged by courts in respect of the type of contract

here in issue. Congress has plainly provided for the rejection of executory contracts, notwithstanding the obvious adverse consequences for contracting parties thereby made inevitable. Awareness by Congress of those consequences is indeed specifically reflected in the special treatment accorded to union members under collective bargaining contracts, *see Bildisco,* 465 U.S. at ----, 104 S.Ct. at 1193-96, and to lessees of real property, *see* 11 U.S.C. § 365(h). But no comparable special treatment is provided for technology licensees such as Lubrizol. They share the general hazards created by § 365 for all business entities dealing with potential bankrupts in the respects at issue here.

The judgment of the district court is reversed and the case is remanded for entry of judgment in conformity with that entered by the bankruptcy court.

REVERSED AND REMANDED.

All Citations

756 F.2d 1043, 226 U.S.P.Q. 961, 12 Collier Bankr.Cas.2d 310, 12 Bankr.Ct.Dec. 1281, Bankr. L. Rep. P 70,311

Footnotes

* We disagree with the district court's characterization of the transaction as effectively a completed sale of property. If an analogy is to be made, licensing agreements are more similar to leases than to sales of property because of the limited nature of the interest conveyed. Congress expressly made leases subject to rejection under § 365 in order to "preclude any uncertainty as to whether a lease is an executory contract" under § 365. 2 *Collier on Bankruptcy* ¶ 365.02 (L. King 15th ed. 1984).

KeyCite Red Flag - Severe Negative Treatment
Vacated and Remanded by In re Exide Technologies, 3rd Cir.(Del.), June 1, 2010

340 B.R. 222
United States Bankruptcy Court, D. Delaware.

In re EXIDE TECHNOLOGIES et al., Debtors.

No. 02–11125–KJC.
|
April 3, 2006.

Synopsis
Background: Chapter 11 debtor sought court approval of its decision to reject integrated asset purchase and trademark licensing agreement.

Holdings: The Bankruptcy Court, Kevin J. Carey, J., held that:

[1] agreement qualified as "executory contract," as that term is used in Bankruptcy Code;

[2] debtor would be allowed to reject agreement, as representing appropriate exercise of business judgment by debtor; and

[3] rejection by debtor of its exclusive trademark licensing agreement would terminate licensee's ability to use mark and result in estate's reacquiring right to use trademark in whatever capacity or market debtor had previously been barred from doing so.

Motion granted.

West Headnotes (31)

[1] Bankruptcy
Partial assumption;burdens and benefits

Debtor's executory contract must be assumed or rejected in toto, and may not be bifurcated into those parts that will be rejected and those that will not. 11 U.S.C.A. § 365.

Cases that cite this headnote

[2] Bankruptcy
Partial assumption;burdens and benefits

All of the executory contracts that comprise an integrated agreement between debtor and other nondebtor party must either be assumed or rejected, since they all make up one contract. 11 U.S.C.A. § 365.

2 Cases that cite this headnote

[3] Bankruptcy
Proceedings

Burden of proof is on party seeking to reject debtor's contract to demonstrate that contract is executory. 11 U.S.C.A. § 365.

Cases that cite this headnote

[4] Bankruptcy
Executory nature in general

Contract is "executory," within meaning of bankruptcy statute governing debtor's executory contracts and unexpired leases, when obligation of both the debtor and the other party to contract are so far unperformed that failure of either to complete performance would constitute a material breach excusing performance of the other. 11 U.S.C.A. § 365.

4 Cases that cite this headnote

[5] Bankruptcy
Executory nature in general

Time for testing whether there are material unperformed obligations on both sides, as required for contract to qualify as "executory contract" under bankruptcy statute governing debtor's executory contracts and unexpired leases, is time bankruptcy petition was filed. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[6] Bankruptcy

Executory nature in general

To determine whether Chapter 11 debtor's contract contained material unperformed obligations on petition date, as required for contract to qualify as "executory contract," bankruptcy court had to consider contract principles under New York law, the relevant nonbankruptcy law that was designated by parties in choice of law provision. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[7] **Contracts**

Effect of breach in general

Under New York contract law, obligation is "material" if breach of the same would justify other party to suspend his own performance or defeat the purpose of entire transaction.

Cases that cite this headnote

[8] **Contracts**

Effect of breach in general

Under New York law, contractual obligation is "material" if it relates to root or essence of contract.

Cases that cite this headnote

[9] **Contracts**

Effect of breach in general

Under New York law, in order for contractual obligation to qualify as "material" obligation, it must be material at time agreement is executed.

1 Cases that cite this headnote

[10] **Bankruptcy**

Executory nature in general

Integrated asset purchase and trademark licensing agreement between Chapter 11 debtor and a prepetition purchaser of its industrial battery division, pursuant to which purchaser had ongoing obligation to use debtor's trademark only within industrial battery business and to maintain quality of any batteries that it sold under this trademark, and debtor had ongoing obligation to maintain registration for trademark, to prosecute all substantial claims of infringement, and to continue to make contributions to employee pension plans, qualified as "executory contract," as that term is used in Bankruptcy Code. 11 U.S.C.A. § 365.

3 Cases that cite this headnote

[11] **Bankruptcy**

Executory nature in general

Exclusive remedies clause in integrated asset purchase and trademark licensing agreement between Chapter 11 debtor and prepetition purchaser of its industrial battery division related solely to claims for indemnification and did not affect either party's ability to terminate agreement for other party's breach of its remaining material obligations thereunder or prevent agreement from qualifying as "executory contract," as that term is used in Bankruptcy Code. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[12] **Contracts**

Performance of Conditions

Under New York law, while contracting party's failure to fulfill condition excuses performance by other party whose performance is so conditioned, it is not, without independent promise to perform that condition, a breach of contract, which subjects nonfulfilling party to liability for damages.

Cases that cite this headnote

[13] **Contracts**

Nature and scope in general

Under New York law, whether particular term of agreement imposes duty or is merely a condition is matter of contract interpretation.

Cases that cite this headnote

[14] **Bankruptcy**
Executory nature in general

Under integrated asset purchase and trademark licensing agreement between Chapter 11 debtor and prepetition purchaser of its industrial battery division, purchaser's ongoing obligation to use debtor's trademark only within industrial battery business and to maintain quality of any batteries that it sold under this trademark were not mere "conditions" but material unperformed "obligations" of purchaser, which helped to make parties' contract "executory," where purchaser agreed affirmatively to maintain quality standards for trademark and debtor devoted some effort to monitoring quality of batteries that purchaser produced, and where purchaser, to extent it used debtor's trademark, agreed to do so only in accordance with terms of agreement. 11 U.S.C.A. § 365.

3 Cases that cite this headnote

[15] **Bankruptcy**
Executory nature in general

Royalty-free, exclusive right to use Chapter 11 debtor's trademark on batteries that it manufactured, which prepetition purchaser of debtor's industrial battery division received under integrated agreement between parties, was in nature of "license" rather than of "closed sale," for purpose of deciding whether parties' agreement was still "executory" on petition date, where debtor retained ownership of and control over use of trademark, required purchaser to maintain quality of mark, and prohibited purchaser from transferring or sublicensing mark without debtor's consent. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[16] **Bankruptcy**
Executory nature in general

Generally, license agreement is "executory contract," as that term is used in the Bankruptcy Code. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[17] **Bankruptcy**
"Business judgment" test in general

Propriety of decision to reject debtor's executory contract is governed by "business judgment" standard. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[18] **Bankruptcy**
"Business judgment" test in general

Under "business judgment" standard employed by court in ruling on request to reject debtor's executory contract, court must examine whether reasonable business person would make similar decision under similar circumstances; standard is not difficult one to satisfy, and requires only a showing that rejection will benefit estate. 11 U.S.C.A. § 365.

2 Cases that cite this headnote

[19] **Bankruptcy**
"Business judgment" test in general

Under "business judgment" standard employed by court in ruling on request to reject debtor's executory contract, court may not substitute its own judgment for that of debtor. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[20] **Bankruptcy**
"Business judgment" test in general

Chapter 11 debtor would be allowed to reject executory asset purchase and trademark licensing agreement, in order to secure for estate the benefits of again being able to use mark in all markets, thereby eliminating customer confusion and securing for debtor the benefits of brand unification, where debtor had conducted extensive analyses and considered benefits and harms of rejection,

where licensee's alleged $67 million rejection damages claim was speculative at best and, as compared with unsecured claims of roughly $900 million, would not significantly diminish dividend to unsecured creditors in any event, and where decision to reject had support of unsecured creditors' committee. 11 U.S.C.A. § 365.

2 Cases that cite this headnote

[21] Bankruptcy
Proceedings

Sales forecasts which were prepared by corporate Chapter 11 debtor's employees based on debtor's own internal data, regarding likely effects on debtor's business if debtor was able to reacquire right to use trademark from licensee and succeeded in its efforts at brand unification, were relevant and could be considered by court in deciding whether debtor had exercised requisite business judgment in deciding to reject licensing agreement, notwithstanding that much of information in reports had been redacted on confidentiality grounds.

Cases that cite this headnote

[22] Bankruptcy
Evidence;witnesses

Questions concerning reliability, accuracy or completeness of document go to weight of evidence, not to its admissibility.

Cases that cite this headnote

[23] Bankruptcy
Proceedings

Sales forecasts which were prepared by corporate Chapter 11 debtor's employees based on debtor's own internal data, regarding likely effects on debtor's business if debtor was able to reacquire right to use trademark from licensee and succeeded in its efforts at brand unification, were admissible under "business records" exception to hearsay rule in proceeding to decide whether debtor exercised requisite business judgment in electing to reject licensing agreement, where testimony of debtor's officers established that it was part of debtor's routine practice to conduct kind of analyses contained in these forecasts, that information contained in forecasts was recorded at or near time it was obtained, and that information was reliable. Fed.Rules Evid.Rule 803(6), 28 U.S.C.A.

Cases that cite this headnote

[24] Bankruptcy
Evidence;witnesses

Documents created expressly for purpose of litigation do not fall within "business records" exception to hearsay rule, as lacking requisite indicia of reliability and trustworthiness. Fed.Rules Evid.Rule 803(6), 28 U.S.C.A.

Cases that cite this headnote

[25] Bankruptcy
Evidence;witnesses

"Business records" exception to hearsay rule does not require that foundation evidence for admission of business records be provided by actual custodian of records; rather, other qualified witnesses are permitted to lay foundation, and the group of those who may fall within this rubric is broad. Fed.Rules Evid.Rule 803(6), 28 U.S.C.A.

Cases that cite this headnote

[26] Bankruptcy
Evidence;witnesses

To be qualified to lay foundation for admission of evidence under "business records" exception to hearsay rule, witness need only have familiarity with business' record-keeping practices and be able to attest (1) that declarant in the records had personal knowledge to make accurate statements; (2) that declarant recorded statements contemporaneously with actions which were subject of reports; (3) that declarant made record in regular course of

the business activity; and (4) that such records were regularly kept by business. Fed.Rules Evid.Rule 803(6), 28 U.S.C.A.

1 Cases that cite this headnote

[27] Bankruptcy
Grounds for and Objections to Assumption, Rejection, or Assignment

Impact of potential rejection damages claim on estate is relevant in determining appropriateness of decision to reject debtor's executory contract. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[28] Bankruptcy
Grounds for and Objections to Assumption, Rejection, or Assignment

In reviewing Chapter 11 debtor's decision to reject executory contract, bankruptcy court need not determine exact amount of other party's rejection damages claim, but need only determine whether this rejection damages claim will be so large as to make debtor's decision to reject contract unreasonable. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[29] Bankruptcy
Grounds for and Objections to Assumption, Rejection, or Assignment

Burden or impact that rejection of debtor's executory contract will have on nondebtor party is not factor to be considered in determining propriety of decision to reject contract. 11 U.S.C.A. § 365.

Cases that cite this headnote

[30] Bankruptcy
Grounds for and Objections to Assumption, Rejection, or Assignment

That Chapter 11 debtor's decision to reject its executory contract had support of unsecured creditors' committee was significant factor weighing in favor of permitting rejection. 11 U.S.C.A. § 365.

Cases that cite this headnote

[31] Bankruptcy
Effect of Acceptance or Rejection

Rejection by Chapter 11 debtor-licensor of its exclusive trademark licensing agreement would terminate licensee's ability to use mark and result in estate's reacquiring right to use trademark in whatever capacity or market debtor had previously been barred from doing so by licensing agreement; trademark was not "intellectual property," as that term was used in provision of the Bankruptcy Code according special rights to licensees upon debtor-licensor's rejection of license to use intellectual property. 11 U.S.C.A. §§ 101(35A), 365(n).

3 Cases that cite this headnote

Attorneys and Law Firms

***226** James E. O'Neill, Esquire, Kathleen Marshall DePhillips, Esquire, Pachulski, Stang, Ziehl, Young, Jones & Weintraub, P.C., Wilmington, DE, Matthew N. Kleiman, Esquire, Kirkland & Ellis, LLP, Chicago, IL, for Debtor.

Thomas G. Whalen, Esquire, Stevens & Lee, P.C., Wilmington, DE, Robert Lapowsky, Esquire, Stevens & Lee, Philadelphia, PA, for EnerSys.

David B. Stratton, Esquire, David M. Fournier, Esquire, Pepper Hamilton, LLP, Wilmington, DE, Fred S. Hodara, Esquire, Elaine M. Laflamme, Esquire, Mitchell P. Hurley, Esquire, Mary R. Masella, Esquire, Jeffrey M. Anapolsky, ***227** Esquire, Akin, Gump, Strauss, Hauer & Feld, LLP, New York, NY, for the Official Committee of Unsecured Creditors.

Opinion

OPINION [1]

KEVIN J. CAREY, Bankruptcy Judge.

INTRODUCTION

Exide Technologies, Inc. and its affiliated debtors, as debtors and debtors in possession in the above-captioned matter (collectively "Exide"), seek approval from this Court to reject certain agreements entered into with EnerSys, Inc. ("EnerSys"). [2] EnerSys vigorously opposes Exide's decision to reject, contending that the agreements are not executory and that even if they are, Exide did not exercise proper business judgment in making such decision. After an arduous and lengthy pre-trial period, hearings were held on March 3, 4, 5, 12, 17, 25, 26 and 31, 2004, to consider Exide's rejection of the agreements.

For the reasons set forth below, I will approve Exide's decision to reject the agreements.

BACKGROUND

In 1991, Exide entered into a series of agreements with EnerSys for the sale of substantially all of Exide's industrial battery division. The parties executed over twenty-three agreements as part of the transaction. The following four agreements are at the heart of this dispute: (1) the Trademark and Trade Name License Agreement, dated June 10, 1991 ("Trademark License"), (2) the Asset Purchase Agreement, dated June 10, 1991, (3) the Administrative Services Agreement, dated June 10, 1991, and (4) a letter agreement, dated December 27, 1994 (collectively, all four are referred to herein as the "Agreement"). [3] I ruled previously that the Agreement is a fully integrated, unambiguous document. *See* 11/20/03 Tr. 25:23–26:4; 3/12/04 Tr. 3:18–4:22.

As part of the transaction, EnerSys paid in excess of $135 million at closing. In exchange for such payment, EnerSys received various assets, including manufacturing plants, equipment and certain intellectual ***228** property rights. Certain Exide employees in the industrial battery division became EnerSys employees.

Exide owns a trademark that it used in connection with its transportation battery business (the "Exide mark"). [4] Exide wanted to continue to use the Exide mark outside of the industrial battery business. Conversely, EnerSys wanted to use the Exide mark in the industrial battery business. To accommodate the needs of both parties, Exide granted EnerSys a perpetual, exclusive, royalty-free license to use the Exide mark in the industrial battery business. This way, Exide retained ownership of the mark and could use it outside the industrial battery business and EnerSys could use the mark exclusively within the industrial battery business. The license of the Exide mark was subject to certain conditions and could be terminated as set forth in the Agreement.

For almost a decade following the closing of the transaction, the parties enjoyed a relatively amicable business relationship. In the year 2000, the parties agreed to the early termination of a ten-year non-competition agreement, which termination allowed Exide to re-enter the industrial battery business. Shortly after the non-competition agreement was terminated, Exide re-entered the industrial battery business when it purchased GNB Industrial Battery Company.

Prior to re-entering the industrial battery business, Exide's strategic goal was to unify its corporate image, including all of its brands that it used on the various products that Exide produced. The single name and mark that Exide wanted to use was "Exide." Its corporate name was Exide and Exide believed that there was significant goodwill attached to that name. However, EnerSys had the exclusive right to use the Exide mark in the industrial battery business. Exide made several unsuccessful prepetition overtures to EnerSys in attempts to regain the Exide mark. Exide's chapter 11 proceeding now provides it with the opportunity to regain the Exide mark by rejecting the Agreement. EnerSys has objected to the rejection. [5]

DISCUSSION

The Court is called upon to determine whether the Agreement is an executory contract and, if so, whether Exide exercised proper business judgment in rejecting the Agreement.

I. *Rejection of the Agreement.*

[1] **[2]** An executory contract must be assumed or rejected *in toto*. *See Sharon Steel Corp. v. National Fuel*

Gas Distribution Corp., 872 F.2d 36, 41 (3d Cir.1989); *In re Teligent, Inc.,* 268 B.R. 723, 728 (Bankr.S.D.N.Y.2001). A contract will not be bifurcated into parts that will be rejected and those that will not. *See In re Metro Transp. Co.,* 87 B.R. 338, 342 (Bankr.E.D.Pa.1988). Correspondingly, all of the contracts that comprise an integrated agreement must either be assumed or rejected, since they all make up one contract. *See Philip Servs. Corp. v. Luntz (In re Philip Servs., Inc.),* 284 B.R. 541, 547–548 (Bankr.D.Del.2002), *aff'd* 303 B.R. 574 (D.Del.2003); *In re Karfakis,* 162 B.R. 719, 725 (Bankr.E.D.Pa.1993). EnerSys contends that rejection must be denied ***229** because Exide failed to reject all of the agreements executed between the parties (not just the agreements at the center of dispute in this case), but I have already determined that the Trademark License, the Asset Purchase Agreement, the Administrative Services Agreement, and the December 27, 1994, letter agreement all comprise one, integrated agreement.

II. *Is the Agreement Executory?*

[3] Section 365(a) of the Bankruptcy Code allows debtors in possession to reject an executory contract. [6] *See* 11 U.S.C. § 365(a). The party seeking to reject a contract bears the burden of demonstrating that it is executory. *See DSR, Inc. v. Manuel (In re Hamilton Roe Int'l, Inc.),* 162 B.R. 590, 593 (Bankr.M.D.Fla.1993); *In re Rachels Industries, Inc.,* 109 B.R. 797, 802 (Bankr.W.D.Tenn.1990).

[4] In determining whether a contract is executory and, hence, subject to rejection, courts in this Circuit utilize the Countryman standard, which provides that a contract is executory when "the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other." Vern Countryman, *Executory Contracts in Bankruptcy: Part I,* 57 Minn. L.Rev. 439, 460 (1973); *Sharon Steel,* 872 F.2d at 39; *In re Waste Systems Int'l, Inc.,* 280 B.R. 824, 826–827 (Bankr.D.Del.2002). "Thus, unless both parties have unperformed obligations that would constitute a material breach if not performed, the contract is not executory under § 365." *Enterprise Energy Corp. v. United States (In re Columbia Gas Sys., Inc.),* 50 F.3d 233, 239 (3d Cir.1995). Consequently, I must determine whether both parties have unperformed material obligations under the Agreement. *See Columbia Gas,* 50 F.3d at 239; *Waste Systems Int'l,* 280 B.R. at 827; *In re Access Beyond Technologies, Inc.,* 237 B.R. 32, 43 (Bankr.D.Del.1999). In doing so, I look initially at the "four corners" of the Agreement. *See Shoppers World Community Ctr., L.P. v. Bradlees Stores, Inc. (In re Bradlees Stores, Inc.),* 2001 WL 1112308, at *8, 2001 U.S. Dist. LEXIS 14755, at *27 (S.D.N.Y. September 20, 2001) ("the executoriness analysis examines an agreement on its face to determine whether there are material obligations that require substantial performance from the parties").

[5] **[6]** "The time for testing whether there are material unperformed obligations on both sides is when the bankruptcy petition is filed." *Columbia Gas,* 50 F.3d at 240; *see Waste Systems Int'l,* 280 B.R. at 827; *In re HQ Global Holdings, Inc.,* 290 B.R. 507, 510 (Bankr.D.Del.2003). Exide sought chapter 11 relief on April 15, 2002. To determine whether the Agreement contained any material obligations as of April 15, 2002, I must "consider contract principles under relevant nonbankruptcy law." *Columbia Gas,* 50 F.3d at 240 n. 10. The parties designated New York as their choice of law governing the Agreement.

A. *Material Obligations*

[7] **[8]** **[9]** Under New York law, an obligation is material if a breach of the same "would justify the other party to suspend his own performance, or ... defeat the ***230** purpose of the entire transaction." *Lipsky v. Commonwealth United Corp.,* 551 F.2d 887, 895 (2d Cir.1976); *accord Bradlees Stores,* 2001 WL 1112308, at *2001 U.S. Dist. LEXIS 14755, at *25. That is, an obligation is material if it relates to the root or essence of the contract. *See Medical Malpractice Ins. Ass'n v. Hirsch (In re Lavigne),* 114 F.3d 379, 387 (2d Cir.1997); *see also Philip Services,* 284 B.R. at 547. An obligation must be material at the time the agreement is executed.

[10] Exide contends that the following are material obligations under the Agreement:

(1) Exide must refrain from suing EnerSys for trademark infringement for the use of the Exide mark (i.e., must permit EnerSys to use the Exide mark) ("the Use Grant");

(2) EnerSys must refrain from using the Exide mark outside of the industrial battery business ("EnerSys's Use Restriction");

(3) Exide must refrain from using the Exide mark within the industrial battery business ("Exide's Use Restriction");

(4) EnerSys must maintain a minimum level of quality for its products that contain the Exide mark ("the Quality Standards");

(5) Exide must make payments into a pension plan maintained for the benefit of its employees ("Pension Plan Obligation");

(6) Exide must maintain the registration of the Exide mark ("Registration Obligation");

(7) Exide and EnerSys must indemnify each other from and against certain costs, losses, liabilities, damages, lawsuits, claims, etc. ("Indemnification Obligations"); and

(8) Exide and EnerSys must cooperate with one another after the closing of the Agreement in order to effectuate certain provisions contained therein ("Further Assurances Obligations").

1. Paragraph 13.6 of the Asset Purchase Agreement.

[11] EnerSys claims that paragraph 13.6 of the Asset Purchase Agreement makes clear that none of the foregoing obligations are material, because Exide's remedies are limited to those remedies contained in paragraph 13.6 of the Asset Purchase Agreement, which provides:

> *Exclusive Remedies.* The indemnification provided for in this Article XIII shall be the exclusive remedy available to any Indemnitee against any Indemnitor for any Damages hereunder to the exclusion of all other common law or statutory remedies, including without limitation the right to contribution under CERCLA or analogous state law; *provided,* however, that notwithstanding the foregoing, the parties hereby agree that failure of the parties to perform certain of their respective obligations under this Agreement or the Ancillary Agreements may result in consequences to the non-breaching party for which money damages may not be sufficient. In such case, the non-breaching party shall be entitled to seek specific performance and other equitable relief, which shall be cumulative and non-exclusive of any other remedy available to such non-breaching party pursuant to this Article XIII.

EnerSys contends that Exide does not have the right to terminate all future performance under the Agreement upon default because Exide's remedies are limited strictly to indemnification, or equitable relief, when monetary damages prove to be insufficient. If Exide cannot terminate its performance upon default, which element is necessary to satisfy the Countryman ***231** test, EnerSys argues that the Agreement cannot be executory. [7]

Paragraph 13.6 of the Asset Purchase Agreement does not preclude Exide from terminating performance under the Agreement. When viewing paragraph 13.6 in relation to the other provisions of the Asset Purchase Agreement, it is apparent that paragraph 13.6 relates solely to claims for indemnification. The Asset Purchase Agreement contains a separate article regarding termination. Furthermore, the language of paragraph 13.6 suggests that the non-breaching party is entitled to equitable relief in addition to monetary relief with respect to any claim for indemnification. It does not, as EnerSys argues, limit a non-breaching party's remedies under the Agreement solely to indemnification or equitable relief.

2. Paragraph 8 of the Trademark License.

Paragraph 8 of the Trademark License provides:

> *Termination.* Licensor shall have the right to terminate this Trademark License if (a) products covered hereunder and sold by Licensee in connection with the Licensed Marks fail to meet the Qaulity Standards, or (b) Licensee uses, assigns or sublicenses its rights under the Licensed Trade Name or the Licensed Marks outside the scope of the Licensed Business [8] and, in either such case, reasonable measures are not initiated to cure such failure or improper use within ninety (90) days after written notice from Licensor. Upon termination of this Trademark License, Licensee and its sublicensees shall, within a reasonable period of time not to exceed two (2) years, discontinue all use of the Licensed Marks and Licensee shall discontinue all use of the Licensed Trade Name and shall cancel all filings or registrations made pursuant to Paragraph 10 hereof and change its corporate or trade name registrations, if any, to exclude the Licensed Trade Name; provided, however, that if any failure to meet Quality Standards or improper use of, or assignment or sublicense of rights under, the Licensed Trade Name or Licensed Marks occurs in any jurisdiction other than the United

> States and is not remedied as permitted hereunder, this Trademark License will terminate only with respect to the jurisdiction in which such failure or improper use occurred.

EnerSys's Use Restriction and the Quality Standards are material, since both relate to the foundation of the Agreement.[9] ***232** These restrictions are necessary because they protect Exide's, as well as EnerSys's, interests in the Exide mark. A default of either would result in a material breach. Therefore, EnerSys's agreement to refrain from using the Exide mark outside of the industrial battery business, as well as to maintain quality standards set for the mark, are material components to which EnerSys remained subject as of the petition date.

If EnerSys violates its Use Restriction or the Quality Standards, Exide may terminate the Trademark License. Contrary to EnerSys's contentions, a breach of its Use Restriction or the Quality Standards allows Exide to terminate the Agreement, not simply the Trademark License, because the Agreement is an integrated contract. Consequently, Exide may terminate the performance of any of its remaining obligations under the Agreement upon the breach of either obligation.

3. Conditions vs. Obligations

Alternatively, EnerSys contends that its Use Restriction and the Quality Standards are not obligations under the Agreement, but are conditions. Because the failure of a condition cannot result in a material breach, EnerSys argues that the Use Restriction and the Quality Standard cannot satisfy the Countryman test.

[12] **[13]** There is a critical distinction in the law between the failure of a condition and a breach of a duty (i.e., a promise).[10] *See Columbia Gas,* 50 F.3d at 241. "While a contracting party's failure to fulfill a condition excuses performance by the other party whose performance is so conditioned, it is not, without an independent promise to perform the condition, a breach of contract subjecting the nonfulfilling party to liability for damages." *Merritt Hill Vineyards, Inc. v. Windy Heights Vineyard, Inc.,* 61 N.Y.2d 106, 113, 472 N.Y.S.2d 592, 460 N.E.2d 1077 (N.Y.1984) (citing Restatement (Second) of Contracts § 225). A party is not in breach of contract if a condition does not occur unless that party is under a duty to cause the occurrence of such condition. *See Columbia Gas,* 50 F.3d at 241. Whether a particular term of an agreement imposes a duty or is a condition is a matter of contract interpretation. *Id.,* at 241.

a. *The Quality Standards.*

[14] Paragraph 5 of the Trademark License, which concerns the Quality Standards, provides, in relevant part, that:

> [l]icensee shall maintain the standards of quality set by Licensor for the conduct of the Licensed Business under the Licensed Trade Name and the goods bearing the Licensed Marks which Licensor established prior to the execution of this Trademark License (the "Quality Standards").[11]

It is apparent that the parties intended the Quality Standards to be an affirmative undertaking rather than a condition. EnerSys agreed affirmatively to maintain the standards of quality for the mark set by ***233** Exide. As such, the Quality Standards are an obligation. *See, e.g., HQ Global Holdings,* 290 B.R. at 510 (noting that franchisees' duty to maintain quality standards under license was an obligation). EnerSys also argues that, even if the Quality Standards are material, Exide waived performance of EnerSys's duty to comply with the Quality Standards because Exide failed, *inter alia,* to enforce them. As a result, according to EnerSys, the Quality Standards cannot serve as a basis for executoriness to satisfy the Countryman test.

Paragraph 5 of the Trademark License also provides that:

> [l]icensee agrees to furnish to Licensor, upon Licensor's request, representative samples of all labels, advertising materials and other associated materials used in the sale, offering for sale, or marketing of goods bearing the Licensed Trade Name or Licensed Marks to enable Licensor to confirm that the labeling and advertising meet the Quality Standards.

The evidence established that Exide did devote some effort at monitoring the quality of EnerSys's batteries bearing the Exide mark. Exide inspected EnerSys's plants and batteries, tested the batteries and received technical data about the batteries from EnerSys. *See* 3/3/04 Tr. 68:11–69:19. These efforts provided Exide with information about the quality of EnerSys's batteries. Exide was satisfied that EnerSys met the Quality Standards. Moreover, Exide was under no affirmative duty to track regularly and monitor the quality of EnerSys's products that contained the Exide mark to ensure that EnerSys was complying with the Quality Standards. Likewise, EnerSys's duty to comply with the Quality Standards was not made contingent upon Exide's efforts at monitoring EnerSys's products.

The circumstances here demonstrate that the quality control measures exercised by Exide were sufficient.[12] There was no evidence that EnerSys was not complying with the Quality Standards. The record reflects that Exide did not receive any reports from within the industrial battery industry regarding any significant problems with the quality of EnerSys's batteries. If anything, the evidence established that EnerSys was making high quality products. Indeed, EnerSys claims that it is the leading manufacturer of motive power batteries in the world.

b. *EnerSys's Use Restriction.*

Paragraph 2 of the Trademark License provides, in relevant part, that:

> Licensor hereby grants to Licensee, and Licensee hereby accepts from Licensor, ... a perpetual, exclusive, world-wide, royalty-free license to use the Licensed Trade Name as a corporate name or trade name within the scope of the Licensed Business, and a non-exclusive, perpetual, world-wide, royalty-free license to use the Licensed Trade Name in connection with the motorcycle battery business, but only as part of the trade name or corporate name "Yuasa–Exide, Inc." While retaining the corporate name "Yuasa–Exide, Inc.", Licensee may sell products in businesses other than the Licensed Business and the motorcycle battery business but Licensee shall not sell such products under the Licensed Trade Name and shall sell such products under an assumed name, ***234** fictitious name or through some other mechanism whereby the Licensed Trade Name is not used before the public or trade in relation to such products.
>
> Licensor hereby grants to Licensee, and Licensee hereby accepts from Licensor, ... a perpetual, exclusive, world-wide, royalty-free license to use the Licensed Marks within the scope of the Licensed Business on and in connection with the goods for which such Licensed Marks are registered or as otherwise permitted under applicable law within the scope of the Licensed Business ...

Furthermore, paragraph 8 of the Trademark License provides, in relevant part, that:

> Licensor shall have the right to terminate this Trademark License if ... Licensee uses, assigns or sublicenses it rights under the Licensed Trade Name or the Licensed Marks outside the scope of the Licensed Business ....

Under these two provisions, EnerSys is permitted to use the Exide mark within the industrial battery market. Although there is no affirmative undertaking by EnerSys actually to use the Exide mark, EnerSys is obliged to use the mark only in accordance with the terms of the Agreement. *See Novon Int'l, Inc. v. Novamont (In re Novon Int'l. Inc.),* 2000 WL 432848, at *4, 2000 U.S. Dist. LEXIS 5169, at *12 (W.D.N.Y. March 31, 2000). EnerSys must observe the restrictions imposed by the grant of the license; the EnerSys's Use Restriction is an affirmative undertaking, or, obligation. *Id.*

4. Materiality of the Obligations

Lastly, EnerSys contends that notwithstanding the terms of paragraph 13.6 of the Asset Purchase Agreement and paragraph 8 of the Trademark License, none of the obligations identified by Exide are material.

a. *The Use Grant.*

Pursuant to the Use Grant, Exide is obligated to allow EnerSys to use the Exide mark subject to the terms of the Trademark License. In connection with the Use Grant, Exide also agreed to prosecute all substantial claims of infringement and oppose all attempted registrations of potentially confusing trademarks, trade names or service marks (paragraph 17 of the Trademark License). This

is a material obligation. *See, e.g., Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers, Inc.),* 756 F.2d 1043, 1046 (4th Cir.1985), *cert. denied* 475 U.S. 1057, 106 S.Ct. 1285, 89 L.Ed.2d 592 (1986) (holding that the licensor's contingent duty to defend infringement suits was a material obligation). [13]

b. *EnerSys's Use Restriction and the Quality Standard.*
For the reasons previously set forth, EnerSys's Use Restriction and the Quality Standard are ongoing material obligations. [14]

***235** c. *Exide's Use Restriction.*
The Use Grant gives EnerSys an exclusive license to use the Exide mark within the industrial battery business. It would be contrary to the terms of the Use Grant that Exide be permitted to use the Exide mark within the industrial battery business. Indeed, Exide agreed not to grant any licenses to third parties which would be inconsistent with EnerSys's use of the mark. This agreement, in and of itself, is a material obligation of Exide. *See, e.g., Otto Preminger Films, Ltd. v. Qintex Entertainment, Inc. (In re Qintex Entertainment, Inc.),* 950 F.2d 1492, 1496 (9th Cir.1991) (holding that the licensor's duty to refrain from selling the rights to subdistribute movies to third parties was a significant obligation); *Fenix Cattle Co. v. Silver (In re The Select–A–Seat Corp.),* 625 F.2d 290, 292 (9th Cir.1980) (holding that because of the exclusive nature of the license which the licensee received, the licensor was under a continuing obligation not to sell its software packages to third parties). Therefore, an agreement by Exide to forbear from using the Exide mark in the industrial battery business is a continuing, material obligation. *See, e.g., HQ Global Holdings,* 290 B.R. at 510 (holding that the franchisor's agreement to refrain from using the proprietary marks in the exclusive territories of the franchisees was an ongoing material obligation as of the petition date).

d. *Pension Plan Obligations.*
Under the Agreement, Exide was obligated to contribute to certain employee pension plans. Specifically, paragraph 7.2(b) of the Asset Purchase Agreement provides, in relevant part, that:

> With respect to all defined benefit plans maintained by Seller as of the Closing Date ... Seller agrees that it shall be solely responsible to employees and former employees of the Division with respect to pension benefits accrued thereunder as of the Closing Date. Seller agrees to vest the Subject Employees ***236** immediately after such Closing Date in their accrued benefits, if any, under the Exide Hourly Employees' Pension Plan, the Exide Retirement Income Security Plan, and the Exide Corporate Pension Plan as of the Closing Date.

Furthermore, paragraph 7.3(a) of the Asset Purchase Agreement provides:

> With respect to the Exide Savings Plan (the "Savings Plan") and the Exide Salaried Retirement Plan (the "Retirement Plan"), except as otherwise provided, Seller agrees that it shall be solely responsible to Subject Employees with respect to benefits accrued thereunder as of the Closing Date. Seller further agrees to vest the Subject Employees immediately following such Closing Date in their respective accounts, if any, under the Savings Plan and the Retirement Plan. Seller shall contribute to each said plan, in accordance with the terms of said plans, all amounts attributable to employees and former employees of the Division which are owed to or under the plans as of the end of the plan year last preceding the Closing Date.

Exide submitted sufficient evidence at hearing demonstrating that it has been paying and will continue to pay millions of dollars to the Exide Hourly Employees' Pension Plan until there are no more participants in the plan. [15] *See* 3/4/04 Tr. 107:13–109:14. Contributions to pension plans are considered ongoing, material obligations. *See, e.g., In re The Bastian Co., Inc.,* 45 B.R. 717, 720–721 (Bankr.W.D.N.Y.1985) (finding

that pension plan contributions were ongoing, material obligations). Failure by Exide to make contributions to the plans could subject EnerSys to claims by employees and EnerSys, in turn, could assert claims against Exide. [16] The Pension Plan Obligations are material, ongoing obligations under the Agreement.

e. *Registration Obligation.*

Exide contends that it is obligated to maintain registration of the Exide mark under the Agreement. Specifically, paragraph 12 of the Trademark License provides, in relevant part, that:

> Licensor shall maintain Licensed Marks in accordance with Licensor's usual and customary business practices. In the event that Licensor intends in good faith to cease payment of maintenance fees for or otherwise allow to lapse any of the Licensed Marks in a particular country, Licensor will notify Licensee of its intention to take such action at least one hundred twenty (120) days in advance ... except in the case where Licensor intends to refile an application to register such Licensed Mark covering goods ***237** within the scope of the Licensed Business ....

EnerSys argues that the Registration Obligation is not really an obligation, since paragraph 12 also provides that if Exide intends to cease support of the Licensed Marks, all it need do is notify EnerSys in advance. Failure to maintain the marks or to give the appropriate notice could very well deprive EnerSys of the benefit of its bargain. I conclude that the affirmative duty to maintain the Licensed Marks and the added duty to give notice to EnerSys upon any expected lapse of the Licensed Marks, taken together, are material, ongoing obligations of Exide.

Moreover, under the Agreement, EnerSys must refrain from making an application for or otherwise attempting to register the Exide mark in the United States Patent and Trademark Office or other similar agency in any foreign country or state, except where required by law (*see* paragraph 10 of the Trademark License). EnerSys is also required to execute and obtain registered user agreements for countries which require registration of the use of a trademark under a license. These are an ongoing, material obligations of EnerSys.

f. *Indemnification Obligations.*

In the Agreement, the parties agree to indemnify each other against certain liabilities and cooperate in the defense of indemnified claims (*see* Article 13 of the Asset Purchase Agreement). In addition, EnerSys agrees to indemnify Exide against claims arising in connection with EnerSys's use of the Exide mark. These obligations to indemnify in the Agreement "carry significant burdens and create considerable benefits." *See Philip Services,* 284 B.R. at 549. Insofar as claims for indemnification can still arise under the Agreement (and the parties recognize the possibility of such), [17] the obligation to indemnify is ongoing and material since unperformed obligations remain under the Agreement for both parties. *See, e.g., Qintex Entertainment,* 950 F.2d at 1496 (holding that the licensor's duty to indemnify and defend the licensee was a significant obligation); *Richmond Metal Finishers,* 756 F.2d at 1046 (holding that the licensor's contingent duty of indemnifying the licensee was material); *Philip Services,* 284 B.R. at 549–550 (holding that indemnity provisions constituted ongoing, material obligations since neither party completed performance of the contract and obligations remained to be performed).

g. *Further Assurances Obligations.*

Paragraph 9.9 of the Asset Purchase Agreement provides:

> Seller hereby acknowledges that its assistance may be required from time to time to enable Purchaser to record or perfect title in, or otherwise to consummate more effectively, the transaction contemplated in this Article IX with respect to the Assigned Marks, the Assigned Letters Patent, the Proprietary Rights, and the Intellectual Property Rights, and Seller agrees that after the Closing and at the request of Purchaser or its designee, at the cost or expense of Purchaser (except in relation to United States patents, trademarks and applications therefor), Seller

> will (or will cause its Affiliates, as applicable, to) use all reasonable efforts to execute and deliver such other documents and take such other actions as may reasonably be requested by Purchaser or its designee to record the transfer to Purchaser or its ***238** designee of the rights assigned herein, or otherwise to consummate more effectively the transactions contemplated in this Article IX. [18]

This common type of provision requires the parties to execute certain documents or undertake other acts to effectuate the intellectual property transactions provided for in the Agreement. This duty is ongoing, and, without such assurances, the parties may not be able to effectuate or maintain their intellectual property-related rights as required in the Agreement. Thus, the Further Assurances Obligations, even if seldom invoked, are ongoing, material obligations.

B. ***Performance of the Obligations***

EnerSys contends that no material obligations existed as of the petition date because both parties substantially performed the Agreement. I disagree. As discussed above, both parties had a number of material obligations under the Agreement to perform as of the petition date and, therefore, could not have rendered substantial performance. At a minimum, EnerSys remained obligated to use the Exide mark in accordance with the terms of the Agreement. *See Novon Int'l,* 2000 WL 432848, at *4, 2000 U.S. Dist. LEXIS 5169, at *12. The Agreement included a license and a license imposes a number of ongoing performance obligations on the part of the parties. *See In re Kmart Corp.,* 290 B.R. 614, 618 (Bankr.N.D.Ill.2003).

C. ***Sale vs. License.***

[15] In a related argument, EnerSys claims that the Agreement evidences a "closed sale" transaction rather than a license and, therefore, cannot be executory. While there was a sale aspect to the Agreement, the Exide mark was not one of the assets that EnerSys purchased. Rather, the Agreement granted to EnerSys only a right to use the Exide mark. Title to the Exide mark remained with Exide despite the fact that EnerSys was granted a royalty-free, exclusive license. [19] EnerSys cannot transfer or sublicense it without Exide's consent. [20] Exide retained ownership and control over the use of the mark.

The Agreement was the result of an arm's-length transaction between two well-represented, sophisticated businesses. EnerSys might have bargained for an assignment of the Exide mark, if available, rather than only a license for the right to use it. [21] Indeed, EnerSys obtained assignments of other marks. The Agreement makes clear which marks were assigned (*see* paragraph and schedule 9.1 of the Asset Purchase Agreement) and which marks were licensed, such as the Exide mark (*see* paragraphs 2.1[c] and 9.5 and schedule 9.5 of the Asset Purchase Agreement). Moreover, the Agreement reflects that EnerSys purchased only those marks and other intellectual property that were to be assigned (*see* paragraph 2.1[a][vi] of the Asset Purchase Agreement).

***239** **[16]** I conclude that the Agreement is a license with respect to the Exide mark: "[g]enerally speaking, a license agreement is an executory contract as such is contemplated in the Bankruptcy Code." *Novon Int'l,* 2000 WL 432848, at *4, 2000 U.S. Dist. LEXIS 5169, at *12; *accord Kmart Corp.,* 290 B.R. at 618. *See also Matter of Superior Toy & Mfg. Co., Inc.,* 78 F.3d 1169, 1176 (7th Cir.1996) (trademark license was an executory contract); *HQ Global Holdings,* 290 B.R. at 511 (trademark license was an executory contract); *Blackstone Potato Chip Co., Inc. v. Mr. Popper, Inc. (In re Blackstone Potato Chip Co., Inc.),* 109 B.R. 557, 560 (Bankr.D.R.I.1990) (trademark license was an executory contract); *In re Chipwich, Inc.,* 54 B.R. 427, 430 (Bankr.S.D.N.Y.1985) (trademark license was an executory contract). [22]

III. ***Did Exide's Decision to Reject the Agreement Satisfy the Business Judgment Test?***

[17] The propriety of a decision to reject an executory contract is governed by the business judgment standard. *See Group of Institutional Investors v. Chicago, Milwaukee, St. Paul, and Pacific R. Co.,* 318 U.S. 523, 550, 63 S.Ct. 727, 87 L.Ed. 959 (1943); *HQ Global Holdings,* 290 B.R. at 511; *In re Trans World Airlines, Inc.,* 261 B.R. 103, 120–121 (Bankr.D.Del.2001); *Wheeling–Pittsburgh Steel Corp. v. West Penn Power Co. (In re Wheeling–Pittsburgh Steel Corp.),* 72 B.R. 845, 845–846 (Bankr.W.D.Pa.1987).

[18] A court is required to examine whether a reasonable business person would make a similar decision under similar circumstances. *See In re Vencor, Inc.,* 2003 WL 21026737, at *3, 2003 Bankr.LEXIS 659, at *8 (Bankr.D.Del. April 30, 2003). This is not a difficult standard to satisfy and requires only a showing that rejection will benefit the estate. *See Sharon Steel,* 872 F.2d at 39–40; *HQ Global Holdings,* 290 B.R. at 511; *In re Patterson,* 119 B.R. 59, 60 (E.D.Pa.1990); *Wheeling–Pittsburgh,* 72 B.R. at 846. [23]

A. *Exide's Decision–Making Process.*

[19] Exide claims that its decision to reject the Agreement was the result of a ***240** deliberative and thoughtful process. EnerSys contends, however, that Exide's decision-making was insufficient to satisfy the business judgment standard. The Court must not substitute its own judgment for that of Exide's. *See Vencor,* 2003 WL 21026737, at *3, 2003 Bankr.LEXIS 659, at *8.

[20] Exide's chairman and CEO, Craig Muhlhauser, testified that it was his decision, ultimately, to reject the Agreement and he did so based upon the advice of his management team and his own business judgment. [24] *See* 3/4/04 Tr. 22:14–19. Muhlhauser testified that having unrestricted use of the Exide mark was necessary to achieve the goal of unifying Exide and, therefore, he believed the Agreement should be rejected. *See* 3/4/04 Tr. 22:23–23:6. Muhlhauser and other Exide officials believed Exide needed to "unify" so that it could compete effectively in the marketplace. *See* 3/3/04 Tr. 78:15–84:3, 179:5–16; 3/4/04 Tr. 35:17–36:22, 161:15–162:6, 175:14–176:13.

Furthermore, there was considerable testimony from members of Muhlhauser's management team (upon whom Muhlhauser relied) concerning Exide's pre-bankruptcy efforts in attempting to develop a strong, unified corporate name, unify its products under a common brand, and decrease confusion in the marketplace. *See* 3/3/04 Tr. 85:4–110:22, 180:1–10. In Exide's view, critical to achieving these goals was getting the Exide mark back. *See* 3/3/04 Tr. 92:8–24, 98:23–102:7; 3/4/04 Tr. 23:1–6, 173:24–175:17. Exide officers approached EnerSys several times to discuss ways of returning the Exide mark to Exide. *See* 3/3/04 Tr. 98:23–99:11, 106:23–107:6; 3/12/04 Tr. 133:18–134:19. Based upon these longsought-after goals, Exide seeks to reject the Agreement. *See* 3/3/04 Tr. 116:14–18, 180:18–184:12.

The evidence reveals that Exide spent considerable time and effort in studying its business operations, customer relations, competitive positioning and its general needs in formulating its strategic goal. Exide undertook additional analyses concerning its decision to reject. These sales forecasts (contained in Exide exhibits 155, 156 and 157) (the "Forecasts") assessed the expected impact on Exide's business of this Court's decision to approve rejection. *See* 3/3/04 Tr. 110:23–111:4; 185:1–186:1. That these Forecasts were undertaken demonstrate Exide's efforts at reviewing its rejection decision. [25]

Based upon the foregoing, I conclude that Exide undertook appropriate steps in reaching its decision to reject the Agreement. [26] Exide's decision took into account ***241** the potential benefits, as well as the harms, in rejecting the Agreement.

B. *Impact of Rejection on the Estate.*

1. Qualitative Benefits of Rejection

EnerSys contends that Exide failed to demonstrate that the estate will benefit from rejection. Exide responds that rejecting the Agreement will result in both qualitative and quantitative benefits to the estate. Under the circumstances present, I conclude that the qualitative benefits alone, namely, brand unification and elimination of confusion in the marketplace, are sufficient to support the Debtor's decision to reject.

The evidence submitted by Exide demonstrates that brand unification will likely make Exide more competitive. Neil Bright, President of the Industrial Energy Business Unit of Exide, testified that the lack of brand unification has hurt Exide's customer relations and made Exide less competitive because of the increased costs that Exide's customers incur as a result of dealing with different battery brands. *See* 3/3/04 Tr. 78:15–79:6, 100:21–101:8, 108:12–109:9. Reducing Exide's customers' costs would certainly improve its current customer relations and may even increase its customer base.

Furthermore, Bright indicated that Exide risks losing market share because it is unable to "present a unified face [for all of its brands] in front of the customer." *See* 3/3/04

Tr. 79:1–6. In this sense, Exide's ***242** customers are having trouble making the connection that the different brands Exide is using are actually associated with Exide. *See* 3/3/04 Tr. 75:9–76:10; 3/4/04 Tr. 172:12–20. This problem is two-fold: (1) customers may not use products that they do not believe are associated with Exide and (2) customers do not believe that Exide has global capabilities (because Exide appears to be a fractured company) which, according to Exide, is what customers want. *See* 3/3/04 Tr. 96:14–97:3, 100:21–101:8, 177:5–8; 3/12/04 Tr. 90:4–9. Indeed, one of EnerSys's own witnesses testified that EnerSys had lost market share because of a lack of focus on a single brand. *See* 3/12/04 Tr. 89:8–22. By unifying the brand, Exide expects to diminish these problems and become more competitive. Thus, an increase in Exide's competitive advantage is a benefit to the estate.

Eliminating confusion in the marketplace with respect to the Exide mark will also benefit the estate.[27] Both Mitchell Bregman, the President of Exide Industrial Energy Americas Business, and Bruce Cole, the Vice President of Marketing for the Industrial Energy Business Unit, testified that Exide is continually having to explain to its customers that it does not produce industrial batteries that contain the Exide mark even though it is Exide. *See* 3/3/04 Tr. 181:17–182–16; 3/4/04 Tr. 170:5–24. Exide's customers do not understand why an industrial battery that contains the Exide mark is not manufactured by the company with the same name. *See* 3/3/04 Tr. 181:6–15. As a result of such confusion, Exide has devoted considerable efforts at trying to reduce the confusion and differentiate its products. *See* 3/3/04 Tr. 182:6–15; 3/4/04 Tr. 171:1–24. By eliminating the confusion over the Exide mark, Exide will no longer have to continue with its efforts to reduce confusion (and incur any of the costs associated therewith) and can freely exploit the Exide mark. Cole testified that confusion over the Exide mark frustrates customers. *See* 3/4/04 Tr. 172:23–173:12. Like brand unification, elimination of confusion will likely improve Exide's customer relations.[28]

2. Quantitative Benefits of Rejection

While the qualitative benefits alone justify rejection, the quantitative benefits of rejection further support Exide's decision to reject the Agreement.

Exide's evidence suggests that achieving brand unification will decrease some of Exide's operating costs. Bright testified that Exide currently uses a large number of brands on its industrial batteries and that maintaining all of these brands is expensive. *See* 3/3/04 Tr. 101:9–15. Having only one corporate brand to maintain would likely decrease Exide's expenses and any reduction in expenses is a benefit to the estate. *See, e.g., HQ Global Holdings,* 290 B.R. at 512 (holding that reduction in the debtor's advertising costs was a benefit to the estate). Likewise, Exide's expert witness, Scott Phillips, testified that brand unification would increase Exide's effectiveness and efficiency in its marketing efforts, which could also reduce Exide's costs. *See* 3/4/04 Tr. 134:14–135:8; 141:7–142:19.[29]

***243** The sales analyses conducted by Exide demonstrate that rejection will likely benefit the estate; Exide will realize an increase in sales revenue from rejection. Exide believes that the information contained in the Forecasts demonstrates that rejection would result in an increase in its sales revenue. While the exact amount of any increase in revenue may be undetermined—whatever the amount—the estate will benefit. Exide will be allowed to use the mark in a business in which it was previously prohibited from so doing, and, in combination with its own name. Bregman testified that Exide believes its sales will increase by combining the Exide mark with its corporate name. *See* 3/3/04 Tr. 183:7–12.

[21] **[22]** EnerSys argues that the Forecasts are inadmissible because much of the information contained therein (confidential material) has been redacted, thereby rendering such exhibits so unreliable as to be irrelevant. While significant portions of the analysis were redacted, perhaps diminishing the usefulness of the remaining information, the Forecasts still provide some useful information concerning the quantitative benefit of Exide's decision to reject the Agreement.[30] Questions concerning the reliability, accuracy or completeness of a document go to the weight of the evidence, not its admissibility. *See Greener v. The Cadle Co.,* 298 B.R. 82, 92 (N.D.Tex.2003). Based upon the foregoing, Exide Exhibits 155–157 are relevant.

[23] **[24]** EnerSys claims that the Forecasts, even if relevant, are inadmissible because they do not meet the requirements of the business records exception to the hearsay rule.[31] Here, the testimonies of Bright and Cole establish that Exide employees prepared the Forecasts

contained in exhibits 155–157 based upon Exide's own internal data. *See* 3/3/04 Tr. 111:19–112:8; 3/4/04 Tr. 184:25–201:1. Second, it appears that the information contained in the Forecasts was recorded at or near a time it was obtained. Third, both Bright and Cole testified that it was a routine practice for Exide to conduct such type of analyses. *See* 3/3/04 Tr. 112:17–112:21; 3/4/04 Tr. 186:8–186:17. Finally, Bright testified credibly that the information obtained from conducting analyses, ***244** such as the ones contained in the Forecasts, to be reliable. *See* 3/3/04 Tr. 112:22–115:8. EnerSys argues that the Forecasts were neither the product of a regularly conducted business activity nor regularly kept in the ordinary course of business; the Forecasts were created solely for the purposes of the present litigation. Documents created expressly for the purpose of litigation do not fall within the business records exception because they lack the requisite indicia of reliability and trustworthiness that are necessary for the business records exception to apply. *See Palmer v. Hoffman,* 318 U.S. 109, 114, 63 S.Ct. 477, 87 L.Ed. 645 (1943), *reh'g denied* 318 U.S. 800, 63 S.Ct. 757, 87 L.Ed. 1163 (1943); *United States v. Casoni,* 950 F.2d 893, 910–911 (3d Cir.1991); *Certain Underwriters at Lloyd's, London v. Sinkovich,* 232 F.3d 200, 205 (4th Cir.2000).

The Forecasts are a part of Exide's continual decision-making efforts concerning the proposed rejection. Obviously, it was important for Exide to conduct the analyses to quantify, as best it could, the effect of its decision to reject the Agreement and determine whether its decision to reject was appropriate.

EnerSys also contends that the testimonies of Bright and Cole concerning these exhibits and the analyses contained therein should be stricken from the record because they lack foundation. EnerSys argues that Bright and Cole did not perform any of the calculations or Forecasts contained in the exhibits and otherwise have no firsthand knowledge about them.

[25] **[26]** Rule 803(6) of the Federal Rules of Evidence does not require that foundation evidence for the admission of business records be provided by the actual custodian of the records. *See United States v. Console,* 13 F.3d 641, 656–657 (3d Cir.1993); *United States v. Pelullo,* 964 F.2d 193, 201 (3d Cir.1992). Rather, "other qualified witnesses" are permitted to lay a foundation and those whom may fall within this rubric is broad. *See Console,* 13 F.3d at 657; *Pelullo,* 964 F.2d at 201. Indeed, a qualified witness need only have a familiarity with a business' record-keeping practices and be able to attest that:

> (1) the declarant in the records had personal knowledge to make accurate statements; (2) the declarant recorded the statements contemporaneously with the actions that were the subject of the reports; (3) the declarant made the record in the regular course of the business activity; and (4) such records were regularly kept by the business.

See Console, 13 F.3d at 657; *Pelullo,* 964 F.2d at 201.

Based upon the record, Bright and Cole are both "other qualified witnesses" who are permitted to lay a foundation for the admission of Exide exhibits 155–157 as business records. Bright testified generally about the electronic data warehouse system ("the System") Exide used in gathering the information for the analyses contained in the exhibits, the purpose of System, how Exide uses the System, and the System's usefulness in his decision-making process. *See* 3/3/04 110:23–115:8. Cole further expounded upon the use and purpose the System, the origin of the data in the exhibits, the rationale of the analyses performed, and who prepared the analyses set forth in the exhibits. *See* 3/4/04 Tr. 184:25–201:1, 241:10–241:15. It is apparent from the record that Bright and Cole have sufficient personal knowledge of the System used to prepare the analyses contained in Exide exhibits 155–157, as well as the persons who prepared them; consequently, Bright and Cole may provide by their testimony the foundational requirements for the admission of business records. ***245** [32] *See, e.g., United States v. Console,* 13 F.3d at 657 (the witnesses familiarity with the office record-keeping system enabled her to attest to each of the foundation requirements for the admission of an Accident Book as a business record). Exide exhibits 155–157 are relevant and admissible under the business records exception. Accordingly, EnerSys's objection is overruled and such exhibits will be considered by the Court.

In sum, the evidence demonstrates that there will be both qualitative and quantitative benefits to the estate from the rejection of the Agreement. I now consider whether EnerSys's potential rejection damage claim outweighs these benefits.

3. Rejection Damages

EnerSys argues that rejection of the Agreement will result in such a large rejection damage claim that it will outweigh any of the potential benefits identified by Exide. Exide contends that EnerSys has exaggerated its potential rejection damage claim because, *inter alia,* EnerSys did not take into account any mitigation of damages in calculating its rejection damages. Both parties relied upon expert testimony concerning the potential impact of rejection on EnerSys and both seek to discredit the testimony of each other's experts.

[27] [28] [29] The impact of EnerSys's potential rejection damage claim on the estate is relevant in determining the appropriateness of Exide's decision to reject.[33] *See, e.g., Vencor,* 2003 WL 21026737, at *3, 2003 Bankr.LEXIS 659, at *8–9 (holding that it was appropriate to consider the avoidance of a large rejection damage claim); *In re Sun City Invs., Inc.,* 89 B.R. 245, 249 (Bankr.M.D.Fla.1988) (denying the debtor's motion to reject a contract because rejection would create a large claim against the estate, which would not be in the estate's best interest). In reviewing the impact of a rejection damage claim, I not need determine the exact amount of EnerSys's rejection damage claim.[34] Rather, I need only determine if the rejection claim would be so large as to make Exide's decision to reject the Agreement unreasonable.

EnerSys claims that it will suffer more than $67 million in damages as a result of rejection.[35] In support of such claim, EnerSys ***246** presented two expert witnesses, Dr. Warren Keegan (marketing and branding expert) and Brian Blonder (valuation expert). Keegan's opinion pertained to his survey of the motive power battery industry, which survey measured the impact of rejection on the Exide brand and on Exide's marketing communications. Blonder's opinion concerned the effect of rejection, primarily focusing on the amount of damages EnerSys would incur as a result.

Exide contends that the testimony of Keegan and Blonder should be disregarded because they are wholly unreliable and incredible; however, Exide's objections go to the weight to be accorded such testimony, not its admissibility.[36] In considering the appropriate weight to accord each witness, a court may accept all of a witness' testimony, reject all of it, or accept some and reject other parts depending upon the credibility of the witness. *See Bennun v. Rutgers State Univ.,* 941 F.2d 154, 179 (3d Cir.1991), *reh'g denied* 941 F.2d 154 (3d Cir.1991), *cert. denied* 502 U.S. 1066, 112 S.Ct. 956, 117 L.Ed.2d 124 (1992).

Keegan concluded that rejection will harm EnerSys because of marketplace confusion (*see* 3/12/04 Tr. 248:5–253:9); however, the imposition of a transition period will likely reduce, if not eliminate, such confusion. As such, Keegan's survey evidence does little to convince me that EnerSys will likely suffer the magnitude of damages asserted as a result of rejection, especially if measures are put into place that will mitigate marketplace confusion.

Blonder testified that his $67 million damage assessment would remain essentially unaffected by any change in the assumptions or conditions he relied upon in formulating his opinion. *See* 3/26/04 Tr. 87:13–90:2, 109:19–114:19. This position simply undermines Blonder's credibility, particularly when he opines that the damage claim would be unaffected by a transition period. If mitigation efforts, over time, are taken into account, EnerSys's rejection damage claim will likely be far less than $67 million.[37]

While the magnitude of possible damage to EnerSys as a result of rejection remains ***247** undetermined, it is evident that EnerSys will not incur the magnitude of damages it claims or an amount even close to that figure. EnerSys's claim for damages is speculative at best. I conclude, based upon this record, and for purposes of the proposed rejection, that EnerSys's eventual unsecured damage claim will be substantially less than $67 million.

Even if EnerSys's $67 million claim were to be allowed, it will not have as large an impact on the estate as EnerSys suggests. That dollar amount, although large in absolute terms, must be compared to the approximately $900 million of unsecured claims filed in this case. *See* 3/31/04 Tr. 28:1–2. When viewed in a proper perspective, an additional $67 million will not diminish the dividend to unsecured creditors sufficiently to render Exide's decision to reject unreasonable.[38]

The most dramatic indication that rejection is in the best interests of creditors comes from the position taken by the unsecured creditors themselves. After close of the evidence, the Official Committee of Unsecured Creditors

(the "Committee") filed a post-hearing statement (Docket No. 4202) fully supporting Exide's Motion to reject the Agreements.

In its Statement, the Committee says, *inter alia:*

> ....
>
> ...general unsecured creditors would bear 100% of the rejection damages claims, but would own only 10% of the common stock of the reorganized Debtors plus warrants. Therefore, the burden and benefit of rejecting the Trademark License would have a disproportionate impact on general unsecured creditors. Each of the existing general unsecured creditors would be impacted by double dilution: (a) a diluted benefit because of the minority position in the reorganized Debtors' equity and (b) a diluted share of that minority position as a result of an increase in the aggregate amount of general unsecured claims once EnerSys's rejection damages are included. As such, the Debtors' decision to reject the Trademark License should be judged based on its impact upon general unsecured creditors because they are most directly and adversely affected. *See, e.g., In re Klein Sleep Products, Inc.,* 78 F.3d 18, 25 (2d Cir.1996) (judging rejection of executory contract using best interests of unsecured creditors); *In re Kong,* 162 B.R. 86, 96 (Bankr.E.D.N.Y.1993) ("Central to this showing 'is the extent to which a rejection will benefit the general unsecured creditors of the estate.' ").
>
> 4. The Committee is persuaded that rejecting the Trademark License provides a net benefit to general unsecured creditors even after accounting for the double dilution effects described above. This conclusion is based on EnerSys's failure to demonstrate that rejection of Executory License would result in the $65 million rejection damages claimed by EnerSys. EnerSys bears the burden of proof with respect to the size of its damages, but the Committee is not persuaded by EnerSys's supporting evidence. EnerSys's estimates of its damages are excessive, are unrealistic, and, most significantly, exclude EnerSys's legal obligation to mitigate its damages. Such mitigation is straightforward since Exide is offering EnerSys a transition plan whereby EnerSys can reduce its potential damages significantly. Therefore, the Committee is convinced that ***248** EnerSys's allowable claim against the Debtors' estates would be very small, especially since, among other things, the Debtors would be willing to accept a transition plan that is intentionally designed to minimize the loss of EnerSys's sales.
>
> ...Therefore, by authorizing and approving a transition plan as part of its ruling on the rejection of the Trademark License, the Bankruptcy Court would fulfill Congress' desire that bankruptcy courts use their equitable powers to provide appropriate remedies when trademark licenses are rejected by debtors.

Statement, ¶¶ 3–5.

[30] It is particularly appropriate here to give substantial weight to the views of the general unsecured creditors, the *only* constituents (besides EnerSys) in this chapter 11 proceeding who would suffer any ill effects of rejection. [39] This support is a significant factor weighing in favor of permitting rejection. *See Wheeling–Pittsburgh Steel,* 72 B.R. at 850 (in upholding the debtor's decision to reject, the court noted that "quite significantly, the official committee of unsecured creditors, which has been very active in this case, supports the debtor's decision to reject the Contract. It cannot be supposed that the committee of unsecured creditors, which is duty bound to act in the best interests of unsecured creditors, would support a decision which is inimical to the best interests of the debtor's estate and unsecured creditors").

The impact of EnerSys's rejection damage claim against the estate will not be so large that it would cause a reasonable business person not to reject the Agreement.

4. Reversion of the Exide Mark

EnerSys contends that the rejection of the Agreement will not result in a benefit to the estate because, upon rejection, Exide will not have the exclusive right to use the Exide trademark. EnerSys's argument is two-fold. First, EnerSys claims that title to the Exide mark (for use on industrial batteries) already passed to EnerSys in June 1991, when the parties entered into the Agreement. As such, rejection has no effect on EnerSys's right to use the mark. Second, EnerSys claims that rejection of the Agreement does not result in its termination and, therefore, EnerSys retains its right to use the Exide mark. Both arguments lack merit.

a. *Title to the Exide Mark.*

EnerSys's argument concerning the transfer of title to the Exide mark is an offshoot of its argument that the

Agreement was a "closed sale" transaction. However, for the reasons already discussed herein, with respect to the Exide Mark, the Agreement is not a sale, but a license.

As previously noted, the Agreement identifies which marks were assigned to EnerSys (*see* paragraph and schedule 9.1 of the Asset Purchase Agreement) and which marks were licensed to EnerSys (*see* paragraph and schedule 9.5 of the Asset Purchase Agreement). The Exide mark is listed in the category of those marks that were licensed to EnerSys. And with respect to those marks that were licensed to EnerSys, including the Exide mark, paragraph ***249** 9 of the Trademark License provides, in relevant part, that:

> [l]icensee shall acquire no right, title or interest with respect to the Licensed Marks or the Licensed Trade Name as a result of Licensee's use thereof in commerce or otherwise and Licensee acknowledges and agrees that all rights in and to the Licensed Marks and the Licensed Trade Name and the good will pertaining thereto belong exclusively to, and shall inure to the benefit of, Licensor.

Thus, there was never a transfer of ownership in the Exide mark. Rather, title to the Exide mark remained with Exide.

b. *Termination Upon Rejection.*

[31] EnerSys has pointed to authority for the proposition that rejection does not terminate an executory contract (*see Lavigne,* 114 F.3d at 387; *Columbia Gas,* 50 F.3d at 239 n. 8); however, none of the authority cited in support of such proposition involved trademark licenses. Rather, there is authority directly contradicting this proposition in the context of the rejection of trademark licenses. *See, e.g., HQ Global Holdings,* 290 B.R. at 513 (holding that rejection terminates a trademark license); *Raima UK Ltd. v. Centura Software Corp. (In re Centura Software Corp.),* 281 B.R. 660, 673–674 (Bankr.N.D.Cal.2002) (holding that rejection terminates a trademark license). In its trial brief, EnerSys argues that the decisions in *HQ Global Holdings* and *Centura Software* are flawed because their holdings are not reconciled with cases that hold that rejection does not equate to a termination of an executory contract. The unique nature of intellectual property licenses requires different treatment than non-intellectual property-related contracts upon rejection.

Moreover, Bankruptcy Code § 365(n) does not provide EnerSys with any protection from the consequences of rejection. Section 365(n)(1) provides that, upon rejection of an executory contract in which the debtor is a licensor of intellectual property, a licensee may elect either:

> (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or
>
> (B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced ...

11 U.S.C. § 365(n).

The term "intellectual property", as used in § 365(n), is defined as a:

> (A) trade secret; (B) invention, process, design, or plant protected under title 35; (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.

11 U.S.C. § 101(35A). It is clear from the plain language of this definition that trademarks are excluded. *See HQ Global Holdings,* 290 B.R. at 513 (finding that trade names, trademarks and other proprietary marks are not included within the definition of intellectual property). *See also Centura Software,* 281 B.R. at 669–670 ***250** (noting that "Congress has ... expressly withheld § 365[n] protection from rejected executory trademark licenses"). Thus, trademark licensees, such as EnerSys, cannot use §

365(n) to elect to retain their rights to use a mark after rejection. [40]

Various decisions support the view that Exide is excused from its contractual obligations under the Agreement, including its obligation to allow EnerSys to use the Exide mark. *See Lavigne,* 114 F.3d at 387 (noting that rejection frees the estate from its obligation to perform); *HQ Global Holdings,* 290 B.R. at 513 ("[t]he result of the [d]ebtors' rejection of the [a]greements is that they are relieved from the obligation to allow the [f]ranchisees to use their proprietary marks"). Rejection of the Agreement leaves EnerSys without the right to use the Exide mark. *Id.; Centura Software,* 281 B.R. at 674–675 (holding that licensee is not entitled to retain any rights in the trademarks as a result of the rejection of the trademark agreement); *Blackstone Potato Chip,* 109 B.R. at 562 (approving the debtor's motion to reject a license agreement and ordering the return of trademarks and trade names to the debtor); *see also Chipwich,* 54 B.R. at 431 (holding that upon rejection of the trademark licenses, the licensee only has a claim for damages).

The primary benefit to rejecting a trademark license is reacquiring the right to use the mark in whatever capacity or market in which use by the licensor was previously excluded and extinguishing the licensee's right to use it. Taken to its logical end, EnerSys' argument that a licensee's right to use a trademark does not revert back to the licensor upon rejection means that a rejection of a trademark license would never offer meaningful relief to the debtor. This would be an absurd result. Under these circumstances, Exide's obligation to allow EnerSys to use the Exide mark is extinguished upon rejection.

IV. *Transition Period*

Since the exclusive use of the Exide mark in connection with industrial battery market will revert back to Exide, it is appropriate to fashion a transition period to mitigate any potential damage and business disruption that EnerSys may suffer as a result of losing the Exide mark. Other courts have utilized transition periods in connection with the rejection of an executory contract or unexpired lease. *See, e.g., HQ Global Holdings,* 290 B.R. at 514 (allowing for a 30–day transition period to phase out the franchisees' use of a proprietary mark); *In re Texas Health Enters., Inc.,* 255 B.R. 185, 189 (Bankr.E.D.Tex.2000) (approving a transition plan for the turnover of a nursing home after the rejection of the lease for the same). [41]

***251**

Exide proposes a two-year transition period based on the termination provision in the Trademark License that calls for a "reasonable period not to exceed two (2) years" for discontinuing EnerSys's use of the mark. [42] EnerSys suggests a five-year transition period. Given that the parties have already agreed upon a maximum two-year time frame, I conclude that two years from the date of this decision is an appropriate transition period and I will so order. [43]

An appropriate Order follows.

ORDER

AND NOW, this 3rd day of April, 2006, upon consideration of the Exide's Motion to Reject (Docket Nos. 1614, 1615, 1617 and 1618), the opposition of EnerSys, Inc. thereto after hearing thereon and for the reasons set forth in the accompanying Opinion, it is hereby **ORDERED AND DECREED** that:

1. The Motion to Reject is GRANTED;

2. EnerSys shall have two years from the date hereof to discontinue any use of the Exide mark (as described in the accompanying Memorandum);

3. EnerSys, Inc. Shall have thirty days from the date of this Order to file its rejection damage claim;

4. A hearing will be held on **April 27, 2006 at 10:00 A.M.** in Bankruptcy Courtroom No. 5, 824 Market Street, Fifth Floor, Wilmington, Delaware to consider whether the Court should impose a transition plan, and if so, what the terms of such a plan should be; and

5. The parties shall have until **April 24, 2006** to file and serve position papers with ***252** respect to any further relief to be ordered by the Court.

All Citations

340 B.R. 222, 46 Bankr.Ct.Dec. 95

Footnotes

1 This Opinion constitutes the findings of fact and conclusions of law required by FED.R.BANKR.P. 7052. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157(a). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(1) and (b)(2)(A) and (O).

2 Upon the Debtor's motion (Docket No. 17), the Court entered an Order (by my predecessor in this case, The Honorable John C. Ackerd) (Docket No. 62) establishing a procedure for rejection of executory contracts, pursuant to which Exide now has filed the four Notices of Rejection (Docket Nos. 1614, 1615, 1617 and 1618). For ease of reference, these Notices will be referred to collectively as Exide's "Motion" or "Motion to Reject."

At the time Exide entered into the agreements with EnerSys, Exide's name was Exide Corporation. However, after it merged with GNB Technologies, Inc. in 2000, Exide changed its name to Exide Technologies. EnerSys was known as Yuasa Battery (America), Inc. at the time the agreements were executed. Sometime afterward, Yuasa Battery (America), Inc. changed its name to Yuasa–Exide, Inc. and merged with Yuasa, Inc. in 1998. Yuasa, Inc. survived the merger and in 2000 changed its name to EnerSys. For the purposes of this Opinion, the terms Exide and EnerSys will include their predecessors when applicable.

3 Exide also sought to reject two other agreements, (I) the Administrative Services Agreement dated April 1, 1992, and (ii) the Miscellaneous Services Agreement dated April 1, 1992. Enersys did not oppose Exide's rejection of the Miscellaneous Services Agreement and withdrew its objection to rejection of the 1992 Administrative Services Agreement. EnerSys asserts that neither of these two agreements remain in effect and that neither is related to the 1991 transaction. EnerSys Trial Brief at 3, n. 3.

4 For purposes of this Opinion, reference to the "Exide mark" includes those marks licensed to Enersys under the Agreement, as well as the trade name "Exide".

5 EnerSys's President and CEO, Mr. John Craig, described poignantly the tenor of this dispute when he testified that "Exide ... is trying to ... steal back the [Exide] trademark and I don't think that is fair." *See* 3/12/04 Tr. 176:1–4.

6 11 U.S.C. § 365(a) provides:

> [e]xcept as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

7 Exide argues that EnerSys is precluded from making this argument because EnerSys failed to identify it in response to Exide's contention interrogatories or at any time prior to its closing argument. Insofar as EnerSys failed to identify this argument until closing arguments, EnerSys waived its right to assert the same. *See, e.g., Thorn EMI N. America, Inc. v. Intel Corp.,* 936 F.Supp. 1186, 1191 (D.Del.1996), *aff'd,* 157 F.3d 887 (Fed.Cir.1998), *cert. denied* 526 U.S. 1112, 119 S.Ct. 1756, 143 L.Ed.2d 788 (1999) (holding that party is prevented from raising a claim or defense that was not adequately described in a response to a contention interrogatory or joint pre-trial order); *CPC Int'l, Inc. v. Archer Daniels Midland Co.,* 831 F.Supp. 1091, 1102–1103 (D.Del.1993), *aff'd* 31 F.3d 1176 (Fed.Cir.1994), *cert. denied* 513 U.S. 1184, 115 S.Ct. 1176, 130 L.Ed.2d 1129 (1995) (finding that ADM waived the right to assert certain matters as defenses to CPC's claims of infringement by failing to identify them in response to CPC's interrogatories and by failing to include them in the draft pretrial order). Even were I to consider EnerSys's argument, the argument fails.

8 Licensed Business refers to the industrial battery business (*see* paragraphs 1[A] and [B] of the Trademark License).

9 *See* section II.A.3. of this Opinion, *infra.*

10 "A promise is 'a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made.' " *Merritt Hill Vineyards, Inc. v. Windy Heights Vineyard, Inc.,* 61 N.Y.2d 106, 112, 472 N.Y.S.2d 592, 460 N.E.2d 1077 (1984) quoting Restatement (Second) of Contracts § 2(1) (1981). "A condition, by comparison, is 'an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due.' " *Id.,* at 112, 472 N.Y.S.2d 592, 460 N.E.2d 1077 quoting Restatement (Second) of Contracts § 224 (1981).

11 Exide had established quality standards prior to the execution of the Agreement. *See* 3/3/04 Tr. 69:20–71:18.

12 The level of control required depends upon the particular circumstances of each case. *See United States Jaycees v. Philadelphia Jaycees,* 639 F.2d 134, 140 (3d Cir., 1981). *Cf. Creative Gifts, Inc. v. UFO,* 235 F.3d 540, 548 (10th Cir., 2000) (holding that a licensee is estopped from arguing that the licensor lost its rights in its mark because the licensor did not exercise adequate quality control over licensee's use of the mark).

13 Exide also has an ongoing duty to refrain from suing EnerSys for infringement of the mark. *See Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.),* 89 F.3d 673, 677 (9th Cir.1996); *Novon Int'l,* 2000 WL 432848, at *4, 2000 U.S. Dist. LEXIS 5169, at *12; *Access Beyond Technologies,* 237 B.R. at 43. This is important since a "licensor's promise to refrain

from suing the licensee for infringement is the raison d'etre for a [trademark] license." *Id.* A default by Exide in performing this duty would cause a material breach since EnerSys would no longer be getting the benefit of its bargain, i.e., the use of the mark. Thus, the Use Grant is a material obligation.

14 Exide also argues that the extensive negotiations surrounding the terms of the Trademark License evidences the materiality of EnerSys's Use Restriction and the Quality Standard. In support of this argument, Exide sought to introduce certain exhibits (Exide exhibits. 27, 28, 29, 30, 31 and 32) relating to the negotiations of the Agreement and prior drafts of the Agreement. EnerSys objected to the admission of Exide exhibits 27–32 on the grounds that such documents violated the parol evidence rule.

According to New York law, "where the parties have reduced their agreement to an integrated writing, the parol evidence rule operates to exclude evidence of all prior or contemporaneous negotiations between the parties offered to contradict or modify the terms of their writing." *Marine Midland Bank–Southern v. Thurlow,* 53 N.Y.2d 381, 387, 442 N.Y.S.2d 417, 425 N.E.2d 805 (1981); *see Holland v. Ryan,* 307 A.D.2d 723, 724[, 762 N.Y.S.2d 740] (N.Y.App.Div. 4th Dept.2003); *see also In re Worldcorp [WorldCorp], Inc.,* 252 B.R. 890, 895 (Bankr.D.Del.2000).

I have already concluded that the Agreement was a fully integrated, unambiguous document. Thus, the parol evidence rule is applicable. *See Marine Midland Bank[–Southern],* 53 N.Y.2d at 387[, 442 N.Y.S.2d 417, 425 N.E.2d 805]; *see, e.g., Fr. Winkler KG v. Stoller,* 839 F.2d 1002, 1005 (3d Cir.1988) (noting that before the parol evidence rule can be applied, there must be a determination as to whether the parties have adopted a writing as the final and complete expression of their agreement).

However, Exide offers exhibits 27–32 only to demonstrate the materiality or importance of the provisions of the Trademark License. Such evidence is not barred by the parol evidence rule. *See, e.g., Chevron U.S.A. Inc. v. El–Khoury,* 285 F.3d 1159, 1165 (9th Cir.2002), *amended by, reh'g denied* No. 00–57126, 2002 U.S.App. LEXIS 9128 (9th Cir. May 14, 2002) (holding that the parol evidence rule does not bar the consideration of earlier draft agreements for purposes of demonstrating the parties' intent with respect to the importance of the terms in the agreement). Exide Exhibits 27–32 were not offered for the purpose of varying, contradicting or interpreting the terms of the Agreement.

15 EnerSys complains that Exide should be precluded from arguing that the Pension Plan Obligations demonstrate that the Agreement is executory because in its response to EnerSys's first set of interrogatories, Exide failed to identify pension plan contributions under paragraph 7.2 of the Asset Purchase Agreement (dealing with Defined *Benefit* Plans). In its response to EnerSys's interrogatories, Exide instead identified paragraph 7.3 of the Asset Purchase Agreement (dealing with Defined *Contribution* Plans) as a remaining material obligation under the Agreement. In addition, EnerSys claims that Exide did not present any evidence at trial concerning contributions made pursuant to paragraph 7.3 of the Asset Purchase Agreement.

Although Exide may have identified erroneously the applicable benefit plan in its interrogatory response, I will not preclude use of the correct benefit plan and Exide's obligations in connection therewith. Exide supported its claim concerning its pension plan obligations from evidence that was introduced at hearing. EnerSys had ample opportunity then to challenge such evidence.

16 EnerSys acknowledged this much in its post-trial submissions. *See also* footnote 17, *infra.*

17 EnerSys acknowledged in its post-trial submissions that if Exide failed to honor its obligations to contribute to the pension plans, it could seek indemnification from Exide for claims made by employees.

18 Article IX of the Asset Purchase Agreement deals with intellectual property-related matters, including assignment and licensing.

19 *See* section III.B.4.a of this Opinion, *infra.*

20 EnerSys must seek Exide's consent to transfer or sublicense the Exide mark. *See Kmart Corp.,* 290 B.R. at 618 (finding that the licensee's duty to seek consent of the licensor to transfer the licensed material is an ongoing requirement of the licensee under the license agreement).

21 EnerSys complains that the license could not be structured as a sale because Exide also continued use of the mark for itself. This required that the transaction be structured as a license, under the express terms of which the license to be was "perpetual." A non-debtor party's expectation that its transaction will not later be unwound in bankruptcy is common, but not dispositive under § 365.

22 EnerSys attempts to distinguish those cases finding a trademark license to be an executory contract on the grounds that: (1) the licenses did not involve an integrated contract for the sale of a business, (2) the licenses involved continuing royalty obligations, or (3) there were cross-licenses. EnerSys's argument on all three grounds misses the point. First, that the Agreement is integrated is not dispositive. The issue of whether a number of agreements are integrated is separate from whether an integrated agreement is executory. *See Blackstone Potato Chip,* 109 B.R. at 560 (The court, considering

a license agreement along with a number of side agreements, determined the integrated agreement was an executory contract). Second, that there may be no continuing royalty obligations or cross-licenses here is not dispositive, either. The relevant issue is whether any material obligations remain under the Agreement. So long as there are any material, ongoing obligations, a license may be an executory contract.

23 As a leading bankruptcy treatise explained:

> [i]n the nonbankruptcy corporate law context, the business judgment rule is typically invoked after-the fact, when an allegedly improvident management decision has already been made and put into effect. In those cases, the courts concern themselves with the process by which the decision was made, not the wisdom or consequences of a decision that in retrospect turned out to be wrong. In contrast, in chapter 11, the business judgment rule is often invoked before-the-fact, when a trustee or debtor in possession proposes to undertake a transaction that is, or alleged to be, outside the ordinary course of business, or one that by statute requires court authorization, such as the assumption or rejection of an executory contract. In these cases, the courts are, understandably, not only concerned with the process by which the decisions were made, but also with the effect the business decision will have on the estate and the chapter 11 process.

7 Lawrence P. King, Collier on Bankruptcy, ¶ 1108.07[2], at 1108–16 (15th ed. revised 2003).

24 Although the decision to reject was discussed with Exide's board, it does not appear that their express approval was sought. *See* 3/4/04 Tr. 29:23–25, 33:5–14.

25 EnerSys claims that the Forecasts are inadmissible because they are irrelevant and are based on hearsay. This argument lacks merit. *See* section III.B.1 of this Opinion, *infra.*

26 EnerSys offered exhibit 253, which was Exide's supplemental response to an interrogatory request, to demonstrate that Exide attempted belatedly to justify its decision to reject the Agreement. The exhibit concerned a meeting of Exide personnel at which confidential information was discussed. Exide objected to the exhibit's admission on the grounds that: (1) Exide did not rely on the information contained in the exhibit at trial, and (2) the parties expressly agreed that the information contained in the exhibit would not be part of the trial record, irrespective of which exhibit contained that information. Exide further claims that this Court endorsed this agreement between the parties. The information in EnerSys exhibit 253 apparently contains confidential information that Exide does not want disseminated to the public or, more importantly, shared with EnerSys.

> After reviewing the record, it does not appear that there was an agreement between the parties to exclude the information contained in EnerSys exhibit 253 from admission into evidence. If anything, the parties disagreed over the use and admissibility of the information contained therein. Indeed, Exide's counsel commented during trial that the parties were like "two ships passing in the night" with respect to the use of the information contained in EnerSys exhibit 253. *See* 3/3/04 Tr. 26:1. The agreement that Exide alludes to in its post-trial submissions appears to concern inadvertent disclosures of documents that the parties agreed not to use. *See* 3/3/04 Tr. 26:6–28:1.
>
> The fact that Exide did not rely upon the information contained in the exhibit at trial is irrelevant. Under Fed.R.Civ.P. 33, answers to interrogatories are admissible in evidence to the extent permitted by the Federal Rules of Evidence. FED.R.CIV.P. 33(c); *see, e.g., Kelly v. Crown Equip. Corp.,* No. 91–1143, [1991 WL 208771, at *5,] 1991 U.S. Dist. LEXIS 14452, at *12 (E.D.Pa. October 4, 1991). A verified response to an interrogatory request, such as that contained in EnerSys exhibit 253, may be admissible as an admission by a party opponent under Fed.R.Evid. 801(d)(2). *See, e.g., Tamez v. City of San Marcos,* 118 F.3d 1085, 1098 (5th Cir.1997), *cert. denied* 522 U.S. 1125, 118 S.Ct. 1073, 140 L.Ed.2d 132 (1998). Clearly, EnerSys exhibit 253 is admissible under Fed.R.Evid. 801(d)(2)(A), since it is being offered against Exide and is a statement made by Exide (in its representative capacity, of course). EnerSys exhibit 253 is admissible and Exide's objection is overruled.
>
> However, I recognize that the information contained in EnerSys exhibit 253 is confidential and that disclosure of the same may be inimical to Exide's competitive interests. Under appropriate circumstances, material introduced at trial may be safeguarded against disclosure afterwards. *Poliquin v. Garden Way, Inc.,* 989 F.2d 527, 533 (1st Cir.1993). *See also, e.g., Jochims v. Isuzu Motors, Ltd.,* 151 F.R.D. 338, 341–342 (S.D.Iowa 1993) (trial exhibits containing confidential technical and commercial information were to remain sealed from the public). At the request of the parties the entire record of this proceeding was ordered sealed. Certain witnesses, including some of the parties themselves, were excluded during certain testimony, resulting in various levels of confidentiality. It is appropriate to seal EnerSys exhibit 253 and any testimony relating thereto and make it available only to the Court and to counsel for the parties.

27 The evidence establishes that there was confusion in the marketplace concerning the Exide mark.

28 While the evidence suggests that Exide's post-bankruptcy marketing efforts may have contributed somewhat to the confusion in the marketplace, the confusion existed before such marketing efforts.

29 Phillips also testified that brand unification would permit Exide to pursue a variety of umbrella branding strategies. *See* 3/4/04 Tr. 134:14–135:8. Umbrella branding involves the use of a core brand in combination with other brand names or businesses. *See* 3/4/04 Tr. 135:14–136:1. According to Phillips, umbrella branding brings "greater focus and identity to the branding strategy of a company" and helps "create greater brand awareness, particularly in ... a global economy and where companies are increasingly dependent upon global customers." *See* 3/4/04 Tr. 136:2–9. However, Phillips conceded that umbrella strategies are not always appropriate, especially where there is a heightened need for local appeal. *See* 3/4/04 Tr. 152:16–152:13. While it is not entirely clear whether a global or regional branding strategy is better suited for the industrial battery industry, or the commercial power battery market in general, at least Exide will have the opportunity to exploit a global a strategy if it believes it is appropriate to do so. Having this option is a benefit to Exide.

30 Given that the parties are each other's main competitor and the information in the exhibits were confidential, it was necessary that Exide exhibits 155–157 contained redactions.

31 Exide seeks to admit exhibits 155–157 under the business record exception. Consequently, it does not appear that the parties dispute that Exide exhibits 155–157 are hearsay. EnerSys argues that the exhibits contain double hearsay in that Exide must not only establish that the exhibits themselves fall within the business records exception, but that the information from which the exhibits were created must also fall within one of the exceptions to the hearsay rule. The information contained in the exhibits was provided by Exide personnel (under a direction and duty to do so), rather than from any outside source, and was derived from Exide's own business data.

32 I concluded already that Exide exhibits 155–157 qualify as business records.

33 In determining the benefit to the estate, the burden or impact that rejection will have on a nondebtor party is not a factor to be considered in determining the propriety of a decision to reject. *See Trans World Airlines,* 261 B.R. at 123; *Patterson,* 119 B.R. at 61; *Wheeling–Pittsburgh Steel,* 72 B.R. at 847. In other words, there is no balancing of the interests of the estate against the interests of other parties to the contract being rejected. *See Trans World Airlines,* 261 B.R. at 123; *Wheeling–Pittsburgh Steel,* 72 B.R. at 848; *see also, Patterson,* 119 B.R. at 61; *see also Robertson v. Pierce (In re Chi–Feng Huang),* 23 B.R. 798, 801–802 (9th Cir. BAP 1982). Thus, any negative impact of rejection on EnerSys itself is irrelevant in determining the propriety of Exide's decision to reject the Agreement.

34 The determination of the amount of EnerSys's rejection damage claim is not now before this Court.

35 EnerSys's rejection damage claim breaks down as follows:

Harm to EnerSys if Rejection
Summary

Damage Element	*$ (In Millions)*
Lost Price Premium (Price Erosion)	$37
Incremental Cost—Switching to New Brand	$11
Lost Investment	$11
Lost Profit on Lost Sales	$12
Total Damages	$71
Present Value of Total Damages (as of 4/01/04)	$67

36 *See Kannankeril v. Terminix Int'l, Inc.,* 128 F.3d 802, 809 (3d Cir.1997).

37 Phillips' offered rebuttal testimony concerning the duration of harm in the lost advertising category of damages, set forth in Section VII of Blonder's expert report (entitled "Loss of Return on Historical Investment Brand"). EnerSys objected to this testimony on the ground that such testimony was precluded by a prior order of this Court. Specifically, this Court ordered Phillips to produce a certain advertising study upon which he was basing a portion of his opinion and, unless Phillips produced this study, Exide would be precluded from offering rebuttal testimony from Phillips relating to the duration of harm in Section VII of Blonder's expert report.

It is undisputed that Phillips never produced the advertising study. Further, Exide does not contest that Phillips is precluded from offering rebuttal testimony regarding the duration of harm in Section VII of Blonder's expert report because of Phillip's failure to produce the study. Thus, to the extent that Phillips rebuttal testimony relates to the duration of harm depicted in Section VII of Blonder's expert report, it is stricken from the record and will not be considered.

With regard to the remainder of Phillips' rebuttal testimony, EnerSys argues that it is flawed and without a credible basis. Phillips offered an analysis which calculated the fair value of the Exide mark to EnerSys. Phillips calculated the

amount of this value to be $8.4 million. *See* 3/26/04 Tr. 172:5–173:4. Phillips testified that the damage EnerSys would suffer as a result of rejection would bear some relationship to this value. *See* 3/26/04 Tr. 174:19–175:10. While this "fair market" analysis may provide some perspective concerning the amount of EnerSys's true rejection damages, it is not necessarily a complete measure of damages in this instance. This "fair market" approach fails to capture all of the damages that a licensee may incur as a result of losing a trademark, such as the costs of creating and establishing a new mark.

38 The Debtor argues that, under Exide's plan, unsecured creditors will receive approximately 20 to 22 cents on the dollar. *See* 3/31/04 Tr. 28:10–11.

39 The Committee and the Debtor were at bitter odds throughout nearly all of the pre-confirmation phase of this chapter 11. *See In re Exide Technologies,* 303 B.R. 48 (Bankr.D.Del., 2003). Although the plan ultimately confirmed was largely a consensual plan, I easily conclude that this is no committee which would willingly (or quietly) suffer any unnecessary harm at the hands of the Debtor.

40 EnerSys concedes that § 365(n) does not apply to trademark licenses, but argues that a negative inference should not be drawn from the fact that Congress granted protection to certain licensees in § 365(n) but not trademark licensees. I disagree.

Congress enacted § 365(n) in response to the Fourth Circuit's decision in *Richmond Metal Finishers. See HQ Global Holdings.,* 290 B.R. at 513 n. 5; *Centura Software,* 281 B.R. at 668. In *Richmond Metal Finishers,* the Fourth Circuit held that the licensee only had a claim for monetary damages under § 365(g) upon the debtor's rejection of a technology license. *Richmond Metal Finishers,* 756 F.2d at 1048. Rejection of the technology license agreement resulted in its termination and the licensee no longer had the right to use the technology. *Id.*

In enacting § 365(n), Congress sought to protect intellectual property licensees from such a result. Congress certainly could have included trademarks within the scope of § 365(n) but saw fit not to protect them. Therefore, the holding in *Richmond Metal Finishers,* as well as the holdings in the other pre and post § 365(n) trademark rejection cases cited herein, still retain vitality insofar as they relate to trademark licenses. As a result, a trademark license is terminated upon rejection and the licensee is left only with a claim for damages. *See HQ Global Holdings,* 290 B.R. at 513; *Centura Software,* 281 B.R. at 673.

41 The Court requested input in post-hearing submissions from both parties concerning the imposition of a transition period if rejection was approved. Section 105(a) of the Bankruptcy Code allows this Court to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code]." 11 U.S.C. § 105(a). This provision essentially codifies "the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships." *United States v. Energy Res. Co., Inc.,* 495 U.S. 545, 549, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990).

42 Paragraph 8 of the Trademark License provides, in relevant part, that:

> [u]pon termination of this Trademark License, Licensee and its sublicensees shall, within a reasonable period of time not to exceed two (2) years, discontinue all use of the Licensed Marks and Licensee shall discontinue all use of the Licensed Trade Name ....

43 Relying upon the terms of Trademark License to establish the two-year transition period is reasonable given the fact that both parties, who are highly sophisticated businesses, agreed upon such time-frame after much negotiation and, presumably, careful consideration in the course of their arm's-length transaction. Further, EnerSys does not provide any reason for following its suggested 5–year period or any other time period for that matter. Indeed, a transition period as long as the one suggested by EnerSys could actually be more harmful. The longer EnerSys continues to use the Exide mark, the more it would be doing so for Exide's benefit, since the mark ultimately reverts back to Exide. EnerSys's own expert witness testified as much. *See* 3/25/04 Tr. 57:6–12.

However, establishing only a time-frame for the transition may not be sufficient. For the transition to be as smooth as possible, a plan should be created that sets forth how the transition will be carried out. However, before deciding whether the parties should be left to their own devices or whether the Court should impose such a plan and, if so, the terms of such a plan, I will schedule a hearing to solicit the parties' views about how best to proceed.

End of Document

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Tempnology LLC, 1st Cir.BAP (N.H.), November 18, 2016

406 B.R. 180
United States Bankruptcy Court,
S.D. New York.

In re OLD CARCO LLC (f/k/
a Chrysler LLC), et al., Debtors.

No. 09–50002 (AJG).
|
June 19, 2009.

Synopsis

Background: Chapter 11 debtor-car manufacturer and its affiliated debtors sought authorization to reject executory contracts and unexpired leases with certain domestic automobile dealers and related relief.

Holdings: The Bankruptcy Court, Arthur J. Gonzalez, J., held that:

[1] state statutes designed to protect automobile dealers and franchisees did not warrant application of heightened standard, rather than business judgment standard, in determining whether to authorize rejection of dealer contracts and leases;

[2] debtors exercised sound business judgment in rejecting executory contracts of automobile dealers;

[3] under field preemption, rejection statute preempted state dealer protection statutes, so as to permit debtors' rejection of dealer contracts;

[4] under conflict preemption, rejection statute preempted state dealer protection statutes;

[5] notice and opportunity to be heard on rejection motion satisfied due process;

[6] bankruptcy court did not have to consider each contract individually to determine whether rejection was in best interests of bankruptcy estate and satisfied business judgment rule; and

[7] debtors did not violate Sherman Act.

Ordered accordingly.

West Headnotes (43)

[1] **Bankruptcy**
"Business Judgment" Test in General

Business judgment standard is employed by courts in determining whether to permit debtor to assume or reject a contract. 11 U.S.C.A. § 365.

Cases that cite this headnote

[2] **Bankruptcy**
"Business Judgment" Test in General

Business judgment standard employed in determining whether to permit debtor to assume or reject a contract presupposes that bankruptcy estate will reject contracts the performance of which would benefit the counterparty at estate's expense. 11 U.S.C.A. § 365.

4 Cases that cite this headnote

[3] **Bankruptcy**
"Business Judgment" Test in General

Generally, absent a showing of bad faith, or an abuse of business discretion, debtor's business judgment as to whether to assume or reject contract will not be altered. 11 U.S.C.A. § 365.

Cases that cite this headnote

[4] **Bankruptcy**
"Business Judgment" Test in General

Business judgment standard, as applied to debtor's decision to reject executory contract due to perceived business advantage, requires that decision be accepted by courts unless it is shown that debtor's decision was one taken in bad faith or in gross abuse of bankruptcy-

retained business discretion. 11 U.S.C.A. § 365.

Cases that cite this headnote

[5] **Bankruptcy**
Proceedings

Motion to assume or reject executory contract or unexpired lease should be considered summary proceeding, intended to efficiently review trustee's or debtor's decision to adhere to or reject particular contract in the course of swift administration of bankruptcy estate; it is not the time or place for prolonged discovery or lengthy trial with disputed issues. 11 U.S.C.A. § 365.

Cases that cite this headnote

[6] **Bankruptcy**
"Business Judgment" Test in General

Bankruptcy
Leases

State statutes designed to protect automobile dealers and franchisees did not warrant application of heightened standard, rather than business judgment standard, in determining whether to authorize Chapter 11 debtor-car manufacturer and affiliated debtors to reject executory contracts and unexpired leases with certain domestic car dealers; dealer statutes did not protect national public interest, public safety issues raised by closing of dealerships did not create imminent threat to health or safety, and protections under Automobile Dealers Day in Court Act (ADDCA) were coextensive with, and not in conflict with, bankruptcy rejection power, and did not evidence national public interest in protecting car dealers warranting application of heightened standard. 11 U.S.C.A. § 365; Automobile Dealers' Day in Court Act, § 1 et seq., 15 U.S.C.A. § 1221 et seq.

6 Cases that cite this headnote

[7] **Bankruptcy**
"Business Judgment" Test in General

Under business judgment standard employed in determining whether to permit debtor to assume or reject executory contract, effect of rejection on other entities is not a material fact to be weighed; however, under a heightened standard or a balancing of the equities, such effect would be a fact to be weighed. 11 U.S.C.A. § 365.

2 Cases that cite this headnote

[8] **Bankruptcy**
Grounds for and Objections to Assumption, Rejection, or Assignment

Debtor's decision to reject an executory contract must be summarily affirmed unless it is the product of bad faith, or whim or caprice. 11 U.S.C.A. § 365.

2 Cases that cite this headnote

[9] **Bankruptcy**
Rejection of Executory Contract or Lease

Bankruptcy
Effect of Acceptance or Rejection

Debtor's rejection of executory contract gives rise to a breach of contract claim against debtor's bankruptcy estate, the amount of which is determined according to state law. 11 U.S.C.A. § 365(g).

Cases that cite this headnote

[10] **Bankruptcy**
"Business Judgment" Test in General

Local laws designed to protect public health or safety, without imminent harm present, do not give rise to application of a heightened standard, rather than business judgment standard, in determining whether debtor may reject executory contract. 11 U.S.C.A. § 365.

5 Cases that cite this headnote

[11] **Bankruptcy**
"Business Judgment" Test in General

Bankruptcy
Leases

In determining whether to authorize Chapter 11 debtor-car manufacturer and affiliated debtors to reject executory contracts and unexpired leases with certain domestic car dealers, bankruptcy court could not apply standard requiring balancing of equities that focused on harm which affected dealers would suffer from rejection, rather than business judgment standard generally applied; debtors showed that rejection would benefit bankruptcy estate, and were not required to show that rejected agreements were burdensome. 11 U.S.C.A. § 365.

2 Cases that cite this headnote

[12] **Bankruptcy**
Grounds for and Objections to Assumption, Rejection, or Assignment

Debtor may reject executory contract to make itself more attractive to a buyer. 11 U.S.C.A. § 365.

Cases that cite this headnote

[13] **Bankruptcy**
"Business Judgment" Test in General

Bankruptcy
Leases

Under business judgment standard, bankruptcy court must determine whether rejection of executory contracts or unexpired leases will benefit debtor's bankruptcy estate. 11 U.S.C.A. § 365.

4 Cases that cite this headnote

[14] **Bankruptcy**
"Business Judgment" Test in General

Bankruptcy
Leases

As part of determination under business judgment standard, court deciding whether to authorize debtor's rejection of executory contract or unexpired lease must determine whether debtors made their decisions rationally, and irrational bases of decision-making include racial and gender discrimination and retaliatory animus. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[15] **Bankruptcy**
"Business Judgment" Test in General

Whether debtor is making the best or even a good business decision is not a material issue of fact under the business judgment test employed by court in determining whether to permit debtor to assume or reject executory contract. 11 U.S.C.A. § 365.

7 Cases that cite this headnote

[16] **Bankruptcy**
"Business Judgment" Test in General

Chapter 11 debtor-car manufacturer and affiliated debtors exercised sound business judgment in deciding to reject executory contracts of certain domestic automobile dealers, which resulted in requisite benefit to bankruptcy estates and thus would be authorized; rejection removed burden of postpetition performance and gave affected dealers claims against bankruptcy estates, rejection's acceleration of rationalization of debtors' dealership network served debtors' needs to remain within debtor-in-possession budget and fulfill lender commitments, need for rationalization of dealership network was acknowledged by dealers, and no evidence supported affected dealers' assertions of bad-faith rejection decisions. 11 U.S.C.A. § 365(a).

2 Cases that cite this headnote

[17] **Bankruptcy**
Executory Nature in General

Bankruptcy
Leases

Pursuant to field preemption, bankruptcy statute permitting debtor's rejection of executory contracts and unexpired leases

preempted state dealer statutes providing automobile dealerships with rights and remedies related to termination of dealership agreements by car manufacturers, so as to permit rejection, by Chapter 11 debtor-car manufacturer and its affiliated debtors, of their executory contracts and unexpired leases with certain domestic car dealers, notwithstanding federal statute generally requiring debtors-in-possession to comply with state law in managing their property, given that state statutes were concerned with protecting economic or commercial interests, rather than public health or safety. U.S.C.A. Const. Art. 6, cl. 2; 11 U.S.C.A. § 365; 28 U.S.C.A. § 959(b).

6 Cases that cite this headnote

[18] **Bankruptcy**
Rejection of Executory Contract or Lease
Bankruptcy
Executory Nature in General
Bankruptcy
Leases

Although, pursuant to field preemption, bankruptcy statute permitting debtor rejection of executory contracts and unexpired leases preempted state dealer statutes providing automobile dealerships with rights and remedies related to termination of dealership agreements by car manufacturers, so as to permit rejection by Chapter 11 debtor-car manufacturer and its affiliated debtors of their executory contracts and unexpired leases with certain domestic car dealers, state law governed calculation of rejection damages, as with contract rejections in general. U.S.C.A. Const. Art. 6, cl. 2; 11 U.S.C.A. § 365.

2 Cases that cite this headnote

[19] **States**
Conflicting or Conforming Laws or Regulations

Supremacy Clause invalidates state laws that interfere with, or are contrary to, federal law. U.S.C.A. Const. Art. 6, cl. 2.

Cases that cite this headnote

[20] **States**
Preemption in General

Federal law preempts state law when there is an express statement of Congress to that effect, a comprehensive scheme of federal law is enacted that shows Congress's intent to occupy the whole field in that area, or the federal law directly conflicts with the state law. U.S.C.A. Const. Art. 6, cl. 2.

Cases that cite this headnote

[21] **Bankruptcy**
Application of State or Federal Law in General

Although consumer protection laws and ordinances may otherwise be valid as an exercise of the state's police power and carry a heavy presumption against preemption, they must yield if they conflict with the bankruptcy laws. U.S.C.A. Const. Art. 6, cl. 2.

Cases that cite this headnote

[22] **Bankruptcy**
Executory Nature in General
Bankruptcy
Leases

Automobile Dealers Day in Court Act (ADDCA), which was concerned with protecting economic or commercial interests of automobile dealers, did not preclude rejection by Chapter 11 debtor-car manufacturer and its affiliated debtors of their executory contracts and unexpired leases with domestic car dealers pursuant to Bankruptcy Code's rejection statute. 11 U.S.C.A. § 365; Automobile Dealers' Day in Court Act, § 2, 15 U.S.C.A. § 1222.

Cases that cite this headnote

[23] **States**

Conflicting or Conforming Laws or Regulations

State law may be displaced under conflict preemption when it is physically impossible to comply with both the state and federal law or when state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress; such is the case even if a state legislature had some purpose in mind in passing its law other than one of frustration. U.S.C.A. Const. Art. 6, cl. 2.

Cases that cite this headnote

[24] **Bankruptcy**
Executory Nature in General

Bankruptcy
Leases

Conflict existed between statutory right of Chapter 11 debtor-car manufacturer and affiliated debtors to reject executory contracts and unexpired leases with domestic car dealers and state dealer statutes providing automobile dealerships with rights and remedies related to termination of dealership agreements by car manufacturers, and therefore, under conflict preemption, Bankruptcy Code's rejection statute preempted dealer statutes; state requirements, such as waiting periods, buy-back requirements, and good cause hearings, frustrated debtors' rights to reject contract immediately with court authorization and to exercise business judgment and reject contracts to benefit bankruptcy estate, as well as goals of freeing debtor from obligations of rejected contract and giving court authority to determine whether contract could be assumed or rejected. U.S.C.A. Const. Art. 6, cl. 2; 11 U.S.C.A. § 365.

4 Cases that cite this headnote

[25] **Bankruptcy**
Assumption, Rejection, or Assignment

State-law protections cannot be used to negate debtors' contract rejection powers under Bankruptcy Code. 11 U.S.C.A. § 365.

3 Cases that cite this headnote

[26] **Bankruptcy**
Debtor in Possession, in General

Statutory requirement that debtor-in-possession continue to operate according to state-law requirements imposed on debtor-in-possession does not imply that powers of debtor-in-possession under Bankruptcy Code are subject to the state-law protections. 28 U.S.C.A. § 959(b).

2 Cases that cite this headnote

[27] **Bankruptcy**
Contracts Assumable;Assignability

To the extent that injunctive relief against automobile manufacturers was available under state dealer statutes granting protection to automobile dealerships against manufacturers, such relief was preempted by power of Chapter 11 debtor-car manufacturer and its affiliates to reject their dealership contracts under Bankruptcy Code. U.S.C.A. Const. Art. 6, cl. 2; 11 U.S.C.A. § 365.

Cases that cite this headnote

[28] **Bankruptcy**
Proceedings

Constitutional Law
Bankruptcy

Notice of motion by Chapter 11 debtor-car manufacturer and affiliated debtors for authorization to reject certain executory contracts and unexpired leases with domestic automobile dealers and opportunity to be heard were adequate and satisfied due process where motion was served by overnight delivery, hearing originally was scheduled more than 20 days after motion was filed, which exceeded requirements under case management order and local rule, debtors fulfilled requirements under bidding procedures order providing timeframe for notifying dealers whose agreements were to be assumed and assigned, and latter

order provided date of related sale hearing and associated objection deadline. U.S.C.A. Const.Amend. 5; Fed.Rules Bankr.Proc.Rule 2002, 11 U.S.C.A.; U.S.Bankr.Ct.Rules S.D.N.Y., Rule 6006–1.

Cases that cite this headnote

[29] **Constitutional Law**
Notice

Elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections. U.S.C.A. Const.Amend. 5.

Cases that cite this headnote

[30] **Bankruptcy**
Order of Court and Proceedings Therefor in General
Bankruptcy
Proceedings

Hearing on sale of substantially all of Chapter 11 debtors' assets could be conducted before hearing on debtors' motion to reject certain executory contracts and unexpired leases. 11 U.S.C.A. § 365.

Cases that cite this headnote

[31] **Bankruptcy**
Examination and Discovery
Constitutional Law
Bankruptcy

Any shortcomings in discovery related to Chapter 11 debtors' motion to reject executory contracts and unexpired leases did not offend due process. U.S.C.A. Const.Amend. 5; 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[32] **Bankruptcy**
"Business Judgment" Test in General
Bankruptcy
Leases

In deciding motion by Chapter 11 debtor-car manufacturer and affiliated debtors to reject certain executory contracts and unexpired leases of automobile dealers, bankruptcy court did not have to consider each contract individually to determine whether rejection was in best interests of bankruptcy estate and satisfied business judgment rule. 11 U.S.C.A. § 365; U.S.Bankr.Ct.Rules S.D.N.Y., Rule 6006–1.

Cases that cite this headnote

[33] **Bankruptcy**
Proceedings

Circumstances in Chapter 11 cases of debtor-car manufacturer and affiliated debtors warranted waiver of limitation in bankruptcy rule which generally restricted motion to reject multiple executory contracts or unexpired leases that were not between same parties to no more than 100 contracts or leases, given that all of affected agreements were substantially similar, all affected agreements were subject to single comprehensive analysis by debtors, all affected agreements were being rejected, and process would not have been advanced by requiring debtors to file eight separate motions requesting same relief. 11 U.S.C.A. § 365; Fed.Rules Bankr.Proc.Rule 6006(f)(6), 11 U.S.C.A.

Cases that cite this headnote

[34] **Antitrust and Trade Regulation**
Manufacturers
Bankruptcy
Effect of Acceptance or Rejection

Rejection by Chapter 11 debtor-car manufacturer and affiliated debtors of certain domestic automobile dealers' executory contracts and unexpired leases as part of dealership rationalization program was designed to increase competition across automobile industry by putting debtors'

remaining dealership network on stronger footing, and there was no evidence that debtors contracted, combined, or conspired with buyer of their assets to drive up prices in restraint of trade through their rationalization program, and therefore debtors did not violate Sherman Act. 11 U.S.C.A. § 365; Sherman Act, § 1, 15 U.S.C.A. § 1.

Cases that cite this headnote

[35] **Action**
Statutory Rights of Action
Antitrust and Trade Regulation
Right of Action;Persons Entitled to Sue; Standing;Parties

There is no private right of action for "gun-jumping" violation under provision of Hart–Scott–Rodino Act addressing statutory waiting period for mergers. Hart–Scott–Rodino Antitrust Improvements Act of 1976, § 201(g), 15 U.S.C.A. § 18a(g).

Cases that cite this headnote

[36] **Bankruptcy**
Liens and Security Interests in General
Bankruptcy
Effect of Acceptance or Rejection
Eminent Domain
Contracts in General;Creditors' Rights
Eminent Domain
Property and Rights Subject of Compensation

Rejection by Chapter 11 debtor-car manufacturer and affiliated debtors of certain domestic automobile dealers' executory contracts and unexpired leases did not violate Takings Clause, in that rejected agreements were contracts between debtors and affected dealers, whereas lien in some collateral that was estate property was necessary for takings claim in bankruptcy context. U.S.C.A. Const.Amend. 5; 11 U.S.C.A. § 365.

2 Cases that cite this headnote

[37] **Bankruptcy**
Liens and Security Interests in General
Eminent Domain
Property and Rights Subject of Compensation

A lien in some collateral that is property of the bankruptcy estate is a necessary prerequisite to a Fifth Amendment Takings Clause claim in the bankruptcy context. U.S.C.A. Const.Amend. 5.

2 Cases that cite this headnote

[38] **Bankruptcy**
Construction and Operation
Bankruptcy
Effect of Acceptance or Rejection

Trademarks of Chapter 11 debtor-car manufacturer and affiliated debtors were not "intellectual property" as defined by Bankruptcy Code, and therefore statute governing rejection of executory contracts, which allowed retention of rights and continued usage under executory contract of debtor that was licensor of intellectual property right, did not allow automobile dealers whose contracts with debtors were rejected to retain rights in and continue to use debtors' trademarks post-rejection. 11 U.S.C.A. §§ 101(35A), 365(n).

4 Cases that cite this headnote

[39] **Bankruptcy**
Construction and Operation

Trademarks are not "intellectual property" under the Bankruptcy Code. 11 U.S.C.A. § 101(35A).

6 Cases that cite this headnote

[40] **Bankruptcy**
Effect of Acceptance or Rejection
Constitutional Law
Advertising

Rejection by Chapter 11 debtor-car manufacturer and affiliated debtors of certain domestic automobile dealers' executory contracts did not violate First Amendment rights of affected dealers by preventing them from using debtor's name in such publications as newsletter advertisements. U.S.C.A. Const.Amend. 1; 11 U.S.C.A. § 365.

Cases that cite this headnote

[41] **Bankruptcy**
Judicial Proceedings in General

Chapter 11 debtor-car manufacturer and affiliated debtors did not have to seek relief from automatic stay in bankruptcy case of any affected debtor-dealer before exercising their right to reject contract with such debtor-dealer in their own bankruptcy case. 11 U.S.C.A. §§ 362, 365.

Cases that cite this headnote

[42] **Bankruptcy**
Assumption, Rejection, or Assignment

Rejection of executory contract or unexpired lease is a fundamental right of a debtor "not to perform" its contractual obligations. 11 U.S.C.A. § 365.

Cases that cite this headnote

[43] **Judgment**
Courts or Other Tribunals Rendering Judgment

Judgment
Matters Actually Litigated and Determined

Bankruptcy court before which debtor-automobile dealer's case was pending had adjudicated issue of whether Chapter 11 debtor-car manufacturer and affiliated debtors violated automatic stay in bankruptcy case of debtor-dealer by rejecting executory contract with debtor-dealer in deciding debtor-dealer's emergency contempt motion for alleged stay violation, and therefore res judicata barred relitigation of issue in bankruptcy case of debtor-manufacturer and affiliated debtors. 11 U.S.C.A. §§ 362, 365.

Cases that cite this headnote

West Codenotes

Limitation Recognized
11 U.S.C.A. § 365

Attorneys and Law Firms

***186** A. Jeffrey Misler, Daniels & Kaplan, P.C., Kansas City, MO, Benjamin Rosenblum, Corinne Ball, Veerle Roovers, Jones Day, New York, NY, John E. Berg, Clark Hill PC, Detroit, MI, Lawrence V. Gelber, Schulte Roth & Zabel LLP, New York, NY, for debtors.

Andrew D. Velez-Rivera, Office of the U.S. Trustee, New York, NY, Susan D. Golden, Office of United States Trustee SDNY, New York, NY, for trustee.

David Chrysler Jeep, Llc, Neal D. Colton, Cozen O'Connor, Philadelphia, PA, for interim trustee.

Opinion

OPINION REGARDING AUTHORIZATION OF REJECTION OF ALL EXECUTORY CONTRACTS AND UNEXPIRED LEASES WITH CERTAIN DOMESTIC DEALERS AND GRANTING CERTAIN RELATED RELIEF

ARTHUR J. GONZALEZ, Bankruptcy Judge.

In an order (the "Order")[1] dated June 9, 2009, the Bankruptcy Court granted the omnibus motion of Chrysler LLC, now known as Old Carco LLC, ("Chrysler") and certain of its affiliates, as debtors and debtors in possession (collectively with Chrysler, the "Debtors"), for an Order, Pursuant to Sections 105, 365 and 525[2] of ***187** the Bankruptcy Code and Bankruptcy Rule 6006, (A) Authorizing the Rejection of All Executory Contracts and Unexpired Leases With Certain Domestic Dealers and (B) Granting Certain Related Relief (the "Motion"),[3] filed on May 14, 2009.

An evidentiary hearing was held before the Court on June 4, 2009, at which 15 witnesses testified at the hearing and an additional approximately 66 witnesses presented testimony by proffered declaration. At the close of the presentation of evidence on that date, the hearing was continued to June 9, 2009, at which legal arguments were presented. Several of the Debtors' employees, including Peter M. Grady ("Grady"), Director of Dealer Operations for Chrysler Motors, LLC, have made declarations to the Court, participated in depositions, and offered live testimony in various hearings regarding the Motion and its subject matter. The Debtors designated certain of this evidence into the record. [4] Over two hundred objections, statements, correspondence, and other responses (collectively with all supplements, amendments, and joinders thereto, the "Objections," or in the singular, the "Objection") were filed in response to the Motion. The Committee of Chrysler Affected Dealers (the "CCAD") and other parties also designated certain evidence into the record. Additionally, the Debtors filed a consolidated reply (the "Reply") in response to the Objections.

The facts and circumstances of the Debtors' bankruptcy case have been extensively set forth in *In re Chrysler LLC,* 405 B.R. 84 (Bankr.S.D.N.Y.2009) and are incorporated, as further expanded upon by additional findings of fact relevant to the Motion, herein.

DISCUSSION

Business Judgment Standard

The Supreme Court has observed that the "fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.... [T]he authority to reject an executory contract is vital to the basic purpose to a Chapter 11 reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization." *NLRB v. Bildisco and Bildisco,* 465 U.S. 513, 528, 104 S.Ct. 1188, 1197, 79 L.Ed.2d 482 (1984). In this case, substantially all of the Debtors' assets were sold pursuant to § 363, which is to be followed by a plan of reorganization setting forth, *inter alia,* a distribution scheme for the Debtors' estates, but that does not change the relevant analysis herein. *See infra* citations to ***188** *In re G Survivor Corp.,* 171 B.R. 755, 759 (Bankr.S.D.N.Y.1994).

[1] **[2]** **[3]** **[4]** **[5]** The business judgment standard is employed by courts in determining whether to permit a debtor to assume or reject a contract. *See In re Penn Traffic Co.,* 524 F.3d 373, 383 (2d Cir.2008) (citing *In re Orion Pictures Corp.,* 4 F.3d 1095, 1098 (2d Cir.1993)). This standard "presupposes that the estate will ... reject contracts whose performance would benefit the counterparty at the expense of the estate." *Penn Traffic,* 524 F.3d at 383; *see also G Survivor Corp.,* 171 B.R. at 758 (noting that "the court for the most part must only determine that the rejection will likely benefit the estate" (citation omitted)). "Generally, absent a showing of bad faith, or an abuse of business discretion, the debtor's business judgment will not be altered." *G Survivor,* 171 B.R. at 757. Moreover, the business judgment standard "as applied to a bankrupt's decision to reject an executory contract because of perceived business advantage requires that the decision be accepted by courts unless it is shown that the bankrupt's decision was one taken in bad faith or in gross abuse of the bankruptcy retained business discretion." *Id.* at 758 (quoting *In re Richmond Metal Finishers, Inc.,* 756 F.2d 1043, 1047 (4th Cir.1985)). A motion to assume or reject "should be considered a summary proceeding, intended to efficiently review the trustee's or debtor's decision to adhere to or reject a particular contract in the course of the swift administration of the bankruptcy estate. It is not the time or place for prolonged discovery or a lengthy trial with disputed issues." *Orion,* 4 F.3d at 1098–99. [5]

[6] **[7]** Nevertheless, some of the Objections implore the Court either to apply a heightened standard because of the existence of state statutes designed to protect automobile dealers and franchisees (the "Dealer Statutes," or in the singular, the "Dealer Statute") [6] or to balance the equities by considering the harm to those impacted by the rejections, including the communities in which the dealers (the "Affected Dealers," or in the singular, the "Affected Dealer") with rejected dealer and site control agreements (collectively the "Rejected Agreements," or in the singular, the "Rejected Agreement") operate. Under the business judgment standard, "the effect of rejection on other entities is not a material fact to be weighed." *In re Wheeling–Pittsburgh Steel Corp.,* 72 B.R. 845, 848 (Bankr.W.D.Pa.1987), but under a heightened standard or a balancing of the equities, such effect would be a fact to be weighed.

Many of the Affected Dealers cite *Bildisco,* 465 U.S. at 523–24, 104 S.Ct. 1188, where the Supreme Court held that the rejection of collective-bargaining agreements was subject to a somewhat stricter ***189** standard than business judgment even though there was no such indication in section 365(a). *See id.* The Supreme Court agreed with all of the Courts of Appeals that had considered that issue, concluding that Congress intended a higher standard than business judgment for rejection of collective-bargaining agreements because of, *inter alia,* the "special nature of a collective-bargaining contract, and the consequent 'law of the shop' which it creates." *Id.* at 524, 526, 104 S.Ct. 1188 (citations omitted) (further noting "national labor policies of avoiding labor strife and encouraging collective bargaining" under the National Labor Relations Act ("NLRA")). The Supreme Court therefore adopted the test articulated by two Courts of Appeals under which the debtor would be permitted to reject a collective-bargaining agreement if the debtor could show that the collective-bargaining agreement burdened the estate, and that, after careful scrutiny, the equities balanced in favor of rejecting the labor contract. *See id.* at 526, 104 S.Ct. 1188. Even in this context, the Supreme Court delineated the boundaries of such balancing: "the Bankruptcy Court must focus on the ultimate goal of Chapter 11 when considering these equities. The Bankruptcy Code does not authorize free-wheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization." *Id.* at 527, 104 S.Ct. 1188. [7]

The heightened standard articulated in *Bildisco* has been called the "public interest standard." *See In re Pilgrim's Pride Corp.,* 403 B.R. 413, 421 fn. 19 (Bankr.N.D.Tex.2009). The Fifth Circuit applied this standard in *Mirant,* 378 F.3d at 525, concluding that "the business judgment normally applicable to rejection motions is more deferential than the public interest standard applicable in FERC [Federal Energy Regulatory Commission] proceedings to alter the terms of a contract within its jurisdiction. Use of the business judgment standard would be inappropriate in this case because it would not account for the public interest inherent in the transmission and sale of electricity." *Id.* (noting the purpose of FERC's power under the Federal Power Act ("FPA") as being the "protection of the public interest, as distinguished from the private interests of the utilities") (quoting *Fed. Power Comm'n v. Sierra Pac. Power Co.,* 350 U.S. 348, 355, 76 S.Ct. 368, 100 L.Ed. 388 (1956)); *but see In re Calpine Corp.,* 337 B.R. 27, 36 (S.D.N.Y.2006) (holding, contrary to *Mirant*'s holding, that the court lacked jurisdiction to authorize rejection of certain power agreements because doing so would directly interfere with FERC's jurisdiction over various aspects of wholesale energy contracts, even though rejection constituted breach rather than modification or termination of the power agreements).

Critically, both the *Bildisco* and *Mirant* courts found that a heightened standard for contract rejection was warranted because the authority to reject under § 365(a) conflicted with the policies designed to protect the national public interest underlying other federal regulatory schemes. In this case, though, while policies designed to protect the public interest may, in part, underlie the Dealer Statutes, those statutes have been enacted by *state legislatures,* not Congress, and by their very terms protect the public interest of their respective states rather than the national public interest. Further, the fundamental ***190** interests sought to be protected by these state legislatures are the economic interests of local businesses and customer convenience and costs. Although some Dealer Statutes articulate a public safety concern in such enactments, the public safety issues raised by the closing of dealerships do not create an imminent threat to health or safety. *See infra* discussion of *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot.,* 474 U.S. 494, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986).

[8] **[9]** Some of the Affected Dealers point to the Automobile Dealers Day in Court Act ("ADDCA"), 15 U.S.C. §§ 1221, *et seq.,* as evidence of a Congressional intent to protect the national public interest by allowing dealers to bring a federal cause of action for monetary damages against manufacturers who fail to act in good faith in, *inter alia,* terminating, canceling, or not renewing the dealer's franchise. *See* 15 U.S.C. § 1222; *see also id.* § 1221 (defining good faith as "the duty ... to act in a fair and equitable manner ... so as to guarantee the one party freedom from coercion, intimidation, or threats of coercion or intimidation from the other party"). Plainly, the protections provided under the ADDCA are at most coextensive with rather than in conflict with the rejection power under § 365. Under the business judgment standard, "[a] debtor's decision to reject an executory contract must be summarily affirmed unless it is the product of 'bad faith, or whim or caprice.' " *In re Trans World Airlines, Inc.,* 261 B.R. 103, 121 (Bankr.D.Del.2001)

(quoting *Wheeling–Pittsburgh,* 72 B.R. at 849–50). The duty of good faith under the ADDCA is thus embodied by the requirement that a debtor's decision to reject a contract not be in bad faith. Additionally, the monetary damages remedy for violating the ADDCA merely adds a complementary federal cause of action to the remedy for rejection under § 365(g), wherein rejection gives rise to a breach of contract claim against the debtor's estate, the amount of which is determined according to state law. *See In re Lavigne,* 114 F.3d 379, 387 (2d Cir.1997). As discussed *infra,* the rights and remedies under the Dealer Statutes, such as mandatory waiting or notice periods and buy-back requirements, are more expansive than those under the ADDCA. Had Congress considered it in the national public interest to provide such substantive protections to dealers, it could have done so by amendment to the ADDCA or § 365 itself, or by a separate statute.

This observation is consistent with the *Pilgrim's Pride* court's observation that it was "unwilling to hold that a higher standard for rejection must be met any time another federal law is implicated by the contract to be rejected. Not every act of Congress that may touch a debtor's contract will require the court to consider public policy or other extraneous requirements of federal law in determining whether that contract may be rejected." *Pilgrim's Pride,* 403 B.R. at 424–25. Indeed, the Affected Dealers point to no language in the ADDCA requiring such considerations. Similarly, the *Pilgrim's Pride* court declined to apply the "public interest standard" in a case involving potential violations of the federal Packers and Stockyards Act ("PSA") in the contract rejection context because the court could not find language in the PSA requiring such public policy considerations. *See Pilgrim's Pride,* 403 B.R. at 424–25.

[10] The *Pilgrim's Pride* court identified an additional scenario beyond inconsistency with a federal statute or encroachment on the turf of a federal regulator where it may be appropriate to apply a higher standard than business judgment to contract rejection: local laws designed to protect public health or safety. *See Pilgrim's* ***191** *Pride,* 403 B.R. at 424 & fn. 26 (citing *Midlantic,* 474 U.S. 494, 106 S.Ct. 755, 88 L.Ed.2d 859). Many Affected Dealers raised this very issue in the context of federal preemption, arguing that § 365 did not preempt the Dealer Statutes because they were enacted to protect public safety. While the Court continues discussion of this issue in its discussion of federal preemption *infra,* the Court notes that local laws designed to protect public health or safety, without imminent harm present, do not give rise to application of a heightened standard for contract rejection.[8] Further, because the ADDCA does not give rise to such application of a "public interest standard," the Court applies the business judgment standard rather than a "public interest standard" here.

[11] A related argument made by some of the Affected Dealers is that the Court should "balance the equities." Any discussion of equity balancing must begin with the Supreme Court's admonition in *Bildisco* that "[t]he Bankruptcy Code does not authorize free-wheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization." *Bildisco,* 465 U.S. at 527, 104 S.Ct. 1188. Instead of focusing on the success of the reorganization, the Affected Dealers direct the Court's attention to the harm the rejections inflict upon them.

The Affected Dealers cite *In re Monarch Tool & Mfg. Co.,* 114 B.R. 134, 137 (Bankr.S.D.Ohio 1990) for the proposition that "[d]isproportionate damage to the other party to the contract provides a ground for disapproving rejection." *Id.* at 137 (citations omitted). However, in disapproving the rejection of an exclusive distributorship agreement, the *Monarch* court found that this factor was "reinforced by other consequential facts" such that the court could not find rejection of the contract would improve the debtor's fortunes or benefit general unsecured creditors. Thus, even though the distributor would be "ruined" by its contract being rejected, the *Monarch* court did not hold that rejection was impermissible based on that factor alone but rather based on its evaluation of the rejection's lack of beneficial impact on the debtor's reorganization.

Critically, it was not within the ambit of *Monarch*'s holding that a court may disapprove the rejection of a contract when rejection would "ruin" the counterparty despite the rejection benefiting the estate.[9] ***192** Moreover, in a case cited by both the *Petur* court and the Affected Dealers for a supposed "disproportionate damage" test, the court there addressed such interest-balancing only in relation to the benefit derived by unsecured creditors, with such benefit representing the primary criteria for rejection under the business judgment standard. *See In re Chi–Feng Huang,* 23 B.R. 798, 801

(9th Cir. BAP 1982) (citing *In re Minges,* 602 F.2d 38, 43–44 (2d Cir.1979)). In fact, the Bankruptcy Appellate Panel specifically found that the trial court erred by relying on "fairness" rather than the business judgment standard in disapproving the trustee's rejection decision. *See Chi–Feng,* 23 B.R. at 800. In fact, these cases involve circumstances under which the business judgment standard either failed to be met or failed to be properly applied by the bankruptcy court.

[12] However, the Affected Dealers argue that the Court should not allow the Debtors to reject the contracts because the Debtors cannot show that rejection will benefit the estate, particularly its unsecured creditors. The Affected Dealers cite *In re Dunes Hotel Assocs.,* 194 B.R. 967, 988 (Bankr.D.S.C.1995) for the proposition that "there must be a showing that the rejection will benefit the estate or creditor, but certainly more than merely benefiting the debtor itself or its equity holders." *Id.* (citations omitted). As discussed *infra,* the Debtors make a persuasive showing that rejection will benefit their estates.[10] Although couched in "benefit to the estate" language, the thrust of the Affected Dealers' argument implies that the Debtors fail to show that the Rejected Agreements are "burdensome" to the estate (*i.e.,* that continued performance of the Rejected Agreements results in an actual loss to the estate, *see In re Stable Mews Assocs., Inc.,* 41 B.R. 594, 596 (Bankr.S.D.N.Y.1984)), because the Affected Dealers argue that they cost the Debtors nothing.[11] "Burdensome property" is not the relevant test under the business judgment standard, which provides "considerably more flexibility" and "requires only that the trustee demonstrate that rejection of the executory contract will benefit the estate." *Stable Mews,* 41 B.R. at 596 (citations omitted) (noting that the "great weight of modern authority applies the business judgment test" (citations omitted)).

The Court is sympathetic to the impact of the rejections on the dealers and their customers and communities, but such sympathy does not permit the Court to deviate from well-established law and "balance the equities" instead of applying the business judgment standard. The *Pilgrim's Pride* court explained this dilemma inherent in the chapter 11 process by returning to the notion of a "public policy exception" to the business judgment standard:

> While the impact of rejection on the [counterparties'] community may be significant, that is not an uncommon result of the cut-backs that typically accompany a restructuring in chapter 11. Whether through contract rejections or ***193** plant closings, contraction of a debtor's business will often have a harmful effect for one or more local economies. If the bankruptcy court must second-guess every choice by a trustee or debtor in possession that may economically harm any given locale, the business judgment rule applicable to contract rejection and many other decisions in the chapter 11 process will be swallowed by a public policy exception. *Pilgrim's Pride,* 403 B.R. at 425.

Other courts have held that absent Congressional authority, such as through a separate section of the Bankruptcy Code (*e.g.,* § 1113) or a specific carve-out within § 365 itself, the court is not free to deviate from the business judgment standard and weigh the effect of rejection on debtor's counterparty or the counterparty's customers. *See Wheeling–Pittsburgh,* 72 B.R. at 847–48 (citations omitted).

[13] **[14]** **[15]** Accordingly, the scope of the Court's inquiry is limited. Under the business judgment standard, the Court must determine whether rejection will benefit the Debtors' estates. As part of this determination, the Court must determine whether the Debtors made their decisions rationally. *See Pilgrim's Pride,* 403 B.R. at 427. Irrational bases of decision-making include racial and gender discrimination and retaliatory animus. *See id.* at 428. Such bases are antithetical to sound business judgment and demonstrate "bad faith, or whim or caprice." *Wheeling–Pittsburgh,* 72 B.R. at 849–50. However, "whether the debtor is making the best or even a good business decision is not a material issue of fact under the business judgment test." *Id.* at 849.

Application of the Business Judgment Standard

The Debtors exercised sound business judgment in rejecting the Affected Dealers' contracts. Rejection of the contracts pursuant to § 365(a) continued and accelerated the Debtors' efforts to rationalize their dealership

network. Beginning in 2001, the Debtors initiated a program with three goals: evaluate their dealership network and key locations; identify the most desirable dealerships and dealership locations from the perspective of long-term planning; and streamline their domestic dealership network to meet long-term goals, including, among other things, the consolidation of the Debtors' brands at "partial line" dealers to make them "full line dealers." [12] The Debtors re-named this program over the years, and most recently it has been called "Project Genesis."

Project Genesis and its predecessors were launched in response to significant changes in the American automobile industry, particularly the entry of transplant Original Equipment Manufacturers ("OEMs") such as Toyota, Honda, and Hyundai into the American market. The Debtors' dealers have had to compete with these OEMs, the American OEMs, General Motors and Ford, and each other. The transplant OEMs established much smaller dealership networks with new and better locations and facilities in growing markets, and recently they have sold considerably more vehicles annually than the Debtors. As a result, the Debtors' dealers' "throughput" (*i.e.,* annual sales of vehicles) was but a fraction of some of the transplant OEMs' throughput. Meanwhile, the Debtors have had to contend with legacy network dealers, many of ***194** which were no longer in the best or growing locations, served a diminishing population of potential customers, or operated out of outdated facilities.

The Debtors determined that to compete in the automobile marketplace, they would need to streamline their domestic dealership network, specifically through rationalization of dealerships that they determined would not improve their competitive position going forward. The Debtors identified numerous advantages of having a smaller dealership network, including better and more sustainable sales and profitability for each dealer, which in turn would provide greater resources for marketing, reinvesting in the business, improving facilities, enhancing the customer experience and customer service, and keeping and attracting more experienced and highly qualified personnel to work at the dealerships. Even though the overall size of the network would decrease, the Debtors estimated that the greater sales and profitably at the remaining dealerships would eventually result in greater sales for the network overall. A smaller dealership network is expected to concentrate profits such that more capital improvements will be made to a dealership facility, thereby attracting more customers and providing customers with a better experience. A smaller dealership network would also enable the Debtors to reduce expenses and inefficiencies in the distribution system, including reducing costs spent on training, new vehicle allocation personnel, processes, and procedures, dealership network oversight, auditing, and monitoring, and additional operational support functions. Consolidation of "partial line" dealerships would eliminate redundancies and inefficiencies in the dealership network. [13] As previously mentioned, these initial business judgments predated the Debtors' bankruptcy cases by many years, and between 2001 and the filing of the bankruptcy cases, the Debtors reduced their dealership network by over 1100 dealers.

As part of the Debtors' Viability Plan (as defined in *Chrysler,* 405 B.R. 84), the Debtors determined that completion of dealership rationalization was one of their main objectives. The Debtors further determined that to consummate the Fiat Transaction (as defined in *Chrysler,* 405 B.R. 84), they needed to transfer a strong, well-positioned dealership network to the purchaser. In *Chrysler,* 405 B.R. 84, 96, the Court concluded that the Fiat Transaction was the only viable option for the Debtors, with the only other alternative being immediate liquidation. *See id.* at 96. The Court further concluded that the procedures utilized by the Debtors to determine which contracts would be assumed and assigned to the purchaser was a reasonable exercise of the Debtors' business judgment. *See id.* at 96.

The procedures utilized by the Debtors were substantially similar to those used prior to the bankruptcy cases in Project Genesis. [14] The Debtors evaluated each ***195** dealership, reviewing and analyzing numerous performance and planning factors for each dealership. [15] The Debtors also drew on external metrics, including new vehicle registration information, demographic data, average distance to the nearest dealer for each locality, and competing manufacturers' market share within the locality. [16] The Debtors used these factors to create comprehensive statistical assessments of each dealer and make judgments regarding the optimal configuration for each market in the domestic dealer network and the best means of implementing the goals of Project Genesis, as described *supra.* Once the Debtors decided to pursue the

Fiat Transaction, the Debtors also worked with Fiat and New Chrysler to model an anticipated dealership network for the Alliance Viability Plan (as defined in *Chrysler,* 405 B.R. 84), including by refining their evaluation of dealers under the procedures just described. [17]

In their business judgment, the Debtors determined that rejection of the Rejected Agreements was in the best interest of their restructuring efforts and estates. Based on a subjective and objective evaluation, the Debtors determined that the dealerships to be rejected lacked the operational, market, facility, and linemake characteristics necessary to best contribute to the ongoing dealer network under either current or future ownership. New Chrysler agreed with the Debtors' approach. The Debtors determined, and New Chrysler agreed, [18] that rejection of the Rejected Agreements was necessary and appropriate for implementing the Alliance Viability Plan by enabling the Debtors to consummate the Fiat Transaction and transfer to New Chrysler a smaller, more effective, and more profitable dealer network without disruption while limiting the Debtors' potential postpetition obligations to the Affected Dealers. The Debtors also determined that any delay in making rejection decisions could allow the best dealers or their personnel to be poached by other OEMs, thus reducing the value of the Debtors' assets, specifically its dealership network, pending sale to New Chrysler.

Further, funding for the Affected Dealers under the Debtors' debtor-in-possession ***196** budget expired on June 9, 2009. Up to and including that date, the Debtors continued to pay all prepetition and postpetition incentives and warranty obligations to the Affected Dealers. Following that date, the debtor-in-possession budget decreased by 25% for such obligations, reflecting the anticipated rejection of agreements constituting 25% of the Debtors' dealership network. [19] Therefore, if the dealership network were not reduced, the Debtors would be out of compliance with their budget. As a result, if the lenders did not authorize additional funds under the budget, funds set aside for the wind-down of the Debtors' estates would have to be used to cover such expenses.

As previously stated, the Court has already concluded that the procedures utilized by the Debtors to determine which contracts would be assumed and assigned to New Chrysler was a reasonable exercise of the Debtors' business judgment. *See Chrysler,* 405 B.R. at 96. The decision-making process used by the Debtors was rational and an exercise of sound business judgment. While the Court does not disturb that conclusion herein, the Court expands upon it by further concluding that rejection benefits the Debtors' estates. The Court also finds that no evidence has been presented to the Court showing that the Debtors made their individual rejection decisions irrationally, such that the rejections demonstrate bad faith or whim or caprice. Despite intimations of racial and gender discrimination and retaliatory animus, the Court finds that the Affected Dealers making such intimations have not supported them with evidence such as to warrant the Court overturning the Debtors' business judgment. The Court further notes that the scope of its inquiry regarding the business judgment standard for purposes of rejection does not include an evaluation of whether the Debtors made the *best or even a good* business decision but merely that the decision was made in an exercise of the Debtors' business judgment.

[16] With respect to benefiting their estates, the Debtors exercised sound business judgment in rejecting the Rejected Agreements. Following the closing of the Fiat Transaction, the Debtors would no longer be in the car manufacturing business. On the day prior to the legal arguments, June 8, 2009, the closing of the Fiat Transaction was stayed by the Supreme Court. On the following evening, June 9, 2009, the stay was lifted, and the Fiat Transaction closed the next day, June 10, 2009. Moreover, the Fiat Transaction involved the transfer of certain of the Debtors' property, including their trademarks, to New Chrysler, such that the Debtors' would not even have the right to "authorize" the Affected Dealers to continue doing, *e.g.,* warranty work under the Debtors' name after the Fiat Transaction closed. Rejection thus benefits the estate by removing the burden of postpetition performance under these contracts and instead giving the Affected Dealers claims against the Debtors' estates. Certain Affected Dealers argue that they may have claims against the estates that would be characterized as administrative claims and ***197** limited to unsecured claims under § 502(g). This issue is not before the Court and will be addressed if raised in the context of any such administrative claim request. However, the argument that the Debtors' actions related to the rejection process would result in an administrative claim does not alter the conclusion that rejection of the Rejected Agreements benefits the Debtors' estates.

Further, there is no doubt that the acceleration of dealership rationalization benefited New Chrysler by enabling it to avoid the costs attendant to such reduction if it took place outside bankruptcy. Yet this does not undermine the Debtors' need to reduce dealerships to be in line with its budget and fulfill its commitments to its lenders.[20] Moreover, as previously discussed, the alternative to the Fiat Transaction was immediate liquidation. It is immaterial whether Fiat required the Debtors to reject the number of agreements it rejected.[21] Dealership rationalization was a component of the Alliance Viability Plan, and the Debtors were obligated to accelerate this program, as stated above, to fulfill their commitment to their lenders.

Many of the Affected Dealers have argued that the Debtors' specific application of their rejection decisions was not appropriate or in bad faith. Affected Dealers arguing that the Debtors' application of rejection decision was not appropriate primarily asserted that the Debtors erred in rejecting their agreements while assuming and assigning agreements with other dealers in the same market. The Affected Dealers asserted that those other dealers lagged behind them according to one or more of the Debtors' metrics. However, the Debtors have stated that they conducted a subjective and objective evaluation of each dealership, including by balancing objective quantitative and qualitative metrics. Therefore, whether one dealer lagged behind an Affected Dealer according to one or more of these metrics is immaterial because the Debtors in their business judgment had the discretion to determine that another factor or consideration was more important under the circumstances in its evaluation of that market or the network as a whole.[22] The Debtors have ***198** also stated that rationalization was a cumulative network-centric process, rather than a process focused on "targeting" individual dealers. Accordingly, a decision on an individual dealer may well have come down to a strategic decision with respect to the whole network, and the business judgment standard would be rendered irrelevant if the Court stepped in to second guess such a decision.

In his extensive testimony, declarations, and depositions, Grady has given the Court no reason to second guess the decisions made by the Debtors. Moreover, testimony by some of the Affected Dealers at the Sale Hearing shows that the Debtors' decision to rationalize their dealership network was a sound exercise of business judgment. These Affected Dealers agreed that, *inter alia,* there were too many dealers in their markets, there were economies of scale and efficiencies in having all three brands under one roof, and there would likely be increased sales if there were fewer dealers. These Affected Dealers instead asserted that the Debtors erred in rejecting their agreements because, *e.g.,* they were highly ranked or had won awards (in addition to surpassing competitors in their markets according to one or more of the Debtors' metrics). This testimony in no way rebuts the Debtors' exercise of their business judgment. These Affected Dealers presented no evidence to show that the Debtors' rejection decisions as applied to them were irrational. They merely disagree with the specific decision, having agreed that rationalization of the dealer network as a whole was necessary. Without any such evidence, the Court has no basis for overturning the Debtors' business judgment.

The bad faith assertions largely fall in two categories. The first category concerns rejection decisions purportedly made in relation to dealers' acquiescence to or denial of the Debtors' prepetition requests to purchase additional inventory or upgrade facilities. Some of the dealers who denied the Debtors' requests contend that the Debtors' rejection decisions were based on retaliatory animus. The second category concerns rejection decisions purportedly made based on racial and gender discrimination. The Court does not find it necessary to elaborate at length on these assertions here because those making the assertions present no evidence connecting the Debtors' purported prepetition conduct with their rejection decisions.

Some of the Affected Dealers allege that the Debtors' personnel threatened retribution if they did not take additional inventory, sometimes even beyond their capacity. Such purported statements are hearsay and unsupported by evidence, and the Court may not circumstantially infer that the Debtors followed through on such statements by rejecting contracts. Only evidence directly implicating the purported statements as being the cause of the rejection decision would permit the Court to find bad faith and overturn the Debtors' business judgment. Further, there is no evidence that dealers who did not take additional inventory were uniformly rejected. Evidence of such a pattern of conduct would have been relevant evidence to support the retribution argument. Similarly, during the Sale Hearing, Grady was asked why

two dealers who had been labeled "litigious" in emails, including regarding one of whom an email said it was "not a performance issue," were rejected. In both cases, Grady explained that there were strong dealers nearby. The Court finds Grady's testimony credible and finds that the evidence presented by the Affected Dealers does not prove that the rejection decisions were made in bad faith rather than in an exercise ***199** of business judgment.[23]

The assertions related to racial and gender discrimination are conclusory. Although some of the Affected Dealers alleging racial discrimination present statistics showing the impact of rejections on minority-owned dealerships, they present no evidence that the rejection decisions took such ownership into account. In fact, the statistical breakdown itself shows that some minority groups were impacted less than other minority groups and less than dealers overall. Among the factors the Debtors considered were whether markets had growing populations or populations likely to grow. Such is a legitimate basis for exercising business judgment and does not represent a pretext for eliminating minority-owned dealerships. Simply, these Affected Dealers cannot show any pattern outside of the criteria set forth by the Debtors that would allow the Court to conclude otherwise. As for the allegation that Chrysler rejected a female dealer because she was not part of the "good ole boys network," that Affected Dealer presented no evidence for the allegation except to state that it was the only possible explanation for the rejection of her agreement. The Court may not overturn the Debtors' business judgment based on such unsubstantiated allegations.

Federal Preemption

[17] **[18]** Many of the Objections are premised on the argument that Bankruptcy Code does not preempt the Dealer Statutes. As previously mentioned, the Dealer Statutes are nonbankruptcy statutes enacted by state legislatures to protect local automobile dealers from certain commercial conduct, including fraud, coercion, and intimidation, by automobile manufacturers. The Dealer Statutes also set forth the rights and remedies of dealers under such statutes. Relevant to this case are the rights and remedies related to termination of dealership agreements.[24] Rights include statutory waiting and notice periods for wind-downs and buy-back requirements for terminations with or without cause. Remedies include specific types of damages and commencement of legal or administrative proceedings. Consistent with the Order, the Court concludes that the Dealer Statutes are preempted by § 365 with respect to rejection of the Rejected Agreements. Of course, as with contract rejections in general, damages are still calculated according to state law.

***200** **[19]** **[20]** The Supremacy Clause, U.S. Const., art. VI, cl. 2, invalidates state laws that "interfere with, or are contrary to," federal law. *Hillsborough County v. Automated Med. Labs., Inc.,* 471 U.S. 707, 712, 105 S.Ct. 2371, 2375, 85 L.Ed.2d 714 (1985) (quoting *Gibbons v. Ogden,* 22 U.S. (9 Wheat.) 1, 211, 6 L.Ed. 23 (1824)). Federal law preempts state law when there is an express statement of Congress to that effect, a comprehensive scheme of federal law is enacted that shows Congress's intent to occupy the whole field in that area, or the federal law directly conflicts with the state law. *See Hillsborough,* 471 U.S. at 713, 105 S.Ct. 2371 (citations omitted). Because there is no express statement of Congress that the Dealer Statutes are to be preempted by the Bankruptcy Code, the Court's preemption analysis focuses on the latter two types of preemption, field preemption and conflict preemption.

The Supreme Court has held that "Congress' intent to pre-empt all state law in a particular area may be inferred where the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress 'left no room' for supplementary state regulation," *Hillsborough,* 471 U.S. at 713, 105 S.Ct. 2371 (quoting *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218, 230, 67 S.Ct. 1146, 1152, 91 L.Ed. 1447 (1947)), and "[p]re-emption of a whole field also will be inferred where the field is one in which 'the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject,' " *Hillsborough,* 471 U.S. at 713, 105 S.Ct. 2371 (quoting *Rice,* 331 U.S. at 230, 67 S.Ct. 1146, and citing *Hines v. Davidowitz,* 312 U.S. 52, 61 S.Ct. 399, 85 L.Ed. 581 (1941)).

The Debtors argue that field preemption applies for three reasons: first, the comprehensive nature of the Bankruptcy Code; second, the placing of bankruptcy jurisdiction within federal courts; and third, the necessity of promoting a uniform bankruptcy process. Essentially, the Debtors argue that the Bankruptcy Code leaves no room for supplementary state regulation (*i.e.,* the Dealer

Statutes) or precludes enforcement of the Dealer Statutes as to the Rejected Agreements.

The Affected Dealers argue in substance that the "field" the Debtors contend is occupied by the Bankruptcy Code permits certain exceptions, such that the Bankruptcy Code does not occupy the whole "field" with respect to the Dealer Statutes. The Affected Dealers analogize the Dealer Statutes to statutory obligations under consumer protection laws, which they argue are independent of any contract and thus not preempted by § 365. The Affected Dealers argue that the exemption of state or local enforcement of purportedly analogous consumer protection laws from the § 362 automatic stay demonstrates that Congress intended that the Bankruptcy Code *not* affect such laws. Had this been the case for the rejection of executory contracts, though, Congress could have similarly carved out such an exception in § 365 itself. The Affected Dealers give the Court no reason to create such an exception on its own and the Court declines to second guess Congress by doing so. Further, the Court notes that § 362(b)(4) exception addresses the right of a state or locality to take action. The issue that arises in the rejection context is the right of the debtor to no longer perform under a contract. It is that right, "to no longer perform," and the consequences therefrom, that would be in direct conflict with a state statute that would require continued performance by a debtor that is being preempted.

[21] Moreover, the House Report, H.R.Rep. No. 595, 95th Cong., 1st Sess. (1977), ***201** U.S.Code Cong. & Admin.News 1977, p. 5963; H.R. 8200, cited by the CCAD mentions consumer protection laws within the broader category of enforcement of state and local governments' police or regulatory powers. "Even though such laws and ordinances may otherwise be valid as an exercise of the state's police power and carry a heavy presumption against preemption, they must yield if they conflict with the bankruptcy laws." *Stable Mews,* 41 B.R. at 598 (citing, *inter alia, A Framework for Preemption Analysis,* 88 Yale L.J. 363, 380–81 (1978); *Perez v. Campbell,* 402 U.S. 637, 649, 91 S.Ct. 1704, 1711, 29 L.Ed.2d 233 (1971)). Nevertheless, several of the Affected Dealers cite cases from this bankruptcy court, as well as 28 U.S.C. § 959(b), for their argument that the Bankruptcy Code does not preempt all state and local laws related to police or regulatory powers. The cases are distinguishable on the facts and the law, and 28 U.S.C. § 959(b) does not aid in the preemption analysis.

The Affected Dealers cite *In re Kennise Diversified Corp.,* 34 B.R. 237, 245 (Bankr.S.D.N.Y.1983), for the proposition that the "provisions of the Bankruptcy Code do not and are not intended to provide an automatic mechanism for relieving property owners of the unpleasant effects of valid local laws embodying police and regulatory provisions." *Id.* (citation omitted). However, *Kennise* addresses the automatic stay and turnover of property rather than the rejection of contracts. As previously discussed, the automatic stay has a specific exception for enforcement of state and local governments' police and regulatory powers. *See* § 362(b)(4). *Kennise* explains that this exception is to be narrowly interpreted, *see Kennise,* 34 B.R. at 242, and cites another case for the further explanation that the stay exception is limited to police powers "urgently needed to protect public health and welfare." *Id.* (citing *In re IDH Realty, Inc.,* 16 B.R. 55 (Bankr.E.D.N.Y.1981)). [25]

In another case decided by the same judge a few years after *Kennise,* the court found that a debtor-lessor could not reject the leases of rent-controlled tenant-lessees in order to re-let the apartments at higher rents. *See In re Friarton Estates Corp.,* 65 B.R. 586 (Bankr.S.D.N.Y.1986). The court reasoned that, *inter alia,* the tenant-lessees were protected by § 365(h), which allowed them to remain in possession of the property for the balance of the lease term and any renewal or extension of the term that was enforceable by the lessee under "applicable nonbankruptcy law." *See Friarton,* 65 B.R. at 593 (quoting § 365(h)). In that case, New York City's rent-control laws were the applicable nonbankruptcy law at issue, and, in contrast to this case, the debtor's rejection power was specifically subordinated to local law by the language of § 365(h) and its reference to "applicable nonbankruptcy law." *See Resolution Trust Corp. v. Diamond,* 18 F.3d 111, 122 (2d Cir.1994) (noting that the express deference to "applicable nonbankruptcy law" in the Bankruptcy Code saves from rejection lease renewal rights enforceable under rent-control), *vacated and remanded on other grounds sub nom. Solomon v. Resolution Trust Corp.,* 513 U.S. 801, 115 S.Ct. 43, 130 L.Ed.2d 5 (1994), *on remand,* 45 F.3d 665 (2d Cir.1995). As previously discussed, no such "subordination" exists in § 365 which is applicable to the Rejected Agreements. [26]

***202** Requiring the trustee to provide essential services, including by seeking specific performance of that obligation in a nonbankruptcy proceeding commenced pursuant to 28 U.S.C. § 959(b), would be at odds with the express statutory policy of § 365(h) and create a disparity not intended by Congress in its enactment of 28 U.S.C. § 959(b). *See id.* at 959 (citing *Palmer v. Webster & Atlas Nat'l Bank of Boston,* 312 U.S. 156, 163, 61 S.Ct. 542, 547, 85 L.Ed. 642 (1941)). Thus, the trustee would not be able to reap the benefits of his right to reject the leases while the tenant-lessees would still be protected by § 365(h).

By contrast, 28 U.S.C. § 959(b) "embodies a Congressional intention to prevent bankruptcy trustees from using the authority of the federal courts to immunize themselves from state regulation of their business operations.... An ongoing business should not receive unfair competitive advantages merely because it seeks to reorganize itself under Chapter 11 of the Bankruptcy Code." *Stable Mews,* 41 B.R. at 598–99 (citing *Butner v. United States,* 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979); *Palmer,* 312 U.S. at 163, 61 S.Ct. 542). Accordingly, the debtor-in-possession's bankruptcy in *Friarton* would have given him a competitive advantage over fellow owners of rent-controlled buildings but for the tenant-lessees' ability to enforce "applicable nonbankruptcy law" (*i.e.,* the rent-control laws and rights thereunder).[27] However, the tenant-lessees in *Friarton* could only use 28 U.S.C. § 959(b) to enforce such laws because the right to possession enforceable by "applicable nonbankruptcy law" (*i.e.,* the rent-control laws and rights thereunder) prevented the debtor-in-possession from rejecting the leases (and evicting the tenant-lessees) in the first place.[28]

***203** In this light, *Friarton* stands not so much for preemption as it does for reading § 365 and 28 U.S.C. § 959(b) holistically. The rent-control laws did not preempt the right to reject but rather could be read in concert with an express provision of § 365 (*i.e.,* subsection (h)) without conflict. Accordingly, 28 U.S.C. § 959(b) provided a statutory mechanism enabling their enforcement. Because no such laws were enforceable by the tenant-lessees in *Stable Mews,* the use of 28 U.S.C. § 959(b) to compel the trustee's performance would have impermissibly forestalled his right to reject under § 365(a) by subjecting the trustee to obligations from which he was relieved.[29] The contrast is even starker in this case, where the Affected Dealers are unable to cite any subsection of § 365 by which applicable nonbankruptcy law (*i.e.,* the Dealer Statutes) would limit the Debtors' rejection power. Section 365(h) demonstrates a clear direction from Congress that applicable nonbankruptcy law be considered with respect to possession, *inter alia,* under a lease. This factor alone distinguishes the residential and commercial lease cases from the preemption issues before the Court as to the Rejected Agreements.

The Affected Dealers also approach 28 U.S.C. § 959(b) by citing *Midlantic,* 474 U.S. at 505, 106 S.Ct. 755 for the Supreme Court's holding that "Congress did not intend for the Bankruptcy Code to pre-empt all state laws that otherwise constrain the exercise of a trustee's powers." *Id.* at 505, 106 S.Ct. 755. The Court begins by noting two critical distinctions between *Midlantic* and this case. First, *Midlantic* addressed the trustee's power to abandon property contaminated with toxic waste under § 554. Immediately prior to the statement just quoted, the Supreme Court observed that 28 U.S.C. § 959(b) did not directly apply to abandonment under § 554 and "therefore does not de-limit the precise conditions on an abandonment." *Id.* at 505, 106 S.Ct. 755. Likewise, 28 U.S.C. § 959(b) does not de-limit the precise conditions on contract rejection. Second, while the State and City of New York objected to the abandonment because it would threaten the public's health and safety, there were also Congressional enactments expressing concern over the impact of toxic waste on public health. *Id.* at 505–06, 106 S.Ct. 755. As previously discussed, there is no such ***204** Congressional concern over public health or safety expressed in the ADDCA.

However, *Midlantic* primarily addresses the abandonment power with respect to state and local laws, and on this point, the difference between state and local laws regarding toxic waste and the Dealer Statutes is pronounced. The danger to health and safety resulting from the trustee's abandonment in *Midlantic* was "imminent." *Midlantic,* 474 U.S. at 499 fn. 3, 106 S.Ct. 755; *compare, e.g., supra* fn. 8. Accordingly, although the Supreme Court did not "reach[ ] the question whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself," *id.* at 507, 106 S.Ct. 755, the Supreme Court held that a "trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or

safety from identified hazards." *Id.* In a related footnote, the Supreme Court noted that this exception to the abandonment power under § 554 was a "narrow one" and that the abandonment power was "not to be fettered by laws or regulations not reasonably calculated to protect the public health or safety from *imminent and identifiable harm.*" *Id.* at 507 fn. 9, 106 S.Ct. 755 (emphasis added).

The instant case is thus distinguishable from *Midlantic* because even if the Court were to accept the Affected Dealers' argument that the Dealer Statutes are designed to protect the public health or safety (and the vast majority of the Dealer Statutes make no mention of either), the Affected Dealers have not shown any imminent and identifiable harm from a dealership closing. *See, e.g., In re St. Lawrence Corp.,* 239 B.R. 720, 724 (Bankr.D.N.J.1999) (allowing abandonment notwithstanding a state environment law because, *inter alia,* there was no proof of "imminent and identifiable harm"). In fact, the main "hazard" identified by the Affected Dealers as being addressed by the Dealer Statutes is lack of ready access to a dealership for servicing. As previously mentioned, taking this public safety argument to its logical conclusion, driving outside the range of one's Affected Dealer would be a threat to one's safety. Such premise is unwarranted, and it highlights the issue at hand is one of consumer convenience and costs and the protection of local businesses, rather than a concern over public safety.

[22] Further, if one were to accept the premise as presented it would imply that the transplant OEMs' dealership networks create public safety issues because they have smaller dealership networks serving larger geographical areas. As noted previously, nothing in the dealer network rationalization program or the networks it seeks to emulate reveal that dealer proximity for purposes of warranty and other services is not reasonably accessible.[30] In sum, the Dealer Statutes, as well as the ADDCA, are concerned with protecting economic or commercial interests and are thus preempted by the Bankruptcy Code notwithstanding 28 U.S.C. § 959(b). *See* ***205** *In re Baker & Drake, Inc.,* 35 F.3d 1348, 1353 (9th Cir.1994) (noting that "federal bankruptcy preemption is more likely ... where a state statute is concerned with economic regulation rather than with protecting the public health and safety").[31]

[23] **[24]** Moreover, returning the language of *Midlantic* itself, the Supreme Court specifically stated that it did not reach the question of "whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself." *Midlantic,* 474 U.S. at 507, 106 S.Ct. 755. The Supreme Court's statement raises the second type of preemption at issue in this case, conflict preemption. State law may be displaced under conflict preemption when it is physically impossible to comply with both the state and federal law or when state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *See Orson, Inc. v. Miramax Film Corp.,* 189 F.3d 377, 381–82 (3d Cir.1999) (citing *Pacific Gas & Elec. Co. v. Energy Res. Conservation and Dev. Comm'n,* 461 U.S. 190, 204, 103 S.Ct. 1713, 75 L.Ed.2d 752 (1983) and quoting *Jones v. Rath Packing Co.,* 430 U.S. 519, 525, 97 S.Ct. 1305, 51 L.Ed.2d 604 (1977)). Such is the case even if a state legislature had some purpose in mind in passing its law other than one of frustration. *See In re Dan Hixson Chevrolet Co.,* 12 B.R. 917, 923 (Bankr.N.D.Tex.1981) (citing *Perez,* 402 U.S. 637, 91 S.Ct. 1704, 29 L.Ed.2d 233).

In concluding that § 365 preempted the Texas Motor Vehicle Code's "good cause" hearing requirement, the court in *Dan Hixson* demonstrated how a typical Dealer Statute frustrated the Bankruptcy Code's purpose. Under § 365, the bankruptcy court could have permitted the debtor to assume and cure an executory contract it had breached with a nondebtor counterparty, while at the same time the Texas Motor Vehicle Commission could have permitted the contract's termination if it found the nondebtor had "good cause" to terminate. *Dan Hixson,* 12 B.R. at 924. Because of this conflict, the bankruptcy court's jurisdiction preempted the state commission's jurisdiction under the Supremacy Clause and could have held the nondebtor in contempt for termination notwithstanding the state commission's "good cause" finding. *Id.* Likewise, if the bankruptcy court did not permit assumption and cure, the good cause hearing would be rendered unnecessary and moot. *Id.* In another case addressing a conflict between the Bankruptcy Code and certain of a state's Dealer Statutes, the bankruptcy court held that § 365 allowed the debtor to assume an executory contract even though it would have been terminated under Florida law. *See In re Tom Stimus Chrysler–Plymouth, Inc.,* 134 B.R. 676, 679 (Bankr.M.D.Fla.1991).

[25] **[26]** More generally, a bankruptcy court recently held that "Congress enacted [§] 365 to provide debtors the authority to reject executory contracts. This authority preempts state law by virtue of the Supremacy Clause [and] the Bankruptcy Clause." *In re City of Vallejo,* 403 B.R. 72, 77 (Bankr.E.D.Cal.2009). "Where a state law 'unduly impede[s] the operation of federal bankruptcy policy, the state law ***206** [will] have to yield.' " *Id.* (quoting *Perez,* 402 U.S. at 649, 91 S.Ct. 1704).[32] Specifically and by no means exclusively, statutory notice or waiting periods of, *e.g.,* 60 or 90 days before termination clearly frustrate § 365's purpose to allow a debtor to reject a contract as soon as the debtor has the court's permission (and there is no waiting period under the Bankruptcy Rules). Buy-back requirements also frustrate § 365's purpose to free a debtor of obligations once the debtor has rejected the contract. Good cause hearings frustrate § 365's purpose of giving a bankruptcy court the authority to determine whether a contract may be assumed or rejected.[33] Strict limitations on grounds for nonperformance frustrate § 365's purpose of allowing a debtor to exercise its business judgment and reject contracts when the debtor determines rejection benefits the estate.[34] So-called "blocking rights," which impose limitations on the power of automobile manufacturers to relocate dealers or establish new dealerships or modify existing dealerships over a dealer's objection, frustrate § 365's purpose of giving a debtor the power to decide which contracts it will assume and assign or reject by allowing other dealers to restrict that power.

[27] Some of the Affected Dealers argue that the Debtors seek injunctive relief in the Motion and that an adversary proceeding is therefore required. As noted *supra* fn. 2, the Debtors' request that relief under § 525 of the Bankruptcy Code be granted in the Order was no longer sought in connection therewith. Therefore, the main source of the Objections regarding injunctive or declaratory relief was removed. The remaining relief requested by the Debtors does not seek injunctive relief.[35] Further, to the extent that injunctive relief against an OEM is available under the Dealer Statutes, that ***207** relief is preempted by the Debtors' power to reject under § 365.[36] Such preemption does not represent the Court's granting injunctive relief on independent grounds but simply prevents interference with the Debtors' right to reject the agreements at issue.[37] Thus, no adversary proceeding is required.

Procedural Issues

The Affected Dealers raised various procedural arguments regarding the rejection process. These Objections largely fall in two categories: first, whether due process and discovery rights have been adequate; and second, whether consideration of each agreement individually is required and whether waiver of Rule 6006(f)(6)'s limitation is proper.

[28] **[29]** In the first category, many of the Affected Dealers argue that they did not receive full due process or discovery rights, specifically that notice of the Motion was unduly short or that notwithstanding notice of the Motion, they did not receive notice of the Sale Hearing, where their rights would purportedly be adjudicated. The Court concludes that notice of the Motion and opportunity to be heard was adequate because it complied with applicable rules and case law. "An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Mullane v. Central Hanover Bank & Trust Co.,* 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (1950).

The Motion was filed on May 14, 2009, and served that day by overnight delivery. The hearing on the Motion was originally scheduled for June 3, 2009, more than 20 days after the Motion was filed. Twenty days is more than what is required under the Case Management Order (ECF No. 661), which require 14 days notice for matters to be heard at an omnibus hearing, or the Local Rules, which require 10 days notice for contract rejection motions. *See* Local Rule 6006–1 (referencing time limits set forth in Local Rule 9006–1(b)). Additionally, Rule 2002 does not list contract rejection motions among the types of relief requiring 20– or 25–days' notice. The objection deadline was May 26, 2009, and while the Court received over 200 objections, many of the Affected Dealers filed Objections long before that deadline so they could object to the Fiat Transaction itself.

With respect to the Fiat Transaction, the Bidding Procedures Order (ECF No. 492) required that the sale notice (the "Sale Notice"), which was attached as an exhibit thereto, be served within two business days after entry of the Bidding Procedures Order. It is not disputed

that the Debtors fulfilled this requirement. The Sale Notice, which was served on May 11, 2009, notified parties that an order approving the sale, if the sale were approved, would authorize the assumption and assignment of various executory contracts ***208** and unexpired leases. The Bidding Procedures Order, which was annexed to the sale notice, provided the timeframe for when the Debtors were required to notify those dealers whose agreements were to be assumed and assigned.[38] It is not disputed that the Debtors fulfilled this requirement.

[30] The Bidding Procedures Order also provided that the purchaser could request that the Debtor designate (or consent to the Debtor designating) additional executory contracts or unexpired leases for 30 days after the closing, providing a mechanism for the Debtors to correct any errors in the application of their rationalization methodology.[39] The Bidding Procedures Order also provided the date of the Sale Hearing and related objection deadline. The argument by some of the Affected Dealers that they were unaware that the Sale Hearing could affect them is undermined by the large number of Objections filed by Affected Dealers to the Fiat Transaction itself, wherein those Affected Dealers challenged the Fiat Transaction on many of the same grounds discussed in this Opinion. *See, e.g., Advantage Healthplan, Inc. v. Potter,* 391 B.R. 521, 553 (D.D.C.2008) (finding that a party who had sufficient actual notice of a settlement and hearing and filed an objection was not denied due process). Some of those Affected Dealers testified at the Sale Hearing and then had the additional opportunity to press their Objections at the hearing on the Motion. Additionally, it was not improper for the Sale Hearing to be held before the hearing on the Motion. *See G Survivor,* 171 B.R. at 759 (holding that a rejection motion returnable after the sale was proper so long as the rejection passed the business judgment test and the contracts to be rejected were designated prior to court approval of the sale contract).

[31] The Debtors have also provided discovery to parties who have requested it. In fact, the Debtors represent that no Affected Dealer who has actually attempted to obtain discovery from the Debtors has gone ignored or empty-handed by the Debtors. The Debtors represent that they have produced nearly 350,000 pages of documents and made 13 witnesses available for deposition. The Court notes that many of the Affected Dealers deposed and cross-examined certain of these witnesses. It is not clear what additional information the Affected Dealers that are objecting to discovery are seeking that would be relevant to the Court's decision on the Motion. In any event, due process was not offended by whatever, if any, shortcomings in discovery there may have been. *See Batagiannis v. West Lafayette Cmty. Sch. Corp.,* 454 F.3d 738, 742 (noting that a civil litigant's "complaints about a lack of pre-hearing discovery assume that there is such an entitlement, which there isn't. There is no constitutional right to discovery even in criminal prosecutions") (citing *Wardius v. Oregon,* 412 U.S. 470, 93 S.Ct. 2208, 37 L.Ed.2d 82 (1973)).

[32] In the second category, some of the Affected Dealers argue that each of the 789 Rejected Agreements must be considered individually. The Affected Dealers ***209** cite *In re Nickels Midway Pier, LLC,* 341 B.R. 486, 500–01, (D.N.J.2006), for the proposition that the bankruptcy court must "analyze separately" whether rejection is in the best interests of the estate and meets the business judgment standard. *See id.* at 501. *Nickels Midway* is inapposite for a number of reasons, not the least of which being that the court first had to determine whether an agreement between two parties consisted of two independent, divisible components of the agreement, either of which may have given rise to different protections under certain subsections of § 365 not relevant here. *Nickels Midway* also addressed an agreement between two parties, not multiple agreements involving many parties in which one party to the agreements remained constant. *Nickels Midway* therefore does not require separate analysis of each Rejected Agreement by the Court. Indeed, other cases the Affected Dealers cite also address a court's analysis of agreements that may be severable or divisible rather than a court's analysis of agreements that were undeniably separate in the first place, as is the case here.

Additionally, the argument that each agreement must be considered individually is belied by Rule 6006(f)(6). That rule states that "[a] motion to reject ... multiple executory contracts or unexpired leases that are not between the same parties shall: ... (6) be limited to no more than 100 executory contracts or unexpired leases." It would defeat the purpose of the rule if a debtor were allowed to "join requests for authority to reject multiple executory contracts or unexpired leases in one motion," Rule 6006(e), but the court were then required to consider each agreement contained in the

motion separately. In this case, the Debtors sought a waiver for the limitation in Rule 6006(f)(6), and the Court granted the waiver in the Order. Although some of the Affected Dealers cite the 2007 Advisory Committee Note [40] explaining the 2007 amendments to Rule 6006, in which subsections (e), (f), and (g) were added, the Affected Dealers fail to account for the ability of the court to order "otherwise." Specifically, the 2007 Advisory Committee Note to Rule 6006 states that "[a]n omnibus motion to assume, assign, or reject multiple executory contracts and unexpired leases must comply with the procedural requirements set forth in subdivision (f) of the rule, unless the court orders otherwise. These requirements are intended to ensure that the nondebtor parties to the contracts and leases receive effective notice of the motion." 10 COLLIER ON BANKRUPTCY ¶ 6006 App. 6006 [6] (15th ed. rev.2009). [41] As previously discussed, ***210** notice regarding the Motion was adequate and satisfied due process, and no Affected Dealer has asserted that he could not find his name on any list of Affected Dealers.

None of the Affected Dealers argued that they did not immediately realize their names were on the lists attached to the Motion because of the number of dealers listed. The issues raised as to the adequacy of notice had nothing to do with the number of dealers listed. Instead some of the Affected Dealers focused on the time between receiving notice of the rejection and the Sale Hearing because they contend it was not until they received the notice of rejection did they realize that the sale motion would impact their dealerships. As such, these Objections are better characterized as objecting to the sufficiency of notice for the Sale Hearing. However, as previously discussed, that contention is not consistent with the notice required and provided under the Bidding Procedures Order.

[33] Under the circumstances of this case, the Court found it appropriate to order "otherwise" and permit more than 100 agreements to be rejected through one motion. All of the Rejected Agreements were substantially similar, all of the Rejected Agreements were subject to a single comprehensive analysis by the Debtors, and all of them were being rejected and not assigned to New Chrysler. [42] As such, the waiver in the Order helps achieve what the 1983 Advisory Committee Notes deemed the "objective of 'expeditious and economical administration' of cases under the [Bankruptcy] Code [which] has frequently been recognized by the courts to be 'a chief purpose of the bankruptcy laws.' " 9 COLLIER ON BANKRUPTCY ¶ 1001 App. 1001[1] (15th ed. rev.2009) (citing *Katchen v. Landy,* 382 U.S. 323, 328, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966); *Bailey v. Glover,* 88 U.S. (21 Wall.) 342, 346–47, 22 L.Ed. 636 (1874); *Ex parte City Bank of New Orleans,* 44 U.S. (3 How.) 292, 312–14, 320–22, 11 L.Ed. 603 (1845)); *see also In re Harris,* 464 F.3d 263, 271 (2d Cir.2006) (quoting *In re CPDC Inc.,* 221 F.3d 693, 699–700 (5th Cir.2000) (noting that "the primary goal of courts as enforcers of the bankruptcy rules should be to ensure the swift and efficient resolution of disputes pertaining to the distribution of the bankruptcy estate")). Moreover, while the Court understands the concern of certain Affected Dealers regarding compliance with the Rule 6006(f)(6) limitation, the Court notes that it would not have advanced the process by requiring the Debtors to file eight separate motions requesting the same relief. Notice was timely and proper.

Additional Objections

[34] Additional Objections were raised by few of the Affected Dealers. The Objections related to federal antitrust law are without merit. There is no evidence that the Debtors and New Chrysler engaged in any sort of "conspiracy" to "artificially driv[e] up the prices of new vehicles through lowered competition." In fact, the Debtors have stated that one of the purposes of the rationalization program was increasing sales and profits at dealers whose agreements were not rationalized, including prior to the bankruptcy in Project Genesis. In their business judgment, ***211** the Debtors determined that this would make their dealership network as a whole more competitive with other OEMs' dealership networks in today's marketplace. Such determination is not inconsistent with the antitrust laws, which were enacted for "the protection of competition, not competitors" and "restrain mergers only to the extent that such combinations may tend to lessen competition." *Brown Shoe Co. v. United States,* 370 U.S. 294, 320, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962). The Debtors' dealership rationalization program was designed to *increase* competition across the automobile industry by putting them on stronger footing. There is no evidence whatsoever that the rationalization program was undertaken to restrain trade or commerce in violation of the Sherman Act. *See* 15 U.S.C. § 1.

[35] There is also no evidence that the Debtors contracted, combined, or conspired with Fiat to do so. The Debtors stated that they shared their rationalization methodology with Fiat, and Altavilla, Fiat's executive, testified that Fiat agreed with that methodology. There is no evidence that "competitively sensitive information" regarding any specific dealer was exchanged between the Debtors and Fiat at any point. To the extent Fiat agreed with Debtors on which agreements would be rejected and which would be assumed and assigned to New Chrysler, Altavilla testified that the number of dealers to be rejected came from the Debtors' application of the methodology to which Fiat had agreed. Moreover, on May 14, 2009, the Federal Trade Commission ("FTC") terminated early the statutory waiting period under the Hart–Scott–Rodino Act (the "HSR Act"), indicating that neither the FTC nor the Department of Justice Antitrust Division intends to take any enforcement action with respect to the Fiat Transaction, including for any so-called "gun-jumping." On the contrary, there is no private right of action for such a violation in the HSR Act. See 15 U.S.C. § 18a(g).

[36] **[37]** **[38]** **[39]** **[40]** The Objection that the rejection constitutes a violation of the Takings Clause of the Fifth Amendment is without merit because the Rejected Agreement was a contract between the Affected Dealer and the Debtors. A lien in some collateral that is property of the estate is a necessary prerequisite to a Fifth Amendment Takings Clause claim in the bankruptcy context. *See Chrysler,* 405 B.R. at 96 (citing *United States v. Security Industrial Bank,* 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982)). The Objections that § 365(n) entitles the Affected Dealers to retain their rights with respect to the Chrysler trademarks and continue using them post-rejection are also without merit. Section 365(n) only allows such retention of rights and continued usage if the executory contract is one under which "the debtor is a licensor of a right to intellectual property." Section 365(n). Trademarks are not "intellectual property" under the Bankruptcy Code. *See* § 101(35A); *see also In re Chipwich, Inc.,* 54 B.R. 427, 431 (Bankr.S.D.N.Y.1985) (stating that rejection of licenses by licensor deprives licensee of right to use trademark but licensee has allowable claim for damages for breach of contract). Similarly, the Objection that the rejection constitutes a violation of the First Amendment because the Affected Dealers may no longer use the Chrysler name in, *e.g.,* newspaper advertisements is without merit and far afield.

[41] **[42]** Lastly, the Objections that the Debtors violated certain Affected Dealer-debtors' automatic stays by rejecting their agreements are without merit. The Debtors were not required to seek relief from the automatic stay in another debtor's bankruptcy case before exercising their ***212** right to reject a contract with that debtor in this case. *See In re Sun City Investments, Inc.,* 89 B.R. 245, 249 (finding that a debtor need not move for relief from the automatic stay prior to filing a motion to reject an executory contract with another debtor). While relevant authority, *In re Computer Commc'ns, Inc.,* 824 F.2d 725 (9th Cir.1987), indicates that the unilateral termination by one debtor of a contract with another debtor violates the automatic stay of the second debtor, *see id.* at 728, rejection is not termination. *See* 2 NORTON BANKR.L. & PRACT. 3d § 46:23 (footnote omitted) ("Rejection of a contract or unexpired lease, while constituting a breach of contract, does not terminate the contract or lease"). As such, rejection is a fundamental right of a debtor "not to perform" its contractual obligations. From such rejection, depending on the nature of the contract, certain consequences flow to the debtor and its nondebtor counterparty. [43]

[43] Moreover, another bankruptcy court in one of the Affected Dealer-debtors' bankruptcy cases denied that Affected Dealer's emergency contempt motion against the Debtors for the alleged stay violation. *See* Unreported Order in *In re Dave Croft Motors, Inc.,* Case No. 08–32084 (Bankr.S.D.Ill. May 29, 2009) ("The Emergency Motion for Contempt for Chrysler LLC's Violation of the Automatic Stay filed by the Debtor, on May 26, 2009, is DENIED; and, ... Nothing in this Court's Order is intended to delay proceedings in the bankruptcy of Chrysler, LLC, in the Southern District of New York, in Case No. 09–50002."). Accordingly, the issue of whether the Debtors violated that Affected Dealer's automatic stay is precluded by *res judicata* because the issue was adjudicated by the other court. [44]

CONCLUSION

The Court concludes that the Debtors exercised sound business judgment in rejecting the Rejected Agreements and that such rejection benefited the Debtors' estates. The Court further concludes that such rejection is appropriate and necessary based on the evidentiary record and the arguments made by the parties and that such rejection

is warranted and permissible under §§ 105, 365, and Rule 6006. The Court finds that to the extent that any Dealer Statutes conflict with the terms of the Order or the impact of such rejection under the Bankruptcy Code and applicable case law, such laws are preempted by the Bankruptcy Code, pursuant to the Supremacy Clause of the United States Constitution. The Court further finds that a ***213** waiver of the limitation in Rule 6006(f)(6) is warranted and permissible.

This Court shall retain jurisdiction to resolve all matters relating to the implementation, enforcement, and interpretation of the Order. Without limiting the foregoing, the Court also shall retain jurisdiction with respect to the Order and the Rejected Agreements over (a) any actions by the Affected Dealers against the Debtors or the property of their estates, including, without limitation, any actions in violation of the automatic stay under § 362; and (b) any rejection damages claims or other claims alleged against the Debtors' estates, stemming from, or in any way related to, the rejection of the Rejected Agreements, or any objections or defenses thereto. Matters concerning the nature, characterization, priority, or any other aspect of such claims, including damages, related to the rejection of the Rejected Agreements shall be heard by the Court at the hearings regarding such claims and damages and are not decided herein.

All Citations

406 B.R. 180, 51 Bankr.Ct.Dec. 215

Footnotes

1 In the Order, the Court stated that it would issue an opinion (the "Opinion") regarding the Motion (as defined *infra*), addressing, among other things, the Objections (as defined *infra*) raised by the various parties.

2 The request that relief under § 525 of the Bankruptcy Code be granted in the Order was no longer sought in connection therewith.

3 Capitalized terms not otherwise defined herein have the meanings given to them in the Motion.

4 An objection by an Affected Dealer was raised at the June 9, 2009 hearing regarding the admission of evidence from prior hearings. The testimony and deposition designations (and counter-designations) were filed by the Debtors and certain Affected Dealers (as defined *infra*) prior to the June 9, 2009, hearing. Debtor also moved into evidence declarations that had been moved into evidence at prior hearings as well. The Affected Dealer making the objection argued in substance that such evidence was not susceptible to judicial notice, citing *Global Network Communications v. City of New York,* 458 F.3d 150, 157 (2d Cir.2006), but the Debtors did not ask the Court to take judicial notice of the testimony and deposition designations (and counter-designations) and declarations. Rather, the Debtors moved, without objection, the aforementioned into evidence, and it was admitted by the Court. Thereafter, Grady was available for cross-examination at the June 4, 2009 hearing, but no request was made to cross-examine him. Therefore, the evidence at issue is properly before the Court.

5 One bankruptcy court commented on the policy reasons behind § 365 not long after the Bankruptcy Code was enacted: "[C]ourt approval under [§] 365(a) ... except in extraordinary situations, should be granted as a matter of course. To begin, the rule places responsibility for administering the estate with the trustee [or debtor-in-possession], not the court, and therefore furthers the policy of judicial independence considered vital by the authors of the [Bankruptcy] Code. Second, this rule expedites the administration of estates, another goal of the Bankruptcy Reform Act. Third, the rule encourages rehabilitation by permitting the replacement of marginal with profitable business arrangements." *In re Summit Land Co.,* 13 B.R. 310, 315 (Bankr.Utah 1981) (footnote omitted).

6 The Motion referred to the Dealer Statutes as such, but the Order referred to them as the "Dealer Laws." Their definitions are identical and any reference in this Opinion to the Dealer Statutes corresponds to any reference in the Order to the Dealer Laws, and vice versa.

7 "Congress overruled *Bildisco*'s rejection standard for collective-bargaining agreements by passing 11 U.S.C. § 1113 to control the rejection of those agreements." *In re Mirant Corp.,* 378 F.3d 511, 524–25 (5th Cir.2004) (citing *Am. Flint Glass Workers Union v. Anchor Resolution Corp.,* 197 F.3d 76, 82 (3d Cir.1999)).

8 As further discussed *infra,* the Dealer Statutes have a limited connection to public safety. The vast majority of Dealer Statutes concern solely commercial issues affecting the dealers and their customers and communities. A number of Dealer Statutes mention "highway safety" and even then it is in the context of convenient vehicle servicing. Thus, the health and safety of the public are not threatened by rejection. *See Pilgrim's Pride,* 403 B.R. at 425. Further, taking the public safety argument, as articulated by certain Affected Dealers, to its logical conclusion, driving outside the range of

one's local Affected Dealer would be a threat to one's safety. This is simply not the case. The fact that one may have to drive further for service or transport a car further for service is a matter of convenience and not one of public safety. Moreover, there is nothing in the Debtors' dealer rationalization program, as further discussed *infra,* that would create a public safety issue.

9 The Affected Dealers also cite another case in which rejection was disallowed where the counterparty to an exclusive agreement would be "ruined" by rejection of the contract. *See In re Petur U.S.A. Instrument Co., Inc.,* 35 B.R. 561 (Bankr.W.D.Wash.1983). While the Affected Dealers cite other cases for the proposition that rejection may be disallowed when rejection "disproportionately damages" the counterparty as opposed to benefiting the estate or general unsecured creditors, *Petur* represents the outer limit of this strand of jurisprudence. The *Petur* court relied on "equity" to disallow rejection even though the court concluded that the debtor properly exercised its business judgment and that rejection could create additional profits and aid in reorganization. *See Petur,* 35 B.R. at 563. The *Petur* court nonetheless buttressed its conclusion by considering other facts relevant to the debtor's reorganization and whether such profits were likely to materialize. The Court respectfully disagrees with the *Petur* analysis. Also, additional facts present in *Monarch* and *Petur* further distinguish those cases from this case.

10 The Affected Dealers also argue that the Debtors impermissibly considered the benefit to New Chrysler in their rejection decisions, but a "debtor may reject a contract to make itself more attractive to a buyer." *G Survivor,* 171 B.R. at 759 (citing *In re Maxwell Newspapers, Inc.,* 981 F.2d 85 (2d Cir.1992)).

11 *See infra* fn.13.

12 A "partial line" dealer only sells one or two of the Debtors' brands, such as Chrysler or Jeep. A "full line" dealer sells all three of the Debtors' brands, Chrysler, Jeep, and Dodge.

13 These cost-savings stand in contrast to the Affected Dealers' oft-repeated contention that the dealers cost the Debtors nothing. Nevertheless, cost-savings is not the relevant test under the business judgment standard, *see supra* fn. 11 and accompanying text.

14 According to the Debtors, although Project Genesis primarily focused on dealers in metropolitan markets and key secondary markets (where, among other things, there had been less brand consolidation), the Debtors also evaluated the remaining secondary and rural market dealers. According to the Debtors, prior to the bankruptcy they worked with dealers in a cooperative manner to reduce and consolidate the domestic dealer network, within the limitations imposed by the Dealer Statutes and any existing agreements. Further, Project Genesis and its predecessor programs have resulted in an expenditure by the Debtors of over $216 million.

15 The factors included, among other things, (a) the dealer's (i) brand affiliations; (ii) raw sales volume; (iii) sales performance relative to its Minimum Sales Responsibility ("MSR"); (iv) location; (v) type of market; (vi) facilities; (vii) customer service; (viii) history of experience; and (ix) market share; (b) the planning potential for the dealership; and (c) other factors.

16 New vehicle registration information included such information for the Debtors' and other OEMs' comparable products, indicating the location of new vehicle registrations within the market and the location of registrations of new motor vehicles sold by each dealer. Demographic data included (i) current population and household density; (ii) anticipated shift of population and household density; and (iii) average household income.

17 The Fiat executive, Alfredo Altavilla ("Altavilla"), who testified at the Sale Hearing (as defined in *Chrysler,* 405 B.R. 84) testified that Fiat did not participate in the selection of individual dealers for rejection but that it was made aware of and agreed with the Debtors' selection methodology and criteria. Altavilla further testified that New Chrysler would have used the same methodology because the Debtors used the same methodology as Fiat used in Europe for restructuring their dealership network.

18 Altavilla testified that it did not make a material difference whether the restructuring of the dealership network occurred before or after the closing of the Fiat Transaction. However, as discussed *infra* fn. 19, 20 and accompanying text, the debtor-in-possession budget anticipated a 25% reduction in the number of dealerships as of June 9, 2009. The Debtors accordingly exercised their business judgment within the constraints imposed by the debtor-in-possession judgment.

19 The Court notes that it is immaterial that the debtor-in-possession lender also provided financing for the Fiat Transaction. The Court approved the debtor-in-possession budget, and the Debtors were obligated to stay within its constraints. The Court further notes that the Debtors developed a program to assist in the repurchase and reallocation of the Affected Dealers' inventory in a manner designed to maximize the value achieved by the Affected Dealers. This program has been partially subsidized by the Debtors, and on June 9, 2009, the Debtors' counsel represented that as of that date 97% of Affected Dealers were participating in the program.

20 The Debtors' prepetition loan from the Governmental Entities (as defined in *Chrysler,* 405 B.R. at 85) was conditioned, in part, on dealer network rationalization, and the budget for the Debtors' postpetition debtor-in-possession loan was based, in part, upon such rationalization. *See supra* fn. 19 and accompanying text.

21 Altavilla testified that although Fiat did not indicate the size of the restructuring of the dealership network, the number of dealers involved in the restructuring came out of the application of the Debtors' selection methodology. Altavilla also responded affirmatively to a question regarding whether a dealership network needed to be restructured for the Fiat Transaction to close, stating that a "restructuring needs to occur."

22 Some of the Affected Dealers made much of a certain customer survey regarding the sale of new vehicles. Under that survey the Debtors' dealerships outranked Toyota and other transplant OEMs. It was argued, then, that trying to emulate the dealership networks of Toyota and other transplant OEMs would be a mistake and lead to less sales. The survey presented dealt with the customer/dealer relationship at the time of sale and did not include the customer/dealer relationship regarding, *e.g.,* warranty service. However, regardless of where the Debtors' dealers ranked in the sales survey, or any other survey, it is an inescapable fact that the dealership networks of Toyota and other transplant OEMs have been very successful and have over the years taken a considerable amount of the market share away from the American OEMs, including the Debtors. Therefore, the sales survey does not provide any basis to find that the Debtors' efforts to emulate the transplant OEMs' dealership networks was not a proper exercise of their business judgment.

23 These emails were introduced at the Sale Hearing. The admission of each email was objected to based upon hearsay grounds. Following the Sale Hearing, discovery, including depositions, took place. Thereafter, no attempt was made to address the evidentiary objection regarding these emails so as to have them considered for purposes of the Motion.

24 Although the Debtors seek to reject the Rejected Agreements, some of the Affected Dealers argue that the Debtors are constructively terminating those agreements, thus giving rise to the preemption issue. The Debtors argue that because they are only seeking to reject the Rejected Agreements and not terminate them, the rejections are not subject to the Dealer Statutes. *See* 2 NORTON BANKR.L. & PRACT. 3d § 46:23 (footnote omitted) ("Rejection of a contract or unexpired lease, while constituting a breach of contract, does not terminate the contract or lease" except in the narrow situations set out in subsections (h) and (i) of § 365, which are not relevant here). However, the Debtors argue that to the extent any of the Dealer Statutes could be construed to prevent rejection, such laws are preempted. The Debtors further argue that while the Dealer Statutes may limit the Debtors' ability to "terminate" the dealer agreements outside of bankruptcy, the Bankruptcy Code preempts the operation of the Dealer Statutes to prevent rejection within bankruptcy by virtue of field preemption and conflict preemption. Therefore, the issue of whether the Bankruptcy Code preempts the Dealer Statutes is squarely before the Court.

25 Two additional cases cited by some of the Affected Dealers, *In re Synergy Dev. Corp.,* 140 B.R. 958 (Bankr.S.D.N.Y.1992) and *In re Beker Indus. Corp.,* 57 B.R. 611 (Bankr.S.D.N.Y.1986), both addressed action by states in the automatic stay context and are thus not relevant to the issues before the Court.

26 Although the *Friarton* court rejected the holding in *Stable Mews* to the extent *Friarton* differed from it, *see Friarton,* 65 B.R. at 593 fn. 3, the reasoning, if not the result, in the two decisions may be harmonized. The *Friarton* court stated that 28 U.S.C. § 959(b) obligated the debtor-in-possession to work under the same requirements of law with respect to the operation of its real property that it would be if it were not a debtor-in-possession. *Friarton,* 65 B.R. at 590. Because the very language of § 365(h) entitled the tenant-lessees to remain in possession under the rent-control laws (i.e., the "applicable nonbankruptcy law"), the *Friarton* court held that the tenant-lessees could enforce the rights attendant to such possession by commencing a nonbankruptcy proceeding against the debtor-in-possession pursuant to 28 U.S.C. § 959. *See Friarton,* 65 B.R. at 593.

In *Stable Mews,* the court held that the trustee, who took over operating a commercial rental building for the debtor-in-possession, was not required to provide essential services to the tenant-lessees whose leases he had rejected. *See Stable Mews,* 41 B.R. at 599. The tenant-lessees' right to possession of their apartments derived solely from § 365(h) and not any specific nonbankruptcy law protecting the tenant-lessees, but this right could not infringe upon the trustee's right to reject the leases regardless of the condition of the premises at the time of rejection. *See id.* at 597.

27 While some of the Affected Dealers cite *In re White Crane Trading Co., Inc.,* 170 B.R. 694 (Bankr.E.D.Cal.1994) for the proposition that "[s]ince section 959(b) admits no exceptions, the court cannot carve out an exemption from state law," *id.* at 705, they fail to place it in the proper context. The court in that case held that 28 U.S.C. § 959(b) "prohibits the use of bankruptcy as a ruse to circumvent applicable state consumer protection laws by those who continue to operate in the marketplace." *Id.* at 698. There has been no allegation that the Debtors' bankruptcy is a ruse to circumvent the Dealer Statutes by a car manufacturer continuing to operate in the marketplace.

28 The right to possession of *Stable Mews* ' non-rent-controlled tenant-lessees was not enforceable by the rent-control laws or any other "applicable nonbankruptcy law." Therefore, the trustee was able to reject the leases under § 365(a) while the tenant-lessees were limited to their rights (*i.e.,* staying in possession of the rental units) and remedies (*i.e.,* setting-off damages from the trustee's breach against rent reserved in the lease) under § 365(h). *See Stable Mews,* 41 B.R. at 597. The tenant-lessees could not use 28 U.S.C. § 959(b) to enforce a right they did not have under applicable nonbankruptcy law by compelling the trustee to perform an obligation from which he was relieved when he rejected the leases. *See Stable Mews,* 41 B.R. at 600–01; *but see Saravia v. 1736 18th St., N.W., Ltd. P'ship,* 844 F.2d 823, 827 (D.C.Cir.1988) (holding that rejection of leases by a debtor-landlord only released the debtor from the contractual obligations under the leases, not the local statutory obligations of all landlords). *Saravia* relied on *Friarton* for support, but both *Saravia* and *Friarton* addressed residential buildings, while *Stable Mews* addressed a commercial building, which is more closely analogous to the facts in this case.

29 The *Stable Mews* court further concluded that "Congress, in balancing the rights of debtor-in-possession landlords with those of tenants through § 365(h) of the Code, did not intend for that balance to be disturbed by the general prohibitions of 28 U.S.C. § 959(b). Particularly is this so in this case where the general policy of permitting trustees to rid themselves of further executory obligations has been long engrained in bankruptcy law and policy and, most importantly, where the policy of even competition sought to be advanced by the general prohibition will not be markedly disturbed." *Stable Mews,* 41 B.R. at 600. The *Stable Mews* court had previously noted that the Bankruptcy Code's setoff remedy under § 365(h) paralleled the state law remedy for a landlord's discontinuation of services but that the remedy of specific performance was preempted.

30 At the June 9, 2009 hearing, an argument was presented in which one of the Affected Dealers stated that the rationalization program would leave a certain county in California without a dealership and create a public safety issue. Apparently in support of that argument, a local council in that county passed an ordinance in which a public safety concern was raised because many of their police cars were manufactured by the Debtors. The argument is based on the same unwarranted premise that having to seek warranty and other services from a dealer at a greater distance from the customer than that customer's Affected Dealer would create a public safety issue. The Court reiterates that this is an argument based on convenience, not public safety.

31 At the June 9, 2009 hearing, an argument was presented in which one of the Affected Dealers cited *In re G. Heileman Brewing Co., Inc.,* 128 B.R. 876 (Bankr.S.D.N.Y.1991), in regard to preemption. That case is inapposite because the court there held that under the 21st Amendment to the Constitution, a certain Oregon statute preempted § 365. No such Amendment or Article of the Constitution is implicated by the Dealer Statutes at issue here.

32 Returning briefly to 28 U.S.C. § 959(b), state law protections cannot be used to negate the Debtors' rejection powers under § 365. "The requirement that the debtor in possession continue to operate *according to* state law requirements imposed on the debtor in possession (i.e., § 959(b)) does not imply that its powers under the Code are *subject to* the state law protections." *In re PSA, Inc.,* 335 B.R. 580, 587 (Bankr.D.Del.2005) (emphasis in original). Some of the Affected Dealers in substance argue that the Bankruptcy Code's rejection powers are subject to state law. This is not the law. Such argument either flatly ignores the Supremacy Clause or subordinates the Supremacy Clause to a statute (*i.e.,* 28 U.S.C. § 959(b)).

33 "Termination procedures" and related obligations frustrate § 365's purpose of giving a bankruptcy court the authority to determine whether a contract may be assumed or rejected while also frustrating § 365's purpose to free a debtor of obligations once the debtor has rejected the contract. Section 366 is specifically designed for utilities, and it is not relevant to this case that courts have found that state and local regulations regarding procedures for termination are not preempted. *See, e.g., Robinson v. Michigan Consol. Gas Co.,* 918 F.2d 579, 588 (6th Cir.1990). Any such argument is not analogous to and far afield of the issue of whether the Dealer Statutes are preempted.

34 Additionally, some of the Affected Dealers argue that certain of the criteria the Debtors used in making their rationalization determinations were impermissible metrics under certain Dealer Statutes. To the extent such metrics are impermissible under certain Dealer Statutes, they are preempted because they frustrate § 365's purpose of allowing a debtor to exercise its business judgment and evaluate and reject contracts when the debtor determines rejection benefits the estate.

35 The only exception in which the Debtors sought injunctive relief related to the consequence of an Affected Dealer's failure to file a timely and proper damages or administrative claim. The only objection to that provision of the Order was the inclusion of the word "proper." The nature of the relief sought was not controverted.

36 At the June 9, 2009 hearing, an Affected Dealer raised on objection regarding the Debtors' ability to have certain equitable relief available under a Dealer Statute discharged, citing *Gouveia v. Tazbir,* 37 F.3d 295 (7th Cir.1994) and *Matter of Udell,* 18 F.3d 403 (7th Cir.1994) for support. The Court notes that discharge is not before the Court, but reiterates that

to the extent any Dealer Statute provides equitable relief that impacts the Debtors' right under § 365 to reject a contract, such law is preempted.

37 The Court notes that the Order's reference to the "impact" of rejection under the Bankruptcy Code is a restatement of the law of preemption, as described above.

38 No appeal of that order was taken.

39 After the Sale Hearing concluded on May 29, 2009, New Chrysler on June 2, 2009 waived its right to seek the designation of additional contracts or leases. That document was filed by the Debtors on June 3, 2009 (ECF No. 3478). There is no indication that when this provision was discussed at the Sale Hearing or any other hearing the Debtors were aware that New Chrysler would waive its right under that provision, nor is there any indication in the record that New Chrysler had made that determination prior to the conclusion of the Sale Hearing.

40 Courts often look to the Advisory Committee Notes for interpretive guidance. *See, e.g., In re Worcester,* 811 F.2d 1224, 1227 (9th Cir.1987) (relying on the Advisory Committee Notes for clarity as to a rule's application); *In re Crouthamel Potato Chip Co.,* 786 F.2d 141, 145 (3d Cir.1986) (referencing the Advisory Committee Notes for a rule's purpose); *United Consumers Club, Inc. v. Bledsoe,* 441 F.Supp.2d 967, 985 (N.D.Ind.2006) (citing Advisory Committee Notes); *In re Levine,* 287 B.R. 683, 701 (Bankr.E.D.Mich.2002) (using the Advisory Committee Notes to "clear up [an] ambiguity").

41 At the June 9, 2009 hearing, an argument was presented in which one of the Affected Dealers cited *Pfohl Brothers Landfill Site Steering Comm. v. Allied Waste Systems, Inc.,* 255 F.Supp.2d 134 (W.D.N.Y.2003) for the proposition that "shall" indicates that an action is mandatory. See id. at 151. *Pfohl* is inapposite because it discussed the construction of a statute, not a rule, and specifically made reference to the fact that the word "may" was "legislated." The Bankruptcy Rules are developed by the Advisory Committee and accepted by Congress, and unlike legislative histories, which may be consulted for statutory interpretation only in certain circumstances, the Advisory Committee Notes are often read in conjunction with the Rules for interpretive purposes. *See supra* fn. 40.

42 *See, e.g., Pilgrim's Pride,* 403 B.R. at 418 fn. 8 (ruling on a motion to reject the contracts of 26 counterparties in one order, even though seven of the counterparties had not joined an objection when the court initially ruled that the contracts of 19 counterparties would be ruled on in one order, because "as a practical matter" the counterparties filing the objection were "not distinguishable" from the counterparties who did not join the objection).

43 In one of the Affected Dealer-debtors' bankruptcy cases, *In re Prebul Jeep, Inc.,* Case No. 09–10838 (Bankr.E.D.Tenn.2008), that Affected Dealer moved for an order of contempt against the Debtors for violation of the automatic stay. That Affected Dealer so moved on June 10, 2009, with a hearing on the motion scheduled for July 16, 2009. However, that Affected Dealer raised the issue of violation of the automatic stay in an Objection filed with this Court on May 29, 2009, and this Court overruled that Objection in the Order on June 9, 2009, along with the other Objections not otherwise resolved in the Order.

44 The Court notes that counsel for that Affected Dealer failed to disclose this fact when he presented arguments to the Court at the June 9, 2009 hearing. Further, although that Affected Dealer cited *In re Miller,* 397 F.3d 726 (9th Cir.2005) for the proposition that one bankruptcy court's action against a debtor with a bankruptcy case pending before another bankruptcy court constitutes a violation of the automatic stay and is void, *see id.* at 732–33, *Miller* is distinguishable because in that case the first debtor sought attorney's fees (*i.e.,* monetary damages) from the second debtor. In this case, the Debtors are exercising their right "not to perform" their contractual obligations.

End of Document

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Tempnology LLC, 1st Cir.BAP (N.H.), November 18, 2016

607 F.3d 957
United States Court of Appeals,
Third Circuit.

In re EXIDE TECHNOLOGIES, Debtors.
Enersys Delaware, Inc., formerly
known as EnerSys Inc., Appellant.

No. 08-1872.
|
Argued on May 12, 2009.
|
Opinion Filed: June 1, 2010.
|
As Amended June 24, 2010.

Synopsis

Background: Chapter 11 debtor filed motion to reject "integrated agreement" pursuant to which it had licensed its trademark to the entity that had purchased substantially all of its industrial battery business. Purchaser objected. The United States Bankruptcy Court for the District of Delaware granted the motion to reject, and purchaser appealed. The District Court, Sue L. Robinson, J., 2008 WL 522516, affirmed, and purchaser appealed.

[Holding:] The Court of Appeals, Roth, Circuit Judge, held that under New York law, purchaser had substantially performed its obligations under the agreement and, thus, the agreement was not an executory contract.

Order vacated and case remanded with instructions.

Ambro, Circuit Judge, filed concurring opinion.

West Headnotes (19)

[1] Bankruptcy
Conclusions of law;de novo review

Court of Appeals exercises plenary review of an order from a district court sitting as an appellate court in review of a bankruptcy court.

8 Cases that cite this headnote

[2] Bankruptcy
Conclusions of law;de novo review

Bankruptcy
Clear error

In reviewing an order from a district court sitting as an appellate court in review of a bankruptcy court, the Court of Appeals will review both courts' legal conclusions de novo and will set aside the bankruptcy court's factual findings only if clearly erroneous.

8 Cases that cite this headnote

[3] Bankruptcy
Conclusions of law;de novo review

Bankruptcy
Clear error

In reviewing an order from a district court sitting as an appellate court in review of a bankruptcy court, the Court of Appeals will engage in a mixed standard of review for mixed questions of law and fact, affording a clearly erroneous standard to integral facts, but exercising plenary review of the lower court's interpretation and application of those facts to legal precepts.

9 Cases that cite this headnote

[4] Bankruptcy
In general;nature and purpose

Policy behind Chapter 11 of the Bankruptcy Code is the ultimate rehabilitation of the debtor.

1 Cases that cite this headnote

[5] Bankruptcy
Executory nature in general

Congress intended the term "executory contract" to mean a contract on which performance is due to some extent on both sides. 11 U.S.C.A. § 365(a).

2 Cases that cite this headnote

[6] Bankruptcy
Executory nature in general

An "executory contract" is a contract under which the obligation of both the debtor and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other. 11 U.S.C.A. § 365(a).

11 Cases that cite this headnote

[7] Bankruptcy
Executory nature in general

Unless both parties have unperformed obligations that would constitute a material breach if not performed, a contract is not "executory" under the section of the Bankruptcy Code governing executory contracts and unexpired leases. 11 U.S.C.A. § 365(a).

9 Cases that cite this headnote

[8] Bankruptcy
Proceedings

Party seeking to reject a contract bears the burden of demonstrating that it is executory. 11 U.S.C.A. § 365(a).

Cases that cite this headnote

[9] Bankruptcy
Executory nature in general

Time for testing whether there are material unperformed obligations on both sides of a contract, for purposes of determining whether it is an executory contract, is when the bankruptcy petition is filed. 11 U.S.C.A. § 365(a).

5 Cases that cite this headnote

[10] Bankruptcy
Executory nature in general

To assess whether there are material unperformed obligations on both sides of a contract, for purposes of determining whether the contract is an executory contract, the court considers contract principles under relevant nonbankruptcy law. 11 U.S.C.A. § 365(a).

9 Cases that cite this headnote

[11] Contracts
Effect of breach in general

Contracts
Discharge of contract by breach

Under New York law, a "material" breach of a contract, which justifies the other party to suspend his own performance, is a breach which is so substantial as to defeat the purpose of the entire transaction.

Cases that cite this headnote

[12] Contracts
What breach will authorize rescission in general

Under New York law, only a breach in a contract which substantially defeats the purpose of that contract can be grounds for rescission.

Cases that cite this headnote

[13] Contracts
Discharge of contract by breach

Under New York law, the non-breaching party will be discharged from the further performance of its obligations under a contract when the breach goes to the root of the contract.

Cases that cite this headnote

[14] Contracts

Substantial Performance

Under New York law, when a breaching party has substantially performed before breaching the contract, the other party's performance is not excused.

3 Cases that cite this headnote

[15] **Contracts**

Substantial Performance

Under New York law, there is no simple test for determining whether substantial performance has been rendered, and several factors must be considered, including the ratio of the performance already rendered to that unperformed, the quantitative character of the default, the degree to which the purpose behind the contract has been frustrated, the willfulness of the default, and the extent to which the aggrieved party has already received the substantial benefit of the promised performance.

Cases that cite this headnote

[16] **Contracts**

Questions for Jury

Under New York law, the issue of whether a party has substantially performed its obligations under a contract is usually a question of fact and should be decided as a matter of law only where the inferences are certain.

Cases that cite this headnote

[17] **Bankruptcy**

Executory nature in general

Under New York law, purchaser of Chapter 11 debtor's industrial battery business had substantially performed its obligations under the "integrated agreement" pursuant to which debtor had licensed its trademark to purchaser and, thus, the agreement was not an "executory contract" that debtor could reject; purchaser had paid the full $135 million purchase price and had operated under the agreement for over 10 years, purchaser had been producing industrial batteries using all the assets transferred under the agreement, including real estate, real-estate leases, inventory, equipment, and the right to use debtor's trademark, purchaser provided debtor with the substantial benefit of assuming debtor's liabilities, and purchaser's ongoing, unperformed obligations, including obligations to satisfy quality standards provision and to observe use restriction, indemnity obligations, and further assurances obligations, did not outweigh the substantial performance rendered. 11 U.S.C.A. § 365(a).

11 Cases that cite this headnote

[18] **Contracts**

Conditions subsequent

Condition subsequent is not a material obligation of a contract. Restatement (Second) of Contracts § 225(3).

Cases that cite this headnote

[19] **Contracts**

Substantial Performance

Under New York law, the substantial-performance doctrine is not limited to cases involving construction or employment contracts.

1 Cases that cite this headnote

Attorneys and Law Firms

***960** Robert Lapowsky, Esquire (Argued), Neil C. Schur, Esquire, Stevens & Lee, P. C., Philadelphia, PA, Joseph Grey, Esquire, Stevens & Lee, P. C., Wilmington, DE, for Appellant Enersys Delaware, Inc.

Laura Davis Jones, Esquire, James O'Neill, Esquire, Pachulski, Stang, Ziehl & Jones, LLP, Wilmington, DE, Matthew N. Kleiman, Esquire (Argued), Matthew N. Kleiman, P. C., Chicago, IL, Roger P. Furey, Esquire, John P. Sieger, Esquire, Andrew L. Wool, Esquire, Katten, Muchin, Rosenman, LLP, Washington, DC, for Appellee Exide Technologies.

Before: AMBRO, ROTH and ALARCÓN [*], Circuit Judges.

Opinion

OPINION

ROTH, Circuit Judge:

This case presents the question whether the parties' Agreement is an executory contract. EnerSys Delaware, Inc., appeals the judgment of the District Court, which affirmed the Bankruptcy Court's order that the Agreement was an executory contract, subject to rejection under 11 U.S.C. § 365(a), and that Exide Technologies could reject it. We conclude, however, that EnerSys has substantially performed the Agreement. As a result, EnerSys does not have any unperformed material obligations that would excuse Exide from performance. We hold, therefore, that the Agreement is not an executory contract. We will vacate the District Court's order and remand this case to the District Court with instructions to remand it to the Bankruptcy Court for further proceedings consistent with this opinion.

I. *BACKGROUND*

A. Factual background

On April 15, 2002, Exide filed a voluntary petition for bankruptcy protection under Chapter 11 of the Bankruptcy Code, 11 U.S.C § 1101, *et seq.* After filing for bankruptcy, Exide sought to reject various agreements that it had with EnerSys arising from their June 1991 transaction. In June 1991, Exide sold substantially all of its industrial battery business to EnerSys for about $135 million. [1] The assets that Exide sold to EnerSys included physical manufacturing plants, equipment, inventory, and certain items of intellectual property. To formalize the sale, Exide and EnerSys entered into over twenty-three agreements. Four of these agreements constitute the crux of the dispute: (1) the ***961** Trademark and Trade Name License Agreement, (2) the Asset Purchase Agreement, (3) the Administrative Services Agreement, and (4) a letter agreement. The Bankruptcy Court held, in an order predating the order challenged here, that the four agreements constituted a single integrated Agreement (the Agreement). *In re Exide Techs.,* 340 B.R. 222, 227 (Bankr.D.Del.2006). Neither Exide nor EnerSys have challenged this determination. We therefore take the next step of determining whether the Agreement is an executory contract.

Under the Agreement, Exide licensed its "Exide" trademark to EnerSys for use in the industrial battery business. Exide wanted to continue to use the Exide mark outside of the industrial battery business. To accommodate the needs of both parties, Exide granted EnerSys a perpetual, exclusive, royalty-free license to use the Exide trademark in the industrial battery business. This division worked, and, for almost ten years, each party appeared satisfied with the results of the transaction.

In 2000, however, Exide expressed a desire to return to the North American industrial battery market. After the parties agreed to the early termination of a ten-year noncompetition Agreement (thus granting Exide permission to reenter the market), Exide made several attempts to regain the trademark from EnerSys, but EnerSys refused. Exide wanted to regain the mark as a part of its strategic goal to unify its corporate image. Exide hoped to use a single name and trademark on all the products that it produced; this single name and trademark were, naturally, "Exide."

Exide reentered the industrial battery business by purchasing GNB Industrial Battery Company. Exide, however, remained bound by the ongoing obligation to forbear from using the Exide trademark in that business for as long as the license continued in effect. Thus, from 2000 until Exide filed for bankruptcy protection in 2002, Exide was forced to compete directly against EnerSys, which was selling batteries under the name "Exide." Then, when Exide filed for bankruptcy under Chapter 11, Exide was presented the opportunity to try to regain the Exide trademark by rejecting the Agreement. Exide sought the Bankruptcy Court's approval to do so.

B. Bankruptcy and District Court Proceedings

On April 3, 2006, the Bankruptcy Court entered an order granting Exide's motion to reject the Agreement. The court held that the Agreement was an executory contract, subject to rejection under 11 U.S.C. § 365(a), and that rejection terminated Exide's obligations under it. About three months later, on July 11, the Bankruptcy Court entered an order approving the transition plan and denying EnerSys's motion to stay. EnerSys appealed these two orders to the District Court. The District Court,

on February 27, 2008, affirmed the Bankruptcy Court's orders.

EnerSys appeals the District Court's order, arguing two issues: (1) the District Court erred in holding that Agreement was an executory contract, and (2) it erred in holding that rejection terminates EnerSys's rights under the Agreement.

II. *DISCUSSION*

The Bankruptcy Court had jurisdiction under 28 U.S.C. §§ 157(a) and 1334(b). The District Court had jurisdiction to decide EnerSys's appeal under 28 U.S.C. § 158(a). We have jurisdiction under 28 U.S.C. §§ 158(d) and 1291 to review the District Court's final order.

[1] **[2]** **[3]** We exercise plenary review of an order from a district court sitting as an ***962** appellate court in review of a bankruptcy court. *E.g., In re CellNet Data Sys., Inc.,* 327 F.3d 242, 244 (3d Cir.2003). We will review both courts' legal conclusions *de novo.* *Id.*; *In re Gen. DataComm Indus., Inc.,* 407 F.3d 616, 619 (3d Cir.2005). Furthermore, we will set aside a bankruptcy court's factual findings only if clearly erroneous. *In re CellNet Data,* 327 F.3d at 244. For mixed questions of law and fact, we will engage in "a mixed standard" of review, "affording a clearly erroneous standard to integral facts, but exercising plenary review of the lower court's interpretation and application of those facts to legal precepts." *Id.*

A. Executory contract

[4] **[5]** The policy behind Chapter 11 of the Bankruptcy Code is the "ultimate rehabilitation of the debtor." *Nicholas v. United States,* 384 U.S. 678, 687, 86 S.Ct. 1674, 16 L.Ed.2d 853 (1966). The Code therefore allows debtors in possession, "subject to the court's approval, ... [to] reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a). But the Bankruptcy Code does not define "executory contract." Relevant legislative history demonstrates that Congress intended the term to mean a contract "on which performance is due to some extent on both sides." H.R.Rep. No. 95-595, 347 (1977), 1978 U.S.C.C.A.N. 5787, 5963; *see In re Columbia Gas Sys. Inc.,* 50 F.3d 233, 238 (3d Cir.1995).

[6] **[7]** **[8]** **[9]** **[10]** With congressional intent in mind, this Court has adopted the following definition: " 'An executory contract is a contract under which the obligation of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.' " *In re Columbia Gas,* 50 F.3d at 239 (alteration omitted) (quoting *Sharon Steel Corp. v. Nat'l Fuel Gas Distrib. Corp.,* 872 F.2d 36, 39 (3d Cir.1989)).[2] "Thus, unless both parties have unperformed obligations that would constitute a material breach if not performed, the contract is not executory under § 365." *In re Columbia Gas,* 50 F.3d at 239. The party seeking to reject a contract bears the burden of demonstrating that it is executory. And "[t]he time for testing whether there are material unperformed obligations on both sides is when the bankruptcy petition is filed." *Id.* at 240. Finally, to conduct this determination, we "consider contract principles under relevant nonbankruptcy law." *Id.* at 240 n. 10; *see In re Gen. DataComm,* 407 F.3d at 623. New York, because it is the forum selected in the Agreement's choice-of-law provision, provides the relevant nonbankruptcy law.

Accordingly, our inquiry is to determine whether the Agreement, on April 15, 2002, contained at least one obligation for both Exide and EnerSys that would constitute a material breach under New York law if not performed. If not, then the Agreement is not an executory contract.[3] *See In re Gen. DataComm,* 407 F.3d at 623.

[11] **[12]** **[13]** Under New York law, a material breach, which "justif [ies] the other party to suspend his own performance," is "a breach which is so substantial as to defeat the purpose of the entire transaction." *Lipsky v. Commonwealth United Corp.,* 551 F.2d 887, 895 (2d Cir.1976) (citation ***963** omitted); *see In re Lavigne,* 114 F.3d 379, 387 (2d Cir.1997):

> [U]nder New York law, only a breach in a contract which substantially defeats the purpose of that contract can be grounds for rescission. The non-breaching party will be discharged from the further performance of its obligations under the contract when the breach goes to the root of the contract.

Id. (internal quotation marks omitted).

[14] But when a breaching party "has substantially performed" before breaching, "the other party's performance is not excused." *Hadden v. Consolidated Edison Co.,* 34 N.Y.2d 88, 356 N.Y.S.2d 249, 312 N.E.2d 445, 449 (1974); *see Merrill Lynch & Co. Inc., v. Allegheny Energy, Inc.,* 500 F.3d 171, 186 (2d Cir.2007).

[15] **[16]** New York's high court has instructed how to determine when a party has rendered substantial performance:

> There is no simple test for determining whether substantial performance has been rendered and several factors must be considered, including the ratio of the performance already rendered to that unperformed, the quantitative character of the default, the degree to which the purpose behind the contract has been frustrated, the willfulness of the default, and the extent to which the aggrieved party has already received the substantial benefit of the promised performance.

Hadden, 356 N.Y.S.2d 249, 312 N.E.2d at 449. "The issue of whether a party has substantially performed is usually a question of fact and should be decided as a matter of law only where the inferences are certain." *Merrill Lynch & Co. Inc.,* 500 F.3d at 186 (citing *Anderson Clayton & Co. v. Alanthus Corp.,* 91 A.D.2d 985, 457 N.Y.S.2d 578, 579 (1983)).

[17] The Bankruptcy Court here failed to properly measure whether either party had substantially performed. Our inspection of the record, however, reveals that the inferences are clear that EnerSys has substantially performed. Applying *Hadden*'s balancing test, EnerSys's performance rendered outweighs its performance remaining and the extent to which the parties have benefitted is substantial. Specifically, EnerSys has substantially performed by paying the full $135 million purchase price and operating under the Agreement for over ten years. EnerSys has been producing industrial batteries since 1991, using all the assets transferred under the Agreement, including real estate, real-estate leases, inventory, equipment and the right to use the trademark "Exide." Moreover, EnerSys has provided Exide with the substantial benefit of assuming the latter's liabilities, including numerous contracts and accounts receivable, within the business EnerSys purchased.

Exide argues that EnerSys's ongoing, unperformed obligations outweigh its performance. It relies on the following four obligations of EnerSys: (1) an obligation to satisfy the Quality Standards Provision, and obligations to observe (2) the Use Restriction, (3) the Indemnity Obligations, and (4) the Further Assurances Obligations.[4] We reject Exide's argument; these four obligations do not outweigh the substantial performance rendered and benefits received by EnerSys.

[18] First, EnerSys's obligation to observe the Use Restriction, *i.e.,* not to use the Trademark outside the industrial battery business, is not a material obligation because it is a condition subsequent that requires EnerSys to use the mark in accordance ***964** with the terms of the Trademark Licence. A condition subsequent is not a material obligation. *See In re Columbia Gas System, Inc.,* 50 F.3d 233, 241 (3d Cir.1995) ("Non-occurrence of a condition is not a breach by a party unless he is under a duty that the condition occur." (quoting RESTATEMENT (SECOND) OF CONTRACTS § 225(3) (1981))). Moreover, the Use Restriction does not relate to the purpose of the Agreement-which is that Exide would transfer its industrial battery business and the concomitant assets and liabilities to EnerSys and EnerSys in exchange would pay Exide about $135 million. Therefore, even if the obligation were not a condition subsequent, it nevertheless would not affect the substantial performance of the Agreement.

Second, EnerSys's obligation to observe the Quality Standards Provision is minor because it requires meeting the standards of the mark for each battery produced; it does not relate to the transfer of the industrial battery business. Furthermore, the record reveals that Exide never provided EnerSys with any quality standards. (J.A. 297.) The parties, in fact, do not ever seem to have discussed any such standards. (*See id.* at 321-22.) It is an untenable proposition to find an obligation to go to the very root of the parties' Agreement when the parties themselves act as if they did not know of its existence.

Finally, the other two obligations that Exide argues are substantial, the Indemnity Obligation and the Further Assurances Obligation, do not outweigh the

factors supporting substantial performance. In regard to the Indemnity Obligation, under the Asset Purchase Agreement, all representations and warranties arising from it expired in 1994, on the third anniversary of the closing and Exide did not present any evidence that any liability assumed by EnerSys was still pending. Similarly, under the Further Assurances Obligation, EnerSys agreed to cooperate to facilitate the 1991 transaction. Exide has identified no remaining required cooperation.

[19] Exide argues, however, citing *Hadden,* that the substantial-performance doctrine is "irrelevant here" because it applies only in cases involving construction or employment contracts. *See Hadden,* 356 N.Y.S.2d 249, 312 N.E.2d at 449. Our review of New York law reveals that no New York court has held (or even intimated, *see id.*) that the doctrine should be confined to the construction/employment contract areas. Indeed, the Second Circuit Court of Appeals, applying New York law, recently applied *Hadden*'s substantial-performance doctrine in a $490 million asset-purchase contract that formalized the sale of an energy trading commodities business to a larger energy business. *See Merrill Lynch,* 500 F.3d at 186. That contract was neither a construction nor employment contract. We also now conclude that we will not confine the doctrine to construction and employment contract cases.

III. *CONCLUSION*

For the reasons stated above, we have determined that the Agreement is not an executory contract because it does not contain at least one ongoing material obligation for EnerSys. Because the Agreement is not an executory contract, Exide cannot reject it. We will vacate the District Court's order and remand this case to it for remand to the Bankruptcy Court for further proceedings consistent with this opinion.

AMBRO, Circuit Judge, concurring

I join Judge Roth's opinion in full, and write separately to address the Bankruptcy Court's determination, adopted by the District Court, that "[r]ejection of the ***965** Agreement leaves EnerSys without the right to use the Exide mark." *In re Exide Techs.,* 340 B.R. 222, 250 (Bankr.Del.2006). I disagree with that determination, as I believe a trademark licensor's rejection of a trademark agreement under 11 U.S.C. § 365 does not necessarily deprive the trademark licensee of its rights in the licensed mark.

In *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.,* 756 F.2d 1043 (4th Cir.1985), *cert. denied,* 475 U.S. 1057, 106 S.Ct. 1285, 89 L.Ed.2d 592 (1986), a licensor, Richmond Metal Finishers, granted a nonexclusive technology license to Lubrizol. The license stated that Richmond and Lubrizol owed each other certain duties. *See id.* at 1045. Shortly thereafter, Richmond filed for bankruptcy protection and sought to rescind the license by rejecting it under § 365. The Fourth Circuit Court granted this request and "deprive[d] Lubrizol of all rights" under the license:

> Under 11 U.S.C. § 365(g), Lubrizol would be entitled to treat rejection as a breach and seek a money damages remedy; however, it could not seek to retain its contract rights in the technology by specific performance even if that remedy would ordinarily be available upon breach of this type of contract.

Id. at 1048. The Court acknowledged that this interpretation of rejection as a termination "could have a general chilling effect upon the willingness of ... parties to contract at all with businesses in possible financial difficulty." *Id.* "But," it said, "under bankruptcy law such equitable considerations may not be indulged by courts in respect of the type of contract here in issue." *Id.*

Reacting to industry concerns that "after *Lubrizol* any patent or trademark licensor could go into Chapter 11 and invalidate a license perfectly valid under contract law," Congress enacted 11 U.S.C. § 365(n). Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts,* 74 Minn. L.Rev. 227, 307 (1989). Through this provision, 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 pursuant to Section 365 in the event of the licensor's bankruptcy." S.Rep. No. 100-505, at 1 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3200.

Section 365(n) reads in relevant part:

> If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect-
>
> (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or
>
> (B) to retain its rights (including the right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property ..., as such rights existed immediately before the case commenced for-
>
> (i) the duration of such contract; and
>
> (ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.

***966** 11 U.S.C. 365(n)(1). Thus, in the event that a bankrupt licensor rejects an intellectual property license, § 365(n) allows a licensee to retain its licensed rights-along with its duties-absent any obligations owed by the debtor-licensor.

Congress, however, did not include trademarks within the relevant definition of "intellectual property." Instead, it defined "intellectual property" only to include a:

> (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.

11 U.S.C. § 101(35A).

Because Congress did not protect trademark licensees under § 365(n), courts have reasoned by negative inference that it intended for *Lubrizol*'s holding to control when a bankrupt licensor rejects a trademark license. *See, e.g., In re Old Carco LLC,* 406 B.R. 180, 211 (Bankr.S.D.N.Y.2009) ("Trademarks are not 'intellectual property' under the Bankruptcy Code ... [, so] rejection of licenses by [a] licensor deprives [the] licensee of [the] right to use [a] trademark...."); *In re HQ Global Holdings, Inc.,* 290 B.R. 507, 513 (Bankr.D.Del.2003) ("[S]ince the Bankruptcy Code does not include trademarks in its protected class of intellectual property, *Lubrizol* controls and the Franchisees' right to use the trademark stops on rejection."); *In re Centura Software Corp.,* 281 B.R. 660, 674-75 (Bankr.N.D.Cal.2002) ("Because Section 365(n) plainly excludes trademarks, the court holds that [the licensee] is not entitled to retain any rights in [the licensed trademark] under the rejected ... [t]rademark [a]greement."); *In re Chipwich, Inc.,* 54 B.R. 427, 431 (Bankr.S.D.N.Y.1985) ("[B]y rejecting the [trademark] licenses [,] the debtor will deprive [the licensee] of its right to use the ... trademark for its products.").

The Bankruptcy Court here adopted this reasoning:

> Congress certainly could have included trademarks within the scope of § 365(n) [,] but saw fit not to protect them. Therefore, the holding in *[Lubrizol v.] Richmond Metal Finishers,* as well as the holdings in the other pre and post § 365(n) trademark rejection cases ..., still retain vitality insofar as they relate to trademark licenses. As a result, a trademark license is terminated upon rejection and the licensee is left only with a claim for damages.

In re Exide, 340 B.R. at 250 n. 40.

But while the Supreme Court has endorsed reasoning from negative inference in the context of § 365, *see NLRB v. Bildisco & Bildisco,* 465 U.S. 513, 522-23, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984) (holding that § 365(a) applied to collective-bargaining agreements covered by the National Labor Relations Act because Congress failed to draft an

exclusion for them), I believe such reasoning is inapt for trademark license rejections.

When Congress enacted § 365(n), it explicitly explained why it excluded trademark licensees from the protection afforded to "intellectual property" licensees:

> [T]he bill does not address the rejection of executory trademark, trade name or service mark licenses by debtor-licensors. While such rejection is of concern because of the interpretation of section 365 by the *Lubrizol* court and others, *see, e.g.,* ***967** *In re Chipwich, Inc.,* 54 Bankr.Rep. 427 (Bankr.S.D.N.Y.1985), such contracts raise issues beyond the scope of this legislation. In particular, trademark, trade name and service mark licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee. Since these matters could not be addressed without more extensive study, it was determined to postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts.

S.Rep. No. 100-505, at 5, *reprinted in* 1988 U.S.C.C.A.N. at 3204. "Nor does the bill address or intend any inference to be drawn concerning the treatment of executory contracts which are unrelated to intellectual property." *Id.* [1]

In light of these direct congressional statements of intent, it is "simply more freight than negative inference will bear" to read rejection of a trademark license to effect the same result as termination of that license. Michael T. Andrew, *Executory Contracts Revisited,* 62 U. Colo. L.Rev. 1, 11 (1991). "[T]he purpose of § 365" is not "to be the functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions they occupied before the contract was formed." *Thompkins v. Lil' Joe Records, Inc.,* 476 F.3d 1294, 1306 (11th Cir.2007). It "merely frees the estate from the obligation to perform," and "has absolutely no effect upon the contract's continued existence." *Id.* (internal citations omitted); *see also* 3 *Collier on Bankruptcy* ¶ 365.14 n. 3 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.2009) (noting some take the view that "rejection by the debtor terminates the rights of the other parties to the contract as opposed to being simply a determination not to perform, more in the nature of an abandonment, which was the intellectual source of the rejection concept"); 2 *Norton Bankruptcy Law and Practice* § 46:57 (3d ed. 2008) ("The Bankruptcy Code instructs us that rejection is a breach of the executory contract. It is not avoidance, rescission, or termination." (footnotes omitted)).

By permitting Exide to "extinguish [ ]" EnerSys's right in the "Exide" mark through § 365 rejection, the Bankruptcy and District Courts failed to follow this path. Rather than reasoning from negative inference to apply another Circuit's holding to this dispute, the Courts here should have used, I believe, their equitable powers to give Exide a fresh start without stripping EnerSys of its fairly procured trademark rights. *Cf. In re Matusalem,* 158 B.R. 514, 521-22 (Bankr.S.D.Fla.1993) (suggesting that rejection of a trademark license would not deprive a licensee of its rights in the licensed mark).

Courts may use § 365 to free a bankrupt trademark licensor from burdensome duties that hinder its reorganization. They should not-as occurred in this case-use it to let a licensor take back trademark rights it bargained away. This makes bankruptcy more a sword than a ***968** shield, putting debtor-licensors in a catbird seat they often do not deserve.

All Citations

607 F.3d 957, 53 Bankr.Ct.Dec. 57, Bankr. L. Rep. P 81,779, 95 U.S.P.Q.2d 1405

Footnotes

* Honorable Arthur L. Alarcon, Senior United States Circuit Judge for the Ninth Circuit, sitting by designation.

1 EnerSys was known then as Yuasa Battery (America), Inc.

2 Professor Vern Countryman, a leading bankruptcy scholar, created and advocated this definition in a law-review article. *See Sharon Steel Corp.,* 872 F.2d at 39 (citing Countryman, *Executory Contracts in Bankruptcy: PartI,* 57 Minn. L.Rev. 439(1973)).

3 There is no remaining contention made that Exide had any unperformed obligations.

4 Exide does not argue in its Brief that other obligations, set out by the Bankruptcy Court, such as the pension obligation, are substantially unperformed.

1 This statement may stem from the recommendation of the National Bankruptcy Conference that "there should be in this legislative history a caveat that makes it clear that no negative inferences are to be drawn or should be drawn by courts that, because Congress has legislated in a particular way a licensing agreement, those other agreements that are not within the parameters of the legislation are to be dealt with in any particular way." *Intellectual Property Contracts in Bankruptcy: Hearing on H.R. 4657 Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary,* 100th Cong. 101 (1988) (statement of George Hahn, Esq., Representative, National Bankruptcy Conference).

End of Document

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Tempnology, LLC, 1st Cir., January 12, 2018

686 F.3d 372
United States Court of Appeals,
Seventh Circuit.

SUNBEAM PRODUCTS, INC., doing business as Jarden Consumer Solutions, Plaintiff–Appellant,
v.
CHICAGO AMERICAN MANUFACTURING, LLC, Defendant–Appellee.

No. 11–3920.
|
Argued May 22, 2012.
|
Decided July 9, 2012.

Synopsis

Background: Chapter 7 trustee and purchaser of debtor's patents and trademarks brought adversary proceeding against company to which debtor had outsourced production of its fans, alleging patent and trademark infringement, and dispute arose as to whether company was acting within scope of intellectual-property license granted by debtor prepetition and whether that license had terminated upon trustee's rejection of underlying contract. The United States Bankruptcy Court for the Northern District of Illinois, Pamela S. Hollis, J., 459 B.R. 306, entered judgment for company. Plaintiffs appealed.

[Holding:] The Court of Appeals, Easterbrook, Chief Judge, in a matter of first impression, held that trustee's rejection of contract did not abrogate company's license to sell fans branded with debtor's trademark.

Affirmed.

West Headnotes (12)

[1] Bankruptcy
Effect of Acceptance or Rejection
Trademarks
Duration of consent;post-termination use

Chapter 7 trustee's rejection of debtor's contract with company to which debtor had outsourced production of its fans did not abrogate company's license under the contract to sell fans branded with debtor's trademark, and thus company did not infringe trademarks, which had been bought by third party, by continuing to make and sell debtor-branded fans; trustee's rejection of contract constituted a breach, not a rescission, and left company's rights under contract in place. 11 U.S.C.A. § 365(a, g).

4 Cases that cite this headnote

[2] Bankruptcy
Construction and Operation
Bankruptcy
Effect of Acceptance or Rejection

"Intellectual property" under the Bankruptcy Code includes patents, copyrights, and trade secrets, but not trademarks, and thus trademarks are unaffected by the provision of the Bankruptcy Code permitting the debtor's intellectual-property licensees to continue using the debtor's intellectual property after rejection of the license, provided the licensees meet certain conditions. 11 U.S.C.A. §§ 101(35A), 365(n).

Cases that cite this headnote

[3] Bankruptcy
Equitable powers and principles

What the Bankruptcy Code provides, a court cannot override by declaring that enforcement would be inequitable.

6 Cases that cite this headnote

[4] Bankruptcy
Equitable powers and principles
Bankruptcy
Effect of Acceptance or Rejection

After the trustee's rejection of an intellectual-property licensee granted by the debtor, the licensee's rights depend on what the Bankruptcy Code provides rather than on notions of equity. 11 U.S.C.A. § 365(a).

4 Cases that cite this headnote

[5] **Copyrights and Intellectual Property**
Contracts

Outside of bankruptcy, a licensor's breach does not terminate a licensee's right to use intellectual property.

1 Cases that cite this headnote

[6] **Bankruptcy**
Effect of Acceptance or Rejection

Bankruptcy Code, by classifying debtor's rejection of an executory contract as breach establishes that in bankruptcy, as outside of it, the other party's rights remain in place. 11 U.S.C.A. § 365(g).

3 Cases that cite this headnote

[7] **Bankruptcy**
Effect of Acceptance or Rejection

After rejecting a contract, a debtor is not subject to an order of specific performance. 11 U.S.C.A. § 365(a, g).

2 Cases that cite this headnote

[8] **Bankruptcy**
Rejection of executory contract or lease
Bankruptcy
Effect of Acceptance or Rejection

After rejecting a contract, the debtor's unfulfilled obligations are converted to damages; when the debtor does not assume the contract before rejecting it, these damages are treated as a prepetition obligation, which may be written down in common with other debts of the same class. 11 U.S.C.A. § 365(a, g).

3 Cases that cite this headnote

[9] **Bankruptcy**
Rejection of executory contract or lease
Bankruptcy
Effect of Acceptance or Rejection

A lessee that enters bankruptcy may reject the lease and pay damages for abandoning the premises, but rejection does not abrogate the lease, which would absolve the lessee of the need to pay damages. 11 U.S.C.A. § 365(a, g).

Cases that cite this headnote

[10] **Bankruptcy**
Effect of Acceptance or Rejection

A lessor that enters bankruptcy may not, by rejecting the lease, end the tenant's right to possession and thus re-acquire premises that might be rented out for a higher price. 11 U.S.C.A. § 365(a, g).

1 Cases that cite this headnote

[11] **Bankruptcy**
Rejection of executory contract or lease
Bankruptcy
Effect of Acceptance or Rejection

A bankrupt lessor, by rejecting the lease, might substitute damages for an obligation to make repairs, but not rescind the lease altogether. 11 U.S.C.A. § 365(a, g).

Cases that cite this headnote

[12] **Bankruptcy**
Effect of Acceptance or Rejection

Rejection of debtor's executory contract is not the functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions they occupied before the contract was formed, rather, rejection merely frees the estate from the obligation to perform and has absolutely no effect upon the contract's continued existence. 11 U.S.C.A. § 365(a, g).

4 Cases that cite this headnote

Attorneys and Law Firms

***374** Scott R. Clar, Attorney, Crane, Heyman, Simon, Welch & Clar, Chicago, IL, for Debtor.

Joseph D. Frank (argued), Attorney, Frank/Gecker LLP, Chicago, IL, for Appellant.

William John Barrett (argued), Attorney, Barack, Ferrazzano, Kirschbaum & Nagelberg LLP, Chicago, IL, Richard M. Hoffman, Attorney, Northbrook, IL, for Appellee.

Scott R. Clar, Attorney, Crane, Heyman, Simon, Welch & Clar, Chicago, IL, for Trustee.

Before EASTERBROOK, Chief Judge, and WILLIAMS and TINDER, Circuit Judges.

Opinion

EASTERBROOK, Chief Judge.

Lakewood Engineering & Manufacturing Co. made and sold a variety of consumer products, which were covered by its patents and trademarks. In 2008, losing money on every box fan, Lakewood contracted their manufacture to Chicago American Manufacturing (CAM). The contract authorized CAM to practice Lakewood's patents and put its trademarks on the completed fans. Lakewood was to take orders from retailers such as Sears, Walmart, and Ace Hardware; CAM would ship directly to these customers on Lakewood's instructions. Because Lakewood was in financial distress, CAM was reluctant to invest the money necessary to gear up for production—and to make about 1.2 million fans that Lakewood estimated it would require during the 2009 cooling season—without assured payment. Lakewood provided that assurance by authorizing CAM to sell the 2009 run of box fans for its own account if Lakewood did not purchase them.

In February 2009, three months into the contract, several of Lakewood's creditors filed an involuntary bankruptcy petition against it. The court appointed a trustee, who decided to sell Lakewood's business. Sunbeam Products, doing business as Jarden Consumer Solutions, bought the assets, including Lakewood's patents and trademarks. Jarden did not want the Lakewood-branded fans CAM had in inventory, nor did it want CAM to sell those fans in competition with Jarden's products. Lakewood's trustee rejected the executory portion of the CAM contract under 11 U.S.C. § 365(a). When CAM continued to make and sell Lakewood-branded fans, Jarden filed this adversary action. It will receive 75% of any recovery and the trustee ***375** the other 25% for the benefit of Lakewood's creditors.

[1] The bankruptcy judge held a trial. After determining that the Lakewood–CAM contract is ambiguous, the judge relied on extrinsic evidence to conclude that CAM was entitled to make as many fans as Lakewood estimated it would need for the entire 2009 selling season and sell them bearing Lakewood's marks. *In re Lakewood Engineering & Manufacturing Co.,* 459 B.R. 306, 333–38 (Bankr.N.D.Ill.2011). Jarden contends in this court —following certification by the district court of a direct appeal under 28 U.S.C. § 158(d)(2)(A)—that CAM had to stop making and selling fans once Lakewood stopped having requirements for them. The bankruptcy court did not err in reading the contract as it did, but the effect of the trustee's rejection remains to be determined.

[2] *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.,* 756 F.2d 1043 (4th Cir.1985), holds that, when an intellectual-property license is rejected in bankruptcy, the licensee loses the ability to use any licensed copyrights, trademarks, and patents. Three years after *Lubrizol,* Congress added § 365(n) to the Bankruptcy Code. It allows licensees to continue using the intellectual property after rejection, provided they meet certain conditions. The bankruptcy judge held that § 365(n) allowed CAM to practice Lakewood's patents when making box fans for the 2009 season. That ruling is no longer contested. But "intellectual property" is a defined term in the Bankruptcy Code: 11 U.S.C. § 101(35A) provides that "intellectual property" includes patents, copyrights, and trade secrets. It does not mention trademarks. Some bankruptcy judges have inferred from the omission that Congress codified *Lubrizol* with respect to trademarks, but an omission is just an omission. The limited definition in § 101(35A) means that § 365(n) does not affect trademarks one way or the other. According to the Senate committee report on the bill that included § 365(n), the omission was designed to allow more time for study, not to approve *Lubrizol.* See S.Rep. No. 100–505, 100th Cong., 2d Sess. 5 (1988), 1988 U.S.C.C.A.N. 3200.

See also *In re Exide Technologies,* 607 F.3d 957, 966–67 (3d Cir.2010) (Ambro, J., concurring) (concluding that § 365(n) neither codifies nor disapproves *Lubrizol* as applied to trademarks). The subject seems to have fallen off the legislative agenda, but this does not change the effect of what Congress did in 1988.

The bankruptcy judge in this case agreed with Judge Ambro that § 365(n) and § 101(35A) leave open the question whether rejection of an intellectual-property license ends the licensee's right to use trademarks. Without deciding whether a contract's rejection under § 365(a) ends the licensee's right to use the trademarks, the judge stated that she would allow CAM, which invested substantial resources in making Lakewood-branded box fans, to continue using the Lakewood marks "on equitable grounds". 459 B.R. at 345; see also *id.* at 343–46. This led to the entry of judgment in CAM's favor, and Jarden has appealed.

[3] **[4]** What the Bankruptcy Code provides, a judge cannot override by declaring that enforcement would be "inequitable." See, e.g., *Toibb v. Radloff,* 501 U.S. 157, 162, 111 S.Ct. 2197, 115 L.Ed.2d 145 (1991); *In re Kmart Corp.,* 359 F.3d 866, 871 (7th Cir.2004); *In re Sinclair,* 870 F.2d 1340 (7th Cir.1989). There are hundreds of bankruptcy judges, who have many different ideas about what is equitable in any given situation. Some may think that equity favors licensees' reliance interests; others may believe that equity ***376** favors the creditors, who can realize more of their claims if the debtor can terminate IP licenses. Rights depend, however, on what the Code provides rather than on notions of equity. Recently the Supreme Court emphasized that arguments based on views about the purposes behind the Code, and wise public policy, cannot be used to supersede the Code's provisions. It remarked: "The Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law, and it is our obligation to interpret the Code clearly and predictably using well established principles of statutory construction." *RadLAX Gateway Hotel, LLC v. Amalgamated Bank,* —— U.S. ——, 132 S.Ct. 2065, 2073, 182 L.Ed.2d 967 (2012).

Although the bankruptcy judge's ground of decision is untenable, that does not necessarily require reversal. We need to determine whether *Lubrizol* correctly understood § 365(g), which specifies the consequences of a rejection under § 365(a). No other court of appeals has agreed with *Lubrizol*—or for that matter disagreed with it. *Exide,* the only other appellate case in which the subject came up, was resolved on the ground that the contract was not executory and therefore could not be rejected. (*Lubrizol* has been cited in other appellate opinions, none of which concerns the effect of rejection on intellectual-property licenses.) Judge Ambro, who filed a concurring opinion in *Exide,* concluded that, had the contract been eligible for rejection under § 365(a), the licensee could have continued using the trademarks. 607 F.3d at 964–68. Like Judge Ambro, we too think *Lubrizol* mistaken.

Here is the full text of § 365(g):

> Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—
>
> (1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition; or
>
> (2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title—
>
> (A) if before such rejection the case has not been converted under section 1112, 1208, or 1307 of this title, at the time of such rejection; or
>
> (B) if before such rejection the case has been converted under section 1112, 1208, or 1307 of this title—
>
> (i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or
>
> (ii) at the time of such rejection, if such contract or lease was assumed after such conversion.

Most of these words don't affect our situation. Subsections (h)(2) and (i)(2) are irrelevant, and paragraph (1) tells us that the rejection takes effect immediately before the petition's filing. For our purpose, therefore, all that matters is the opening proposition: that rejection "constitutes a breach of such contract".

[5] Outside of bankruptcy, a licensor's breach does not terminate a licensee's right to use intellectual property. Lakewood had two principal obligations under its contract with CAM: to provide CAM with motors and cord sets (CAM was to build the rest of the fan) and to pay for the completed fans that CAM drop-shipped to retailers. Suppose that, before the bankruptcy began, Lakewood had broken its promise by failing to provide the motors. ***377** CAM might have elected to treat that breach as ending its own obligations, see Uniform Commercial Code § 2–711(1), but it also could have covered in the market by purchasing motors and billed Lakewood for the extra cost. UCC § 2–712. CAM had bargained for the security of being able to sell Lakewood-branded fans for its own account if Lakewood defaulted; outside of bankruptcy, Lakewood could not have ended CAM's right to sell the box fans by failing to perform its own duties, any more than a borrower could end the lender's right to collect just by declaring that the debt will not be paid.

[6] **[7]** **[8]** **[9]** **[10]** **[11]** What § 365(g) does by classifying rejection as breach is establish that in bankruptcy, as outside of it, the other party's rights remain in place. After rejecting a contract, a debtor is not subject to an order of specific performance. See *NLRB v. Bildisco & Bildisco,* 465 U.S. 513, 531, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984); *Midway Motor Lodge of Elk Grove v. Innkeepers' Telemanagement & Equipment Corp.,* 54 F.3d 406, 407 (7th Cir.1995). The debtor's unfulfilled obligations are converted to damages; when a debtor does not assume the contract before rejecting it, these damages are treated as a pre-petition obligation, which may be written down in common with other debts of the same class. But nothing about this process implies that any rights of the other contracting party have been vaporized. Consider how rejection works for leases. A lessee that enters bankruptcy may reject the lease and pay damages for abandoning the premises, but rejection does not abrogate the lease (which would absolve the debtor of the need to pay damages). Similarly a lessor that enters bankruptcy could not, by rejecting the lease, end the tenant's right to possession and thus re-acquire premises that might be rented out for a higher price. The bankrupt lessor might substitute damages for an obligation to make repairs, but not rescind the lease altogether.

[12] Bankruptcy law does provide means for eliminating rights under some contracts. For example, contracts that entitle creditors to preferential transfers (that is, to payments exceeding the value of goods and services provided to the debtor) can be avoided under 11 U.S.C. § 547, and recent payments can be recouped. A trustee has several avoiding powers. See 11 U.S.C. §§ 544–51. But Lakewood's trustee has never contended that Lakewood's contract with CAM is subject to rescission. The trustee used § 365(a) rather than any of the avoiding powers—and rejection is not "the functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions they occupied before the contract was formed." *Thompkins v. Lil' Joe Records, Inc.,* 476 F.3d 1294, 1306 (11th Cir.2007). It "merely frees the estate from the obligation to perform" and "has absolutely no effect upon the contract's continued existence". *Ibid.* (internal citations omitted).

Scholars uniformly criticize *Lubrizol,* concluding that it confuses rejection with the use of an avoiding power. See, e.g., Douglas G. Baird, *Elements of Bankruptcy* 130–40 & n.10 (4th ed.2006); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection",* 59 U. Colo. L.Rev. 845, 916–19 (1988); Jay Lawrence Westbrook, *The Commission's Recommendations Concerning the Treatment of Bankruptcy Contracts,* 5 Am. Bankr.Inst. L.Rev. 463, 470–72 (1997). *Lubrizol* itself devoted scant attention to the question whether rejection cancels a contract, worrying instead about the right way to identify executory contracts to which the rejection power applies.

***378** *Lubrizol* does not persuade us. This opinion, which creates a conflict among the circuits, was circulated to all active judges under Circuit Rule 40(e). No judge favored a hearing *en banc.* Because the trustee's rejection of Lakewood's contract with CAM did not abrogate CAM's contractual rights, this adversary proceeding properly ended with a judgment in CAM's favor.

AFFIRMED.

All Citations

686 F.3d 372, 67 Collier Bankr.Cas.2d 1808, 56 Bankr.Ct.Dec. 189, Bankr. L. Rep. P 82,303, 103 U.S.P.Q.2d 1421

End of Document

2013

Sunbeam Offers A Ray of Sunshine for the Licensee when a Licensor Rejects a Trademark License Agreement in Bankruptcy

Alan N. Resnick
Maurice A. Deane School of Law at Hofstra University

SUNBEAM OFFERS A RAY OF SUNSHINE FOR THE LICENSEE WHEN A LICENSOR REJECTS A TRADEMARK LICENSE AGREEMENT IN BANKRUPTCY

*Alan N. Resnick**

ABSTRACT

In 1985, industries that relied heavily on intellectual property licenses were dealt a severe blow when the Court of Appeals for the Fourth Circuit held that a licensee of patent rights could be deprived of the continued use of patent technology by reason of the licensor rejecting the license in bankruptcy. In Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.,[1] *the appellate court characterized a nonexclusive patent license as an executory contract within the meaning of the Bankruptcy Code and approved rejection of the license by the licensor because it was advantageous to the licensor's Chapter 11 reorganization effort. The result, according to the Fourth Circuit, was that the licensee lost its right to use the intellectual property for which it had bargained, had no right to specific performance of the licensing agreement, and was left with nothing but a money-damages claim against the bankruptcy estate.*[2]

It did not take long for Congress to respond to Lubrizol *by enacting the Intellectual Property Bankruptcy Protection Act of 1988, which added § 365(n) to the Bankruptcy Code. This section grants the licensee of intellectual property the option to treat a licensor's rejection as a termination of the license or, alternatively, to continue to use the intellectual property for the remaining term of the rejected license, including any term extension to which the licensee is otherwise entitled, in exchange for continued payments of royalties in accordance with the license agreement. Congress, however, defined "intellectual property" in the Bankruptcy Code so as to exclude trademarks, deliberately depriving trademark licensees of the protections afforded by § 365(n). Though Congress intended to return to the subject of trademark licensees in bankruptcy at a later time, Congress took*

* Alan N. Resnick is the Benjamin Weintraub Distinguished Professor of Bankruptcy Law at Maurice A. Deane School of Law at Hofstra University, and of counsel to Fried, Frank, Harris, Shriver & Jacobson LLP in New York. The author gratefully acknowledges the valuable assistance of Garrett Ledgerwood, and Keely Hamlin, associates at Fried, Frank, Harris, Shriver & Jacobson LLP, in the research and writing of this article.

1. 756 F.2d 1043, 1046–47 (4th Cir. 1985).
2. *Id.* at 1048.

no further legislative action to protect such licensees. Therefore, trademark licensees remained vulnerable.

As shocking as Lubrizol *was to all licensees of intellectual property, and as disappointing as the exclusion of trademarks from the protections of § 365(n) was to trademark licensees, a recent decision by the Court of Appeals for the Seventh Circuit in the* Sunbeam *case*[3] is an unexpected cause for celebration by trademark licensees. The Seventh Circuit, twenty-seven years after the decision in Lubrizol, *directly rejected the holding and reasoning of the Fourth Circuit and held, based on its analysis of bankruptcy law, that a trademark licensee cannot be deprived of the right to use a trademark under a license agreement despite rejection of the agreement in the bankruptcy case of the licensor. The United States Supreme Court declined to review the* Sunbeam *decision, thereby leaving a circuit split and many unanswered questions regarding the effect of a licensor's rejection of a trademark license agreement in bankruptcy.*

I. INTRODUCTION

IT is common for a purchaser of a business to want to use the trade name and trademark long associated with the business so as to capture its goodwill and reputation. A seller that does not want to part with the trademark often grants the buyer a long-term license to use the seller's trademark. From the licensee's standpoint, the right to use the trademark under a licensing agreement can be among the most valuable assets purchased in the transaction. It is also common for the owner of a trademark to grant several entities exclusive or nonexclusive licenses to use the trademark in certain geographic areas or on certain products, unrelated to any sale of other assets, while retaining ownership of the trademark. In all of these scenarios, licensees often invest capital and build their businesses based on an expectation of uninterrupted use of the trademark.

When a company seeks protection under Chapter 11 of the Bankruptcy Code, the debtor in possession or trustee is granted extraordinary powers not available to companies outside of bankruptcy. One of those powers is the right to assume or reject executory contracts under § 365(a) of the Bankruptcy Code.[4] Historically, at least since 1985 when the Court of Appeals for the Fourth Circuit decided *Lubrizol Enterprises, Inc., v. Richmond Metal Finishers, Inc.*, the power to reject executory contracts enabled trademark licensors in bankruptcy to effectively terminate the right of trademark licensees to use trademarks despite the contractual arrangements of the parties and the continuation of the licensees' willingness to pay royalties.[5] Congress responded to *Lubrizol* by enacting legislation to protect licensees of intellectual property from the deprivation of

3. Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 376 (7th Cir. 2012).
4. *See* 11 U.S.C. § 365(a) (2012).
5. 756 F.2d 1043 (4th Cir. 1985).

their rights to continued use of licensed intellectual property when a licensor rejects the license in bankruptcy, but such protection was not afforded to trademark licensees.[6] Most recently, however, the Court of Appeals for the Seventh Circuit rejected the holding and analysis of *Lubrizol* and held that rejection of a trademark license by a licensor in bankruptcy does not deprive the licensee of its right to continued use of the trademark for the duration of the license period, resulting in a circuit split over the consequences flowing from rejection of a trademark license agreement.[7]

This Article will discuss the issue of whether a trademark licensor may deprive a licensee of the use of the trademark by becoming a debtor in a bankruptcy case and rejecting the license as an executory contract. It begins in Part I with a general discussion of the powers of a trustee or debtor in possession to reject executory contracts under the Bankruptcy Code, the meaning of "executory contract," and the consequences of a rejection. Part II of this Article focuses on the landmark decision in *Lubrizol*,[8] in which the rejection of intellectual property licensing agreements resulted in the termination of the licensee's right to use the intellectual property. Part III discusses Congress's response to *Lubrizol*, the enactment of the Intellectual Property Bankruptcy Protection Act of 1988,[9] which added § 365(n) to the Bankruptcy Code but did not include trademarks within the protection afforded to licensees. Part IV discusses transaction structures designed in the wake of *Lubrizol* and the 1988 Act in an attempt to reduce risk and potential harm to a trademark licensee in the event that the licensor rejects the trademark licensing agreement in bankruptcy. Part V discusses the Seventh Circuit's decision in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*,[10] which rejected the holding of *Lubrizol* and protects the right of licensees to continue to use trademarks despite rejection by the licensor in bankruptcy. But the decision leaves several questions unanswered regarding its impact on the survival of the obligations of the parties after a rejection.

II. THE POWERS OF A TRUSTEE OR DEBTOR IN POSSESSION TO ASSUME OR REJECT EXECUTORY CONTRACTS UNDER THE BANKRUPTCY CODE

To help maximize the value of a bankruptcy estate for the benefit of creditors or to assist a company reorganizing under Chapter 11, a trustee in bankruptcy is granted extraordinary powers that are unavailable to the debtor outside of the bankruptcy system, including, among others, the

6. Intellectual Property Bankruptcy Protection Act of 1988, Pub. L. No. 100-56, 102 Stat. 2538, 2539 (codified in Title 11 of the United States Code).
7. *Sunbeam Prods.*, 686 F.3d at 376.
8. 756 F.2d. at 1046–47.
9. 102 Stat. at 2538–39.
10. 686 F.3d at 376.

power to avoid unperfected security interests,[11] to recover preferential payments to creditors made shortly before bankruptcy,[12] and to avoid pre-bankruptcy fraudulent transfers of the debtor's assets.[13] Also included among these powers is the ability to assume or reject executory contracts and unexpired leases.[14] The rationale for granting this power is that the trustee or debtor in possession should be able to take advantage of favorable, yet-to-be-performed contracts that benefit the bankruptcy estate while abandoning those unfavorable contracts that otherwise would burden the estate.[15] Subject to certain exceptions,[16] § 365(a) of the Bankruptcy Code provides that the trustee may assume or reject executory contracts and unexpired leases of the debtor.[17] These extraordinary powers may also be exercised by a debtor in possession in a Chapter 11 case.[18] Notwithstanding this broad power, a decision by the trustee or debtor in possession to assume or reject an executory contract is subject to bankruptcy court approval.[19] The bankruptcy court's oversight, however, is highly deferential, generally applying the "business judgment" standard when determining the propriety of the assumption or rejection decision by the trustee or debtor in possession.[20]

---

11. *See* 11 U.S.C. § 544(a) (2012).

12. *Id.* § 547.

13. *Id.* § 548.

14. *Id.* § 365(a).

15. *See, e.g.*, *In re* Compass Van & Storage Corp., 65 B.R. 1007, 1010 (Bankr. E.D.N.Y. 1986).

16. 11 U.S.C. § 365(a). The exceptions relate to the trustee's right to assume, rather than reject, executory contracts. In certain situations an executory contract may not be assumed, including, among others, (i) where the debtor has defaulted in the performance of the contract and the debtor has neither cured the default nor provide adequate assurance that it will promptly cure the default, or has failed to provide compensation for any losses as a result of such default, or has failed to provide adequate assurance of future performance, *id.* § 365(b); (ii) where the contract is a pre-bankruptcy agreement to provide a loan or other financing to the debtor, *id.* § 365(c)(2); (iii) where applicable law excuses a party other than the debtor from accepting performance from or rendering performance to another entity without its consent, such as personal services contracts that are nonassignable as a matter of law, *id.* § 365(c)(1); or (iv) where the contract is not timely assumed, *id.* § 365(d).

17. *Id.* § 365(a); *see generally* 3 COLLIER ON BANKRUPTCY ¶ 365.01–.03 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2012).

18. In a case under Chapter 11 of the Bankruptcy Code, a "debtor in possession" is the debtor, which is operated by its managers, if a trustee is not serving in the case. 11 U.S.C. § 1101(1). A trustee is not appointed in Chapter 11 cases unless there is cause to appoint one, such as if the debtor's managers are grossly incompetent or dishonest. *See id.* § 1104(a). In the vast majority of Chapter 11 cases, a trustee is not appointed and the debtor remains the debtor in possession. In general, a debtor in possession has all the rights and powers of a trustee. *See id.* § 1107(a). Accordingly, subject to limited exceptions, references in the Bankruptcy Code to the "trustee" include the debtor in possession when the bankruptcy case is a case under Chapter 11 of the Bankruptcy Code. For ease of reference, this Article uses the term "debtor" when referring to a debtor in possession or the trustee with respect to the power to assume or reject executory contracts.

19. *Id.* § 365(a).

20. *See, e.g.*, *In re* Pomona Valley Med. Grp., 476 F.3d 665, 670 (9th Cir. 2007); Orion Pictures Corp. v. Showtime Networks, 4 F.3d 1095, 1099 (2d Cir. 1993).

A. The Effects of Assumption and Rejection

To fully appreciate the power of assumption or rejection, it is necessary to understand the consequences of rejecting or assuming an executory contract. If a debtor assumes an executory contract in bankruptcy, the bankruptcy estate adopts it as its own, which means it accepts responsibility to fully perform its obligations under the contract.[21] If the debtor breaches following assumption or formally rejects the contract after assuming it, any resulting claims (including any right to monetary damages resulting from a post-assumption breach) are entitled to payment as an administrative expense in the bankruptcy case.[22] Under § 507(a)(2) of the Bankruptcy Code, administrative expense claims are entitled to priority in payment over other unsecured creditors,[23] including priority over most other unsecured claims that are also entitled to some degree of priority, such as employee wage claims[24] and priority tax claims.[25] Moreover, in a Chapter 11 case, except to the extent that an administrative expense claimant agrees otherwise, a plan cannot be confirmed unless it proposes to pay administrative claims in full on the effective date of the plan.[26]

Conversely, where the debtor rejects an executory contract, such rejection constitutes a breach of the contract by the debtor.[27] The breach is treated under the Bankruptcy Code as though it occurred immediately before the date of the commencement of the bankruptcy case.[28] Under § 502(g)(1) of the Bankruptcy Code, the nondebtor party to the rejected contract is entitled to a prepetition claim against the estate for damages incurred as a result of the breach.[29] Courts have held that rejection terminates any right that the nondebtor party would have had under applicable nonbankruptcy law to obtain specific performance, thereby limiting the nondebtor party to the assertion of a money-damages claim against the bankruptcy estate.[30] Unlike a claim for breach of a contract previously assumed by a debtor, however, a claim flowing from a debtor's rejection of an executory contract not previously assumed is not entitled to administrative priority.[31] As a result, unless the claim is otherwise secured by collateral or independently entitled to priority under the Bankruptcy Code, the nondebtor party to the rejected contract will share pro rata with the debtor's other general unsecured creditors.[32] To the extent that

21. *See* 11 U.S.C. § 365(b)(1)(c).
22. *See id.* §§ 503(b), 365(g)(2); *see also, e.g.*, Adventure Res. v. Holland, 137 F.3d 786, 793 (4th Cir. 1998).
23. 11 U.S.C. §§ 507(a)(2), 726(a), 1129(a)(9)(A).
24. *Id.* § 507(a)(4).
25. *Id.* § 507(a)(8).
26. *Id.* § 1129(a)(9)(A).
27. *Id.* § 365(g).
28. *Id.* § 365(g)(1).
29. *Id.* § 502(g)(1).
30. *See, e.g.*, NLRB v. Bildisco & Bildisco, 465 U.S. 513, 531 (1984); Midway Motor Lodge v. Innkeepers' Telemanagement & Equip. Corp., 54 F.3d 406, 407 (7th Cir. 1995).
31. *See* 3 Collier on Bankruptcy, *supra* note 17, ¶ 365.10[1].
32. 11 U.S.C. § 726(b).

the claim remains unpaid after all distributions are made in the bankruptcy case or under a Chapter 11 plan of reorganization, such claim is discharged.[33]

To illustrate the consequences of rejection, suppose that a debtor is a party to a pre-bankruptcy contract for the purchase of certain goods for a total price of $100,000. The goods are to be delivered approximately ninety days after the contract was formed and payment of the purchase price is due thirty days after the delivery date. Before the delivery date, the debtor files a Chapter 11 petition and discovers that the market price for such goods fell sharply. In fact, the debtor could buy the same type of goods of the same quality on the market from one of the seller's competitors for only $60,000. If the debtor rejects this contract and buys the goods from the seller's competitor, the rejection would be treated as a breach of the agreement immediately before the filing of the petition.[34] This breach would give the seller under the contract an unsecured, non-priority prepetition claim against the bankruptcy estate for whatever damages it suffers.[35] Because the first seller would presumably be able to mitigate damage by reselling its goods on the market for $60,000, the seller would be left with a $40,000 damage claim against the bankruptcy estate. If, based on the value of the property of the estate, unsecured creditors are entitled to receive payment equal to only ten percent of their unsecured claims in the bankruptcy case, the seller would receive only $4,000 and the balance of the debt would be discharged. Thus, by rejecting the contract, the debtor in possession would pay only $4,000 for the opportunity to be relieved from its obligation to purchase the goods from the original seller, despite the fact that under non-bankruptcy law the original seller would be entitled to a $40,000 money judgment against the debtor.

B. What is an Executory Contract?

The right to assume or reject under § 365(a) applies only to those contracts that are executory on the date when the bankruptcy case is commenced.[36] The term "executory contract" is not defined in the Bankruptcy Code.[37] However, the prevailing definition used by most courts is one commonly known as the "Countryman definition," named after the late Professor Vern Countryman of Harvard Law School. As discussed below, Professor Countryman developed his definition of executory contracts taking into consideration the consequences of assumption and rejection.

In a 1973 article, Professor Countryman analyzed in great depth the

33. *Id.* §§ 727(b), 1141(d).
34. *See id.* § 365(g).
35. *See id.* § 502(g).
36. *Id.* § 365(a); *see also* Collier on Bankruptcy, *supra* note 17, ¶ 365.02[2][e].
37. *See generally* Collier on Bankruptcy, *supra* note 17, ¶ 365.02[2][e].

subject of executory contracts in bankruptcy.[38] He began his analysis by looking at the three types of unperformed contracts that exist outside of bankruptcy: (i) contracts under which the nondebtor party has performed all of its material obligations, but the debtor has not; (ii) contracts under which the debtor has fully performed, but the nondebtor party has not; and (iii) contracts under which both the debtor and the nondebtor party have material obligations not yet performed at the time of bankruptcy.[39] Beginning with the premise that in bankruptcy the term "executory contract" should be defined "in the light of the purpose for which the trustee is given the option to assume or reject"[40] that the definition "should not extend to situations where the only effect of its exercise would be to prejudice other creditors of the estate."[41] Professor Countryman reasoned that the only contracts that should be treated as executory contracts for bankruptcy purposes are the third type: contracts in which, at the time the bankruptcy case was commenced, both the debtor and the nondebtor party have material unperformed obligations remaining so that a breach by either party would relieve the other of the obligation to perform.[42]

With respect to the first type of contract—where the nondebtor party has completed performance but the debtor has not—Professor Countryman reasoned that the trustee or debtor in possession should not be able to assume the contract because to do so would provide no benefit to the estate and would only serve to give preference to the claims of the nondebtor party to the contract over other creditors of the estate.[43] As a practical matter, these contracts are in the nature of accounts payable because there is nothing left but the debtor's duty to render its performance. There is no logical reason for a trustee or debtor to assume an account payable because "[t]he estate has whatever benefit it can obtain from the other party's performance" without the need to assume it.[44] The only consequence of assumption in that circumstance would be to give the nondebtor party an administrative expense claim for the full amount of its damages at the expense of other creditors if the debtor fails to perform, and no reasonable trustee or debtor would opt to do that. And rejecting an account payable would have no legal effect because, with or without rejection, the nondebtor party has fully performed its obligations under the contract and would be entitled to a prepetition unsecured claim for the full amount of its damages. Thus, Professor Countryman concluded that "[t]he trustee's option to assume or reject should not extend to such contracts."[45] Consistent with this analysis, promissory notes and

38. *See* Vern Countryman, *Executory Contracts in Bankruptcy*, 57 MINN. L. REV. 439 (1973).
39. *Id.* at 451–65.
40. *Id.* at 450.
41. *Id.* at 451.
42. *Id.* 457–60.
43. *Id.* at 451–52.
44. *Id.* at 451.
45. *Id.*

loan agreements under which there is no outstanding obligation other than the debtor's obligation to pay money are not executory contracts and may not be assumed or rejected.

With respect to the second type of contract—where the debtor has completed performance but the nondebtor party to the contract has not—Professor Countryman likewise concluded that the trustee should not be able to reject such contracts because doing so would provide no benefit to the estate.[46] These contracts are in the nature of fully-earned accounts receivable owned by the debtor. Upon the filing of a bankruptcy petition, a bankruptcy estate is created,[47] which consists of "all legal or equitable interests of the debtor in property as of the commencement of the case."[48] Property of the estate includes the debtor's contractual rights to further performance due from a nondebtor party under a contract.[49] Thus, assumption of an executory contract where the debtor has fully performed adds nothing to the estate because the further performance by the nondebtor party to which the debtor is entitled under the contract is already property of the estate.[50] The trustee may simply enforce the debtor's right to payment on its accounts receivable without the need to assume the contract. Professor Countryman also wrote that the trustee should not be permitted to reject the contract because, as discussed above, rejection constitutes a breach of the contract by the debtor, which, in light of the debtor's full performance, would make no sense.[51]

For these reasons, Professor Countryman concluded that the only contracts that should be subject to assumption or rejection by the trustee or debtor in possession are those in which material performance remained outstanding on both sides such that a breach by one party would excuse the other party's performance under applicable nonbankruptcy law.[52] In that situation, the trustee or debtor would determine whether the contract is a beneficial one that should be performed by the debtor and enforced against the nondebtor party, in which case it should be assumed.[53] To illustrate, if the contract price for goods in the above hypothetical was $100,000, the market price of such goods has risen to $140,000, and the delivery date and payment date have not yet occurred, the trustee or debtor would assume the contract so that the bankruptcy estate would realize the benefit of this good bargain by paying $100,000 in exchange

46. *Id.* at 458.
47. 11 U.S.C. § 541(a).
48. *Id.* § 541(a)(1).
49. *See generally* 5 COLLIER ON BANKRUPTCY, *supra* note 17, ¶ 541.07[3].
50. *See id.*
51. Countryman, *supra* note 38, at 459 n.81.
52. *Id.* at 460–62. Professor Countryman defined material performance consistent with the Restatement (Second) of Contracts: "[A] contract under which the obligation of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." *Id.* at 460; *accord* RESTATEMENT (SECOND) OF CONTRACTS § 241 (1981).
53. *See* Countryman, *supra* note 38, at 461.

for goods now worth $140,000.[54] But if the market price of the goods has fallen to $60,000, the trustee or debtor should reject the contract, giving the seller nothing but a $40,000 prebankruptcy unsecured claim against the bankruptcy estate while relieving the trustee or debtor of the obligation to purchase the goods under that contract. As Professor Countryman has noted, "Whether in a given case the trustee will assume or reject depends, presumably, on his comparative appraisal of the value of the remaining performance by the other party and the cost to the estate of the unperformed obligation of the bankrupt."[55]

Though the Countryman definition has been adopted by the vast majority of courts that have addressed the issue, and no circuit has rejected it outright,[56] a few courts have used a different test that has been characterized as a more functional alternative for determining whether a contract is executory for purposes of applying § 365 of the Bankruptcy Code.[57] These courts have suggested that the Countryman definition is too restrictive and should also include contracts in which material unperformed obligations exist on only one side, so long as assumption or rejection would benefit the estate.[58]

C. The Shot Heard Around the IP World: *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*[59]

In 1985, a decision of the Fourth Circuit Court of Appeals seemingly shattered the reliability of technology licenses.[60] A few years before that decision, Richmond Metal Finishers, Inc. (RMF) developed a metal-coating process technology on which it wanted to capitalize.[61] In 1982, RMF

54. *See id.*

55. *Id.*

56. Collier on Bankruptcy, *supra* note 17, ¶ 365.02[2][b].

57. *See, e.g.*, *In re* Gen. Dev. Corp., 84 F.3d 1364, 1374 (11th Cir. 1996); *In re* Jolly, 574 F.2d 349, 351 (6th Cir. 1978) (adopting the functional approach in a case under the Bankruptcy Act); Stevens v. CSA, Inc., 271 B.R. 410, 413 (D. Mass. 2001) (explaining that courts in the First Circuit use both the Countryman standard and the functional analysis approach to evaluate executory contracts); Cohen v. Drexel Burnham Lambert Grp., Inc. 138 B.R. 687, 703 n.24 (Bankr. S.D.N.Y. 1992).

58. See *In re* Arrow Air, Inc., 60 B.R. 117, 121–22 (Bankr. S.D. Fla. 1986), where the court wrote:

> The legislative history of § 365, and the statute itself, establish that it is not always the case that there must be outstanding obligations on the part of both parties to the contract in order for a contract to be deemed executory . . . . The express language of § 365 reflects that Congress did not adopt a specific definition of an "executory contract" which would require mutual obligations, in spite of its clear opportunity to do so. The legislative history to that section evidences that Congress considered mutual obligations to be indicative of an executory contract in some, but not all, cases. . . . [E]ven though there may be material obligations outstanding on the part of only one of the parties to the contract, it may nevertheless be deemed executory under the functional approach if its assumption or rejection would ultimately benefit the estate and its creditors.

59. 756 F.2d 1043 (4th Cir. 1985).

60. *See id.*

61. *In re* Richmond Metal Finishers, Inc. (*Richmond II*), 38 B.R. 341, 342 (E.D. Va. 1984), *rev'd sub nom.*, *Lubrizol*, 756 F.2d 1043.

entered into a sixteen-year contract with Lubrizol Enterprises, Inc., under which Lubrizol, as licensee, would have a non-exclusive license to use the technology.[62] The contract provided that Lubrizol was prohibited from using the technology for one year after the execution of the agreement.[63] In consideration for the license, Lubrizol agreed to make royalty payments on product sales resulting from the use of the technology and to forgive certain indebtedness owed by RMF to Lubrizol.[64] Lubrizol also had certain ongoing accounting, reporting, and confidentiality obligations under the agreement.[65] In addition to its licensing obligations, RMF was obligated under the licensing agreement to (i) notify Lubrizol of any patent infringement suit and defend Lubrizol in any such suit, (ii) notify Lubrizol of any other use or license of the technology, and (iii) indemnify Lubrizol for certain losses arising out of the licensing agreement.[66]

RMF filed for protection under Chapter 11 of the Bankruptcy Code in August 1983.[67] At the time RMF filed for bankruptcy, no royalties had been paid or credited and the one-year period in which Lubrizol was prohibited from using the technology had just expired.[68] The licensed technology was a principal asset of RMF's business, and attempts to sell or license the technology to third parties were hindered by the existing Lubrizol license.[69] RMF wanted to have the ability to sell or license the technology to others free from the restrictive provisions in the Lubrizol agreement.[70] For that reason, RMF moved to reject the licensing agreement under § 365 of the Bankruptcy Code shortly after it filed its bankruptcy petition.[71] At the hearing on the motion to reject, RMF presented evidence that to properly fund RMF's Chapter 11 plan, the "sound business decision" was to reject the licensing agreement.[72] Lubrizol opposed the debtor's motion, arguing that (i) the licensing agreement was not executory and, therefore, was not subject to rejection under § 365 of the Bankruptcy Code and (ii) even if the licensing agreement was executory, the debtor should not be permitted to reject the agreement because rejection would not preclude Lubrizol from continuing to use the technology going forward and, as a result, rejection would not benefit the estate.[73]

On the first issue, the bankruptcy court determined that the licensing agreement was executory for § 365 purposes.[74] The court reasoned that Lubrizol's continuing obligation to make royalty payments under the

62. *In re* Richmond Metal Finishers, Inc. (*Richmond I*), 34 B.R. 521, 522 (Bankr. E.D. Va. 1983), *rev'd*, *Richmond* II, 38 B.R. 341 (E.D. Va. 1984).
63. *Richmond II*, 38 B.R. at 342.
64. *Richmond I*, 34 B.R. at 522.
65. *Lubrizol*, 756 F.2d at 1046.
66. *Richmond I*, 34 B.R. at 522.
67. *Id.*
68. *Richmond II*, 38 B.R. at 342.
69. *Id.*
70. *Id.*
71. *Richmond I*, 34 B.R. at 522.
72. *Id.*
73. *Id.* at 523, 526.
74. *Id.* at 526.

agreement was material, as were RMF's ongoing obligations to notify and defend against patent infringement suits and to indemnify Lubrizol for certain losses under the licensing agreement, thus rendering the contract executory.[75]

The bankruptcy court next addressed the issue of whether rejection would provide a benefit to the estate.[76] Applying the business judgment rule, the bankruptcy court held that rejecting the agreement would benefit the estate by permitting the debtor to substitute a new sale or licensing arrangement that would be more advantageous to the estate and to creditors.[77] The bankruptcy court rejected Lubrizol's argument that the debtor could not reject under § 365 because the licensing agreement "represents a future stream of income and, therefore, rejection will not benefit the estate."[78] Noting that the so-called "burdensome test" was "not the appropriate [test] to be applied," the bankruptcy court found that "rejection may and should be approved where a contract, while not actually burdensome to the debtor nonetheless prevents the debtor from entering a more advantageous arrangement."[79] Having found the licensing agreement executory and the business judgment test satisfied, the court granted the debtor's motion to reject the licensing agreement.[80]

On appeal to the district court, the bankruptcy court's decision was reversed.[81] In holding that the licensing agreement could not be rejected,

75. *Id.* at 524. The bankruptcy court cited *In re Select-A-Seat*, 625 F.2d 290 (9th Cir. 1980), to support its conclusion that the license agreement was an executory contract. *Richmond I*, 34 B.R. at 524. The bankruptcy court also rejected Lubrizol's argument that the licensing agreement was not executory as to RMF because its obligations under the agreement were contingent. *Id.* Relying on *In re Smith Jones, Inc.*, 26 B.R. 289, 292 (Bankr. D. Minn. 1982), and *In re O.P.M. Leasing Services, Inc.*, 23 B.R. 104, 117 (Bankr. S.D.N.Y. 1982), the bankruptcy court found that "even obligations that may never arise may form the basis of classifying a contract as executory." *Richmond I*, 34 B.R. at 524–25. The bankruptcy court also found support from Professor Countryman himself who stated, "The usual patent license, by which the patentee-licensor authorizes the licensee to exercise some part of the patentee's exclusive right to make, use and vend the patented item in return for payment of royalties, ordinarily takes the form of an executory contract." *Id.* at 525 (quoting Countryman, *supra* note 38, at 301).

It should be noted, however, that not all intellectual property licenses are executory contracts. In *In re Exide Technologies*, 607 F.3d 957 (3d Cir. 2010), a purchaser of substantially all of an industrial battery business also obtained, as part of the sale transaction, an exclusive, perpetual, royalty-free license to use the seller's trademark. *Id.* at 961. When the seller-licensor filed a Chapter 11 petition many years later and attempted to reject the license in order to prevent the licensee from using the trademark, the Court of Appeals held that all of the licensee's material obligations under the agreement were substantially performed as of the date when the bankruptcy petition was filed and, therefore, if the licensee breached any remaining obligations, the licensor would not be relieved of its obligation to perform under the license agreement. *Id.* at 963–64. Therefore, the agreement was not an executory contract under the Countryman definition and it could not be rejected. *But see In re* Interstate Bakeries Corp., 690 F.3d 1069, 1075, (8th Cir. 2012) *vacating as moot* No. 11-1850, 2013 U.S. App. LEXIS 12463 (8th Cir. 2013) (en banc).

76. *Richmond I*, 34 B.R. at 524.

77. *Id.* at 526.

78. *Id.*

79. *Id.* (citing *In re* Smith Jones, Inc., 26 B.R. 289, 293 (Bankr. D. Minn. 1982)).

80. *Id.*

81. *Richmond II*, 38 B.R. 341, 345 (E.D. Va. 1984), *rev'd sub nom.* Lubrizol Entrs., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1984). .

the district court first determined that, contrary to the bankruptcy court's finding, the licensing agreement was not an executory contract.[82] Analogizing the licensing agreement to a sale of land where the seller retained a purchase money deed of trust, the court found that RMF's notification and defense obligations were insufficient to make the contract executory:

> There, as here, the subject of the contract has been conveyed and possession has been taken by the vendee. There, as here, the vendee has the obligation of making payment for the conveyance as provided in the contract. There, as here, the vendor has the benefit of receiving the periodic payments and has the obligation of defending the vendee's title. . . .
>
> . . . .
>
> The obligations of the vendor of real estate to defend the purchaser's title is no more onerous than the obligation of the vendor of technology to defend the vendee's right to exploit it.
>
> . . . .
>
> Applying this analysis and on the reasoning, (though not necessarily on the conclusion) of Professor Countryman, I find the contract to be essentially nonexecutory.[83]

Further, the district court wrote that even if the licensing agreement was executory, RMF could not reject the contract because rejection provided no benefit to the estate.[84] Most notably, the district court was of the view that rejection would neither affect Lubrizol's ability to continue exercising its property rights under the licensing agreement nor relieve its obligations to continue paying royalties.[85] Despite rejection, the court reasoned that a licensee's right to use licensed technology does not terminate.[86] As a result, the district court concluded, rejection would only serve to relieve RMF of its defense obligations.[87] Because RMF's business judgment rationale for rejection was the refusal of third parties to license the technology so long as the Lubrizol license remained in effect, but rejection of the license agreement would not deprive Lubrizol of the continued use of the technology, rejection would have "at best, a marginal effect upon the technology's marketability."[88] Accordingly, the district court found no basis for the debtor's business judgment and determined rejection was not appropriate.[89]

On appeal, the Court of Appeals for the Fourth Circuit reversed the judgment of the district court and directed entry of an order consistent with the bankruptcy court's decision.[90] First, the Fourth Circuit agreed

82. *Id.*
83. *Id.* at 343–45 (emphasis omitted).
84. *Id.* at 345.
85. *Id.* at 344.
86. *Id.* at 343–45.
87. *Id.* at 344.
88. *Id.* at 344–45.
89. *Id.* at 345.
90. Lubrizol Enters., Inc., v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1044 (4th Cir. 1985).

with the bankruptcy court that the licensing agreement was an executory contract.[91] Relying on an earlier decision where it adopted the Countryman test for determining whether a contract was executory for § 365 purposes,[92] the Fourth Circuit concluded that the continuing obligations of RMF to notify Lubrizol of further licensing of the technology, to reduce Lubrizol's royalty rate to meet any favorable grants to subsequent licensees, to notify and defend Lubrizol against suits, and to indemnify Lubrizol for certain losses under the licensing agreement were material obligations still outstanding such that the contract was executory as to RMF.[93] Likewise, the court found Lubrizol's obligation to make royalty payments, to comply with various accounting and reporting requirements under the licensing agreement, and to keep the licensed technology in confidence for a number of years were sufficiently material to make the contract executory as to Lubrizol as well.[94] Thus, there were material obligations remaining on both sides when the bankruptcy case commenced.

On the question of whether rejection would benefit the estate, the Fourth Circuit again agreed with the bankruptcy court's finding.[95] Turning to the business judgment test, the Fourth Circuit evaluated "whether the decision of the debtor that rejection [would] be advantageous [was] so manifestly [unreasonable] that it could not be based on sound business judgment, but only on bad faith, or whim or caprice."[96] In reversing the district court, the Fourth Circuit found error in two respects. First, the district court improperly substituted its business judgment for the debtor's and, second, the district court misconstrued the law when it concluded that the debtor's rejection of the licensing agreement would not deprive Lubrizol of its right to continue using the licensed technology.[97]

As to Lubrizol's right to continue using the licensed technology, the Fourth Circuit rejected the district court's holding as a "misapprehension of controlling law":

> [W]e can only conclude that the district court was under a misapprehension of controlling law in thinking that by rejecting the agreement the debtor could not deprive Lubrizol of all rights to the process. Under 11 U.S.C. § 365(g), Lubrizol would be entitled to treat rejection as a breach and seek a money damages remedy; however, it could not seek to retain its contract rights in the technology by specific performance even if that remedy would ordinarily be

91. *Id.* at 1044–45.

92. *Id.* at 1045 (citing Gloria Mfg. Corp. v. Int'l Ladies' Garment Workers' Union, 734 F.2d 1020, 1022 (4th Cir. 1984)).

93. *Id.*

94. *Id.* at 1046.

95. *Id.* at 1047.

96. *Id.*

97. *Id.* at 1047–48. The Fourth Circuit found no evidence in the record from which the district court could have determined that the debtor's decision was the result of anything other than its sound business judgment. In the absence of such evidence, the Fourth Circuit found, "the business judgment rule required that the debtor's factual evaluation be accepted by the court." *Id.* at 1047.

available upon breach of this type of contract.[98]

Viewing Lubrizol's continued use of the licensed technology after the debtor's rejection as akin to specific enforcement under the licensing agreement, the Fourth Circuit looked to the legislative history of § 365(g) and found that the nondebtor party to a rejected contract was limited to a money-damages claim against the bankruptcy estate.[99] Allowing Lubrizol to obtain specific performance after the debtor rejected the licensing agreement, the Fourth Circuit concluded, "would obviously undercut the core purpose of rejection under § 365(a), and that consequence cannot therefore be read into congressional intent."[100]

The Fourth Circuit was not unaware of the potential harm that could flow from its decision.[101] The court acknowledged that its decision would create "serious burdens" on contracting parties and "have a general chilling effect upon the willingness of such parties to contract at all with businesses in possible financial difficulty"[102] but felt that it could not consider such equitable considerations in the face of clear Congressional intent.[103] The court wrote that Congress was aware of the consequences flowing to a nondebtor party from a debtor's rejection of an executory contract and how to protect against it, as was evidenced by § 365(h) of the Bankruptcy Code, which allows tenants of real property to remain in possession notwithstanding a debtor-landlord's rejection of a real property lease.[104] Because Congress had not provided comparable treatment for technology licensees, in a grave understatement, the Fourth Circuit cautioned that Lubrizol would have to "share the general hazards created by § 365 for all business entities dealing with potential bankrupts."[105] The hazard for Lubrizol would be the loss of its right to use its licensed intellectual property.

D. The Intellectual Property Bankruptcy Protection Act of 1988: Congress's Response to *Lubrizol*

In 1988, the Intellectual Property Bankruptcy Protection Act was enacted for the purpose of legislatively overruling the *Lubrizol* decision and eliminating the threat to technology licensees when licensors become debtors in bankruptcy.[106]

> The purpose of the bill is to amend § 365 of the Bankruptcy Code 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

98. *Id.* at 1048.
99. *Id.*
100. *Id.*
101. *See id.*
102. *Id.*
103. *Id.*
104. *Id.*; *see* 11 U.S.C. § 365(h); Collier on Bankruptcy, *supra* note 17, ¶ 365.11.
105. *Lubrizol*, 756 F.2d at 1048.
106. Intellectual Property Bankruptcy Act of 1988, Pub. L. No. 100-506, 102 Stat. 2538 (codified in Title 11 of the United States Code); *see* S. Rep. No. 100-505, at 2–3 (1988).

> the rejection of the license pursuant to § 365 in the event of the licensor's bankruptcy. Certain recent court decisions interpreting § 365 have imposed a burden on American technological development that was never intended by Congress in enacting § 365. The adoption of this bill will immediately remove that burden and its attendant threat to the development of American Technology and will further clarify that Congress never intended for § 365 to be so applied.[107]

As reflected in the senate report relating to the legislation, Congress viewed the *Lubrizol* decision as a misreading of § 365 of the Bankruptcy Code.[108] The Intellectual Property Bankruptcy Protection Act was designed to correct this misreading by adding to § 365 of the Bankruptcy Code a subsection (n), which provides that upon rejection by the licensor, the licensee of intellectual property may elect to either treat the contract as terminated by the rejection or retain its rights to the use of the intellectual property, including exclusivity provisions, for the duration of the license period, including any period for which the license could be extended under the agreement.[109] In particular, subsection (1) of § 365(n) provides:

> If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—
>
> (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or
>
> (B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for—
>
> (i) the duration of such contract; and
>
> (ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.[110]

If a licensee elects to keep its rights under the licensing contract under § 365(n)(1), the trustee must allow the licensee to continue exercising its

---

107. S. REP. NO. 100-505, at 1–2.

108. *See* S. REP. NO. 100-505, at 3 ("Congress never anticipated that the presence of executory obligations in an intellectual property license would subject the licensee to the risk that, upon bankruptcy of the licensor, the licensee would lose not only any future affirmative performance required of the licensor under the license, but also any right of the licensee to continue to use the intellectual property as originally agreed in the license agreement.").

109. *Id.* at 5–6.

110. 11 U.S.C. § 365(n)(1).

rights under the agreement, but with certain limitations.[111] Although a licensee electing to retain its rights under a licensing agreement retains its right to specifically enforce exclusivity provisions, it loses the right to seek specific performance with respect to all other covenants under the licensing agreement.[112] As explained in the legislative history of § 365(n), this limitation "recognizes that continued affirmative performance of an intellectual property license may be impractical; for instance, a trustee will generally be unable to perform covenants calling for continued research to improve licensed intellectual property."[113]

It is not surprising that the licensee that elects to retain its rights under a rejected license is not released of all of its obligations under the license agreement.[114] Most notably, in exchange for its continued use of the license, the licensee must continue to make all royalty payments under the licensing agreement. The licensee is also deemed to have waived any setoff rights it may have against the debtor so that royalty payments may not be reduced by any damages suffered by the debtor's nonperformance of covenants.[115] Similarly, the licensee is deemed to have waived any right to seek administrative expense priority under § 503(b) of the Bankruptcy Code with respect to any claim it may have against the debtor licensor.[116] These provisions represent a compromise between the debtor's and licensee's respective needs: the licensee retains its right to use the licensed intellectual property, which may be essential to the continuation of its business, while the debtor, no longer able to relicense or sell the intellectual property after rejection, receives the royalty payments—free of the burden of offsets or administrative priority claims—needed to effectuate its reorganization.[117]

Rejection of a licensing agreement does not free the trustee or debtor of all of its performance obligations under a licensing agreement. To make the election to retain the use of the licensed intellectual property meaningful, on written request, the trustee or debtor in possession must, to the extent provided in the license agreement, provide the licensee with any intellectual property, including an embodiment, held by the trustee or debtor in possession and must not interfere with the licensee's rights to the intellectual property, including the right to obtain it from a third party.[118]

While the Intellectual Property Bankruptcy Protection Act of 1988 legislatively overruled the Fourth Circuit's *Lubrizol* decision with respect to the license of patented technology at issue, the Act did not extend protection to all intellectual property. Section 365(n), by its terms, applies to

111. *Id.* § 365(n)(2).
112. *Id.* § 365(n)(1)(B).
113. S. REP. NO. 100-505, at 8.
114. 11 U.S.C. § 365 (n)(2)(B).
115. *Id.* § 365(n)(2)(C)(i).
116. *Id.* § 365(n)(2)(C)(ii).
117. *See* S. REP. NO. 100-505, at 10.
118. 11 U.S.C. § 365(n)(3).

licensees to "executory contract[s] under which the debtor is a licensor of a right to intellectual property."[119] However, the Act also added a definition of "intellectual property" to the Bankruptcy Code, which does not include all types of property that are generally known in the business and legal worlds as "intellectual property." In particular, "intellectual property" is defined in § 101 of the Bankruptcy Code to mean:

> (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.[120]

Conspicuous in their absence are any mention of trademarks, trade names, and service marks. As explained in the legislative history of the 1988 Act, while Congress was concerned about the rights of licensees under trademark, trade name, and service mark license agreements under the *Lubrizol* line of reasoning, Congress opted not to address these types of intellectual property at that time because "such contracts raise[d] issues beyond the scope of th[e] legislation."[121] Particularly, Congress thought this area required more extensive study because "trademark, trade name and service mark licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee."[122] For example, if a franchisor of restaurants becomes a debtor in a Chapter 11 case, it may want to reject a certain franchise agreement under § 365(a) and terminate its franchise relationship with a poorly-managed, unprofitable restaurant. Since such franchisees are often given trademark licenses so they can use the trade name and trademark of the franchisor on their restaurants, menus, napkins, and related products, if a franchisee with a rejected franchise agreement could continue to use the trademarks but be relieved of the obligation to comply with quality control covenants, the result would be a lowering or elimination of quality standards while the trademark of the licensor would continue to be used by the franchisee. This concern led Congress to "postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts."[123] However, in the quarter century since the enactment of the 1988 Act, Congress has yet to address the rights of licensees when a debtor in bankruptcy rejects a licensing agreement for trademarks, trade names, and service marks.

Of course, under the reasoning of *Lubrizol*, rejection of a trademark license by a licensor in bankruptcy could result in the loss of the licensee's

119. *Id.* § 365(n)(1).
120. *Id.* § 101(35A).
121. S. REP. NO. 100-505, at 5.
122. *Id.*
123. *Id.*

right to use the trademark.[124] Ironically, the likelihood that bankruptcy courts would deprive a licensee of the right to use a trademark under a rejected license was actually enhanced after the enactment of the 1988 Act. Several courts have found that, relying on what they perceived as a negative inference of the legislation, the exclusion of trademarks from the definition of "intellectual property" meant that Congress intended that *Lubrizol*'s holding would continue to govern trademark license rejections.[125]

E. Transactional Structures Designed to Minimize the Risks to a Licensee Flowing from Rejection of a Trademark License

Given the reliance of trademark licensees on long-term licensing arrangements, the magnitude of the investment, and the uncertainty of the long-term financial viability of any licensor, it is not surprising that in the wake of *Lubrizol* and Congress's failure to extend the protections of § 365(n) to trademarks, licensees and their attorneys have devised transactional steps and complex structures designed to offer some degree of protection to trademark licensees from the adverse effects of a licensor's rejection of the license agreement in bankruptcy. For example, rather than structure the transaction as a licensing arrangement, the initial transaction could be structured as a sale or absolute assignment of the intellectual property. If a licensing arrangement is required, the transaction could include the trademark owner first transferring title to the trademark to a trust or "bankruptcy-remote" entity, which becomes the licensor. These entities, which typically have no assets other than the intellectual property, have no debts, and have independent directors and corporate governance documents designed to reduce the likelihood that a bankruptcy petition will be filed, that the licensor will ever become a debtor under the Bankruptcy Code, and that the license therefore, will ever be rejected. Another option is for the licensor to grant the licensee a security interest in its assets, including the trademark itself. Rejection of an executory contract does not deprive the nondebtor party from the benefit of a security interest securing the debtor's obligations under the agreement.[126] Therefore, rejection of a trademark license would not terminate the licensee's security interest in the trademark. Although the security interest will not eliminate the licensor's power to reject the license, it will result in the licensee having a secured claim for any damages that

124. *See, e.g.*, Harrell v. Colonial Holdings, Inc., 923 F. Supp. 2d 813 (E.D. Va. 2013).

125. *See, e.g.*, *In re* Old Carco LLC, 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009) ("Trademarks are not 'intellectual property' under the Bankruptcy Code . . . [therefore,] rejection of licenses by [a] licensor deprives [the] licensee of [the] right to use [a] trademark . . . ."); *In re* HQ Global Holdings, Inc., 290 B.R. 507, 513 (Bankr. D. Del. 2003) ("[S]ince the Bankruptcy Code does not include trademarks in its protected class of intellectual property, *Lubrizol* controls and the Franchisees' right to use the trademarks stops on rejection.").

126. *See, e.g.*, Leasing Servs. Corp. v. First Tenn. Bank, 826 F.2d 434, 437 (6th Cir. 1987).

result from the rejection, which would give the licensee the right to receive full payment for all such damages up to the value of the collateral, including the value of the trademark subject to the security interest, rather than receiving only a fraction of its claim as an unsecured creditor.[127] This enhanced position is likely to act as a disincentive to the licensor that otherwise may be inclined to reject the license agreement.[128]

These transactional options do not necessarily give perfect protection, and they may not be feasible or cost efficient in a particular situation. From the standpoint of trademark licensees, a more preferable development would be a legislative solution that provides the kind of protection offered to other intellectual property licensees under § 365(n) or a judicial solution that assures licensees of the right to continued use of a trademark under a licensing agreement despite rejection by the licensor in bankruptcy.

F. A Recent Victory for Trademark Licensees in the Seventh Circuit: The Sunbeam Products Decision

The first major appellate decision to determine the effect of rejection by a licensor of an intellectual property licensing agreement after *Lubrizol* and the passage of the Intellectual Property Bankruptcy Protection Act of 1988 was the decision of the Court of Appeals for the Seventh Circuit in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC.*[129] Sunbeam involved the Lakewood Engineering & Manufacturing Company, which manufactured and sold various consumer products, including box fans.[130] Losing money on every fan, Lakewood decided to outsource the manufacture of some of its products, including its box fans, to third parties.[131] As a result, Lakewood entered into an outsourcing agreement with Chicago American Manufacturing ("CAM"), under which CAM would manufacture Lakewood's box fans.[132] Under the terms of the outsourcing agreement, Lakewood would supply the fan motor and cord at no cost to CAM, and CAM, in turn, would provide the other raw materials and assemble the fans.[133] Lakewood would then purchase the fans at a set price directly from CAM and then resell them to its customers.[134]

---

127. *Id.* at 436.

128. For a more fulsome discussion of these structural devices and transactional options designed to minimize the risks flowing from rejection of an intellectual property license, see Richard M. Cieri & Michelle M. Morgan, *Licensing Intellectual Property and Technology from the Financially-Troubled or Startup Company: Prebankruptcy Strategies to Minimize the Risk in a Licensee's Intellectual Property and Technology Investment*, 55 Bus. Law. 1649, 1691 (2000).

129. 686 F.3d 372, 376 (7th Cir. 2012).

130. *Id.* at 375. "Prior to 2008, Lakewood was one of the three largest manufacturers of box fans in the United States." *In re* Lakewood Eng'g & Mfg., 459 B.R. 306, 312 (Bankr. N.D. Ill. 2011).

131. *Sunbeam*, 686 F.3d at 374.

132. *Lakewood*, 459 B.R. at 313.

133. *Id.*

134. *Id.*

Concerned about Lakewood's financial status, in late 2008 CAM sought to replace the outsourcing agreement with a supply agreement that would allow CAM to license the Lakewood trademark and sell the box fans it had manufactured directly to third parties in the event Lakewood was unable to purchase the fans CAM manufactured.[135] Under the supply agreement, CAM was to manufacture a set number of fans each month in accordance with a forecast schedule, and Lakewood was to order all of its actual requirements of box fans within thirty days after each forecasted month solely from CAM.[136] If Lakewood failed to purchase all fans manufactured under the forecast schedule within thirty days after the month for which those fans were forecasted as required by Lakewood, CAM would have been entitled under the supply agreement to sell any fans not purchased by Lakewood "in Lakewood's packaging and under Lakewood's name, to any customer whatsoever, including, but not limited to, any customers of Lakewood."[137] The parties entered into the supply agreement in December 2008.[138] Two months after signing the contract, however, Lakewood's profits did not improve, and several of Lakewood's creditors filed an involuntary petition against the company under Chapter 7 of the Bankruptcy Code.[139] The order for relief under Chapter 7 was entered, and a trustee was appointed to liquidate Lakewood's assets in 2009.[140]

When the trustee sought to effectuate a sale of the company's assets, he filed a motion to reject the supply contract with CAM because of his concern that it would negatively impact the sale process.[141] Although CAM did not oppose the motion, it took the position that the rejection did not affect its continuing right to sell fans under the supply agreement.[142]

Shortly after rejection, the trustee entered into a purchase agreement with Sunbeam Products, Inc., doing business as Jarden Consumer Products, under which Jarden purchased Lakewood's assets, including its patents and trademarks.[143] Jarden, however, did not want to buy the fans in CAM's inventory, nor did it want CAM selling the fans in competition with Jarden.[144] Despite Jarden's objections, however, CAM continued to sell the Lakewood-branded fans, resulting in Jarden's commencement of an adversary proceeding in the bankruptcy court against CAM alleging patent and trademark infringement.[145]

Entering judgment in favor of CAM, the bankruptcy court held that the trustee's rejection of the supply agreement did not terminate either

135. *Id.* at 316.
136. *Id.* at 317–18.
137. *Id.* at 333.
138. *Id.* 335.
139. *Id.* at 320.
140. *Id.* at 322.
141. *Id.* at 323.
142. *Id.* at 323, 325.
143. *Id.* at 326.
144. Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 374 (7th Cir. 2012).
145. *Lakewood*, 459 B.R. at 310.

the patent or trademark licenses granted to CAM under that agreement.[146] With respect to the patents, the bankruptcy court held that § 365(n) of the Bankruptcy Code protected CAM's right to continue to use the intellectual property despite the rejection.[147] The bankruptcy court also held that, despite the fact that § 365(n) does not apply to trademark licenses, CAM was entitled to continue using the trademarks and to make and sell as many fans as Lakewood had estimated it would need for the entire 2009 selling season.[148]

The bankruptcy court explicitly rejected the Fourth Circuit's decision in *Lubrizol*. Finding no controlling authority on point in the Seventh Circuit, the bankruptcy court found persuasive a concurring opinion rendered by Judge Thomas L. Ambro in a recent Third Circuit case, *In re Exide Technologies*.[149] In *Exide*, the bankruptcy court approved rejection under § 365(a) of the Bankruptcy Code of an integrated agreement for the sale of Exide's industrial battery business, which included a perpetual, exclusive, royalty-free license granting the buyer the right to use the Exide trademark in connection with the business.[150] Based on the reasoning of *Lubrizol* and a negative inference from § 365(n), the bankruptcy court held that rejection of the agreement terminated the licensee's right to use the licensed trademark.[151] "[A] trademark license is terminated upon rejection and the licensee is left only with a claim for damages."[152]

The district court affirmed the decision in *Exide*, but the Court of Appeals for the Third Circuit reversed, holding that the agreement was not an executory contract under the Countryman standard because all obligations of the licensee had been substantially performed and, therefore, the license could not be rejected.[153] In a concurring opinion in *Exide*, Judge Ambro agreed with the majority's decision, but added that even if the agreement were an executory contract, rejection would not necessarily result in termination of the licensee's right to use the trademark.[154] Judge Ambro pointed to the legislative history of § 365(n) indicating that trademarks were excluded from the definition of "intellectual property" because trademarks needed more extensive study, and "it was determined to postpone congressional action in this area and *to allow the development of equitable treatment of this situation by bankruptcy courts*."[155] Judge Ambro found this statement in the legislative history to be justification for bankruptcy courts to use their equitable powers to give the debtor a fresh start without stripping a licensee of its fairly-procured trademark

146. *Id.* at 347.
147. *Id.* at 341–43.
148. *Id.* at 345–46.
149. 607 F.3d 957, 964–68 (3d Cir. 2010).
150. *Id.* at 961.
151. *In re* Exide Tech, 340 B.R. 222, 250 (Bankr. D. Del. 2006), *vacated*, 607 F.3d 957 (2010).
152. *Id.* at 250 n.40.
153. *Id.* at 964.
154. *Id.* at 964–65.
155. S. REP. NO. 100-505, at 5 (1988) (emphasis added).

rights[156]:

> Courts may use § 365 to free a bankrupt trademark licensor from burdensome duties that hinder its reorganization. They should not—as occurred in this case—use it to let a licensor take back trademark rights it bargained away. This makes bankruptcy more a sword than a shield, putting debtor-licensors in a catbird seat they often do not deserve.[157]

Following Judge Ambro's reasoning in *Exide*, the bankruptcy court in *Sunbeam* opted to "not follow, in lockstep fashion, those few trial courts to have decided that the non-binding *Lubrizol* holding is the only possible outcome," and it found on equitable grounds that CAM was entitled to continue using the Lakewood trademark to sell the forecasted fans that Lakewood failed to purchase under the supply agreement.[158]

Jarden appealed the bankruptcy court's decision in *Sunbeam* directly to the court of appeals under a direct appeal procedure reserved for, among others, situations involving a matter of public importance or in which there is no controlling decision of the court of appeals or Supreme Court as to a question of law.[159] The Seventh Circuit affirmed the decision of the bankruptcy court, holding that rejection of the trademark license did not deprive the licensee, CAM, of the right to continued use the trademark.[160] However, the Seventh Circuit rejected the reasoning of the bankruptcy court and Judge Ambro's concurring opinion in *Exide*, which justified allowing CAM to retain its right to use the trademark based on equitable grounds.[161] Judge Frank H. Easterbrook, who wrote the Seventh Circuit's opinion, explained his disapproval of bankruptcy judges making these determinations based on equitable principles:

> What the Bankruptcy Code provides, a judge cannot override by declaring that enforcement would be 'inequitable.' . . . There are hundreds of bankruptcy judges, who have many different ideas about what is equitable in any given situation. Some may think that equity favors licensees' reliance interests; others may believe that equity favors the creditors, who can realize more of their claims if the debtor can terminate IP licenses. Rights depend . . . on what the Code provides rather than on notions of equity.[162]

Taking a more textual approach in applying the Bankruptcy Code, the Seventh Circuit based its conclusion on § 365(g) of the Bankruptcy Code, which provides that rejection constitutes a breach by the debtor licensor.[163] Focusing on what would happen outside of bankruptcy if the licen-

156. *In re Exide Tech.*, 607 F.3d at 967.
157. *Id.* at 967–68.
158. *In re* Lakewood Eng'g & Mfg., 459 B.R. 306, 345 (Bankr. N.D. Ill. 2011).
159. 28 U.S.C. § 158(d)(2) (2006); Sunbeam Prods. Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372, 372–73 (7th Cir. 2012).
160. *Sunbeam*, 686 F.3d at 373.
161. *Id.* at 375.
162. *Id.* at 375–76.
163. *Id.* at 376–77.

sor breached the license agreement, the court found that the licensee's right to use the trademark would continue despite the licensor's breach.[164] "[O]utside of bankruptcy, Lakewood could not have ended CAM's right to sell the box fans by failing to perform its own duties any more than a borrower could end the lender's right to collect by declaring that the debt will not be paid"[165]:

> After rejecting a contract, a debtor is not subject to an order of specific performance. . . . The debtor's unfulfilled obligations are converted to damages; when a debtor does not assume the contract before rejecting it, these damages are treated as a pre-petition obligation, which may be written down in common with other debts of the same class. *But nothing about this process implies that any rights of the other contracting party have been vaporized.*[166]

Commenting that scholars uniformly criticized *Lubrizol* because it confused rejection of a contract with the use of an avoiding power,[167] the Seventh Circuit indicated that it too was unpersuaded by the landmark Fourth Circuit decision.[168] It criticized *Lubrizol* for devoting "scant attention to the question whether rejection cancels a contract, worrying instead about the right way to identify executory contracts to which the rejection power applies."[169]

Though the Seventh Circuit's decision goes a long way in protecting the rights of trademark licensees, the full impact of *Sunbeam* is unclear because of the many unanswered questions that remain for courts that follow it. In particular, if the license agreement gives the licensee the exclusive right to use a trademark, what effect will rejection have on such exclusivity rights? Since rejection constitutes a breach by the debtor-licensor, is the licensee relieved of its obligations under the agreement? Is the licensee under a rejected license agreement, as a condition to continued use of the trademark, required to continue to make royalty payments under the agreement? Will the licensee be required to comply with other covenants, such as those relating to quality control, after the license agreement is rejected? Since the licensee's remedies are limited to filing a claim against the bankruptcy estate for any monetary damages caused by the licensor's rejection, and the licensee has no right to seek specific performance of the agreement, is the debtor-licensor or any successor to the licensor relieved of any contractual obligations to defend the trademark and protect it against infringement?

---

164. *Id.* at 377.

165. *Id.*

166. *Id.* (emphasis added).

167. The court cited various scholars. *See* DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY 130–40, 139 n.10 (Foundation Press 4th ed. 2006); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U. COLO. L. REV. 845, 916–19 (1988); Jay Lawrence Westbrook, *The Commission's Recommendations Concerning the Treatment of Bankruptcy Contracts*, 5 AM. BANKR. INST. L. REV. 463, 470–72 (1997).

168. *Sunbeam*, 686 F.3d at 377–78.

169. *Id.* at 377.

It remains to be seen how courts will resolve these questions and the extent to which they will look to § 365(n) for guidance or analogous application. In any event, despite Judge Easterbrook's disapproval of bankruptcy judges basing their decisions on what they think is the equitable result, the lack of legislative direction in this complex area resulting from Congress's failure to address the effects of rejection of trademark licenses in almost twenty-five years since the Intellectual Property Bankruptcy Protection Act of 1988 was enacted may leave judges with no alternative but to resolve these questions by weighing the equities of the parties under the particular circumstances.

III. CONCLUSION

The split in the circuits on whether a licensee has the right to continue to use a trademark after the licensor rejects the license agreement in bankruptcy can only be resolved by Congress or the United States Supreme Court. Unfortunately, it is unlikely that such resolution will come in the near term, especially since the Supreme Court denied a writ of certiorari in *Sunbeam*.[170]

The circuit split and the unanswered questions raised by the decision in *Sunbeam* cry out for a legislative solution. Congress has already made the policy determination in 1988 that licensees of intellectual property should not lose the right to continued use of technology by reason of a licensor's rejection in bankruptcy—a decision that affords the intellectual property rights of such licensors greater weight than the general reorganization policy underlying the Bankruptcy Code. The time is long overdue for Congress to complete its task of refining and implementing a clear policy relating to the rights of licensees of a rejected trademark license agreement.

170. Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 133 S. Ct. 790, 790 (2012).

AMERICAN BANKRUPTCY INSTITUTE

Circuit Split Deepens on Rejection of Trademark Licenses

First Circuit follows the Fourth Circuit's Lubrizol and rejects the Seventh Circuit's Sunbeam.

Pointedly disagreeing with the Seventh Circuit, the First Circuit deepened an existing split by adopting the Fourth Circuit's conclusion in *Lubrizol* and holding that rejection of a trademark license agreement precludes the licensee from continuing to use the license. Help Center

The 2/1 opinion from the First Circuit on Jan. 12 reversed the Bankruptcy Appellate Panel, which, to the contrary, had followed Circuit Judge Frank Easterbrook's decision in *Sunbeam Products Inc. v. Chicago American Manufacturing LLC*, 686 F.3d 372 (7th Cir. 2012). In *Sunbeam*, the Seventh Circuit rejected the Fourth Circuit's rationale in *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc.*, 756 F.2d 1043 (4th Cir. 1985).

In simple terms, the First Circuit's decision means that the licensee of patents can continue using the technology after rejection as a consequence of Section 363(n), but the same licensee cannot continue using trademark licenses that went along with the technology.

The Genesis of Section 365(n)

In *Lubrizol*, the Fourth Circuit ruled in 1985 that rejection of an executory contract licensing intellectual property halted the non-bankrupt's right to use patents, trademarks and copyrights. Three years later, Congress responded by adding Section 365(n), which, in conjunction with the definition of "intellectual property" in Section 101(35A), provides that the non-debtor can elect to continue using patents, copyrights and trade secrets despite rejection of a license.

The amendment conspicuously omitted reference to trademarks. The Senate Report said that the amendment did not deal with trademarks because the issue "could not be addressed without more extensive study." According to the report, Congress decided to postpone action "to allow the development of equitable treatment of this situation by bankruptcy courts."

Since then, courts have split into two camps. One group takes a negative inference from the omission of trademarks from Section 365 (n) by holding that rejection terminates the right to use a trademark, although the licensee could elect to continue using patents covered by the same agreement.

In *Sunbeam*, the Seventh Circuit split with the Fourth in 2012. Judge Easterbrook acknowledged that Section 365(n) does not preserve the right to use trademarks, but at the same time does not prescribe the consequences of rejection. Judge Easterbrook instead relied on Section 365(g), which teaches that rejection "constitutes a breach" of contract.

Judge Easterbrook reasoned that a licensor's breach outside of bankruptcy would not preclude the licensee from continuing to use a trademark. He ruled that rejection converted the debtor's unfulfilled obligations into damages. He said that "nothing about this process implies than any other rights of the other contracting party have been vaporized." He added that *Lubrizol* has been "uniformly criticized" by scholars and commentators.

The First Circuit Case

Before bankruptcy, the debtor in the case before the First Circuit had granted the licensee a non-exclusive, irrevocable, fully paid, transferrable license to its intellectual property including patents. However, the irrevocable license excluded the debtor's trademarks.

Separately, the license agreement granted a non-exclusive, non-transferable, limited license to use the debtor's trademarks.

The day after filing a chapter 11 petition, the debtor filed a motion to reject the trademark and patent licenses as executory contracts under Section 365(a). During the ensuing litigation, the debtor conceded that Section 365(n) allowed the licensee to retain its rights in the intellectual property and patents, but not the trademarks.

Ultimately, the bankruptcy court ruled that Section 365(n) did not preserve the licensee's rights in the trademarks. The bankruptcy judge believed that the omission of trademarks from the definition of intellectual property in Section 101(35A) meant that Section 365 (n) does not protect rights in trademarks.

On the first appeal, the BAP followed *Sunbeam* and reversed the bankruptcy court, calling *Lubrizol* "draconian" and saying that rejection does not "vaporize" trademark rights. To read ABI's report on the BAP opinion, click here.

With regard to trademarks, Circuit Judge William J. Kayatta, Jr. reversed the BAP in a 2/1 opinion, holding that the right to use trademarks did not survive rejection.

Judge Kayatta said that *Sunbeam* "largely rests on the unstated premise that it is possible to free a debtor from any continuing performance obligations under a trademark license even while preserving the licensee's right to use the trademark." That premise, he said, is wrong because "effective licensing of a trademark" requires the licensor to continue monitoring and exercising control over the quality of the goods sold under the mark.

Sunbeam is wrong, in Judge Kayatta's view, because it "entirely ignores the residual enforcement burden it would impose on the debtor just as the Code otherwise allows the debtor to free itself from executory burdens" and "invites further degradation of the debtor's fresh start options."

Judge Kayatta therefore favored "the categorical approach of leaving trademark licenses unprotected from court-approved rejection, unless and until Congress should decide otherwise."

The Dissent

Circuit Judge Juan R. Torruella dissented with regard to trademarks. Like *Sunbeam*, he would have held that rights in a trademark "did not vaporize" as a result of rejection.

Judge Torruella based his dissent in large part on the legislative history surrounding the adoption of Sections 363(n) and 101(35A). He saw Congress as allowing courts to use their equitable powers to protect trademark licensees.

Rather than eviscerating the licensee's trademark rights, Judge Torruella said he instead would "be guided by the terms of the [license agreement], and non-bankruptcy law, to determine the appropriate equitable remedy of the functional breach of contract."

Distribution Rights

The litigation in bankruptcy court also involved the debtor's license of distribution rights. Affirmed by the BAP, the bankruptcy court had ruled that rejection cut off distribution rights too.

On appeal in the circuit, the licensee mounted several creative arguments aimed at showing that distribution rights were an adjunct to the patents and technology and therefore should survive.

Judges Kayatta and Torruella agreed that rejection cut off distribution rights.

The Next Steps

If the licensee does not throw in the towel, the next step will be a petition for rehearing *en banc* or a petition for *certiorari*. The circuit split pits not only the First Circuit against the Seventh. In his concurrence in *In re Exide Technologies*, 607 F.3d 957, 964 (3d Cir. 2010), Third Circuit Judge Thomas L. Ambro reached the same result as the Seventh Circuit on much the same reasoning.

Opinion Link:	Opinion Link
Judge Name:	William J. Kayatta, Jr., Juan R. Torruella
Case Citation:	Mission Product Holdings Inc. v. Tempnology LLC (In re Tempnology LLC), 16-9016 (1st Cir. Jan. 12, 2018)
Case Name:	In re Tempnology LLC
Case Type:	Business
Court:	1st Circuit
Bankruptcy Tags:	Asset Sales Bankruptcy Litigation Executory Contracts/Leases Business Reorganization Telecom/Tech

By The Numbers

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Tempnology LLC, 1st Cir.BAP (N.H.), November 18, 2016

522 B.R. 766
United States Bankruptcy Court,
D. New Jersey.

In re: Crumbs Bake Shop, Inc.,
et al., Debtors–in–Possession.

Case No. 14–24287
|
Signed October 31, 2014

Synopsis

Background: Motion was filed for an order in aid of bankruptcy court's order authorizing and approving sale of substantially all of Chapter 11 debtor corporation's assets free and clear of liens, claims, encumbrances, and interests to purchaser.

Holdings: The Bankruptcy Court, Michael B. Kaplan, J., held that:

[1] trademark licensees to rejected intellectual property licenses fell under the protective scope of Bankruptcy Code provision governing executory contracts and unexpired leases;

[2] sale of debtor's assets free and clear of any interests in property did not trump or extinguish the trademark rights of third party licensees under Bankruptcy Code provision governing executory contracts and unexpired leases, in the absence of consent; and

[3] debtor was the only party entitled to the collection of royalties generated as a result of licensees' use of licensed intellectual property.

Motion denied.

West Headnotes (7)

[1] Bankruptcy
Effect of Acceptance or Rejection

Trademark licensees to rejected intellectual property licenses fall under the protective scope of Bankruptcy Code provision governing executory contracts and unexpired leases, notwithstanding that "trademarks" are not explicitly included in Code definition of "intellectual property." 11 U.S.C.A. § 365(n).

2 Cases that cite this headnote

[2] Bankruptcy
Effect of Acceptance or Rejection

Courts may use Bankruptcy Code provision governing executory contracts and unexpired leases to free a bankrupt trademark licensor from burdensome duties that hinder its reorganization, however, courts should not use it to let a licensor take back trademark rights it bargained away; this makes bankruptcy more a sword than a shield, putting debtor-licensors in a catbird seat they often do not deserve. 11 U.S.C.A. § 365.

1 Cases that cite this headnote

[3] Bankruptcy
Adequate protection; sale free of liens

Sale of Chapter 11 debtor's assets free and clear of any interests in property did not trump or extinguish the trademark rights of third party licensees under Bankruptcy Code provision governing executory contracts and unexpired leases, in the absence of consent. 11 U.S.C.A. §§ 363(b, f), 365(n).

6 Cases that cite this headnote

[4] Statutes
General and specific terms and provisions; ejusdem generis

Appropriate way to construe a statute is to conclude that the specific governs over the general.

1 Cases that cite this headnote

[5] Statutes

General and specific terms and provisions; ejusdem generis

For purposes of statutory construction, the specific prevails over the general.

1 Cases that cite this headnote

[6] **Statutes**

General and specific terms and provisions; ejusdem generis

For purposes of statutory construction, when there is potential for conflict, specific provisions should prevail over the more general.

1 Cases that cite this headnote

[7] **Bankruptcy**

Rights and liabilities of purchasers, and right to purchase

Following sale of substantially all of Chapter 11 debtor corporation's assets free and clear of liens, claims, encumbrances, and interests to purchaser, debtor was the only party entitled to the collection of royalties generated as a result of licensees' use of licensed intellectual property, given that license agreements between debtor and licensees were explicitly excluded from the sale and were neither assumed nor assigned. 11 U.S.C.A. § 365(n).

1 Cases that cite this headnote

Attorneys and Law Firms

Michael D. Sirota, Esq., David M. Bass, Esq., Felice R. Yudkin, Esq., Cole, Schotz, Meisel, Forman & Leonard, Court Plaza North, 25 Main Street, Hackensack, NJ *768 07601, Attorneys for Crumbs Bake Shop, Inc., et al.

Mitchell Malzberg, Esq., Law Offices of Mitchell J. Malzberg, LLC, P.O. Box 5122, 6 E. Main Street, Suite 7, Clinton, NJ 08809, and Beauchamp M. Patterson, Esq., McAfee & Taft, 10th Floor, 2 Leadership Square, 211 N. Robinson, Oklahoma City, OK 73102, Attorneys for Lemonis Fischer Acquisition Company, LLC.

Douglas T. Tabachnik, Esq., Law Offices of Douglas T. Tabachnik, P.C., Woodhull House, 63 West Main Street, Suite C, Freehold, NJ 07728, Attorney for Brand 2 Squared Licensing a Division of Peppercomm.

Jeffrey A. Cooper, Esq., Barry J. Roy, Esq., Rabinowitz, Lubetkin & Tully, LLC, 293 Eisenhower Parkway, Suite 100, Livingston, NJ 07039, Attorneys for Coastal Foods Baking, LLC.

Sharon L. Levine, Esq., Elie J. Worenklein, Esq., Lowenstein Sandler LLP, 65 Livingston Avenue, Roseland, NJ 07068, Attorneys for the Official Committee of Unsecured Creditors.

Opinion

Chapter 11

MEMORANDUM DECISION

MICHAEL B. KAPLAN, U.S.B.J.

INTRODUCTION

This matter comes before the Court on the motion of Lemonis Fischer Acquisition Company, LLC ("LFAC") for an order in aid of the Court's prior order ("Sale Order"), dated August 27, 2014, which, *inter alia,* authorized and approved the sale of substantially all of the Debtors' assets free and clear of liens, claims, encumbrances, and interests to LFAC. The issues now facing the Court are:

I. Whether trademark licensees to rejected intellectual property licenses fall under the protective scope of 11 U.S.C. § 365(n), notwithstanding that "trademarks" are not explicitly included in the Bankruptcy Code definition of "intellectual property";

II. Whether a sale of Debtors' assets pursuant to 11 U.S.C. §§ 363(b) and (f) trumps and extinguishes the rights of third party licensees under § 365(n); and

III. To the extent there are continuing obligations under the license agreements, which party is entitled to the collection of royalties generated as a result of third party licensees' use of licensed intellectual property.

JURISDICTION

The Court has jurisdiction over this contested matter under 28 U.S.C. §§ 1334(a) and 157(a) and the Standing Order of the United States District Court dated July 10, 1984, as amended October 17, 2013, referring all bankruptcy cases to the bankruptcy court. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2)(A), (B), (M), and (O). Venue is proper in this court under 28 U.S.C. § 1408. The court issues the following findings of fact and conclusions of law pursuant to Fed. R. Bankr.P. 7052. [1]

BACKGROUND

Crumbs Bake Shop, Inc., *et. al.,* the within debtors and debtors-in-possession (collectively, the "Debtors") specialized in the retail sales of cupcakes, baked goods, and beverages. Debtors sold their products through retail stores, an e-commerce ***769** division, catering services, and wholesale distribution business. In addition, Debtors entered into licensing agreements with third parties, which allowed such parties to utilize the Crumbs trademark and trade secrets, and sell products under the Crumbs brand. To maximize licensing revenues, Debtors entered into a Representation Agreement with Brand [2] Squared Licensing ("BSL"). Under the Representation Agreement, BSL agreed to provide certain services to Debtors, including the provision of brand licensing services related to license agreements. On Debtors' behalf, BSL procured agreements ("License Agreements") with the following licensees for use of Debtors' trademark and trade secrets: Coastal Foods Baking, LLC; Pelican Bay LTD; White Coffee Company; Uncle Harry's, Inc.; Mystic Apparel, LLC; and POP! Gourmet (collectively, the "Licensees").

Given severe liquidity constraints, limited available cash, and to avoid incurring liabilities they could not pay, Debtors ceased operations on July 7, 2014. Thereafter, on July 11, 2014 ("Petition Date"), Debtors filed voluntary petitions for relief pursuant to Chapter 11 of the United States Code ("Bankruptcy Code"). Since the Petition Date, Debtors have managed their businesses as debtors-in-possession pursuant to §§ 1107 and 1108 of the Bankruptcy Code.

On the Petition Date, Debtors entered into a credit bid Asset Purchase Agreement ("APA") with LFAC for the sale of substantially all of Debtors' assets. On July 14, 2014, Debtors filed a motion ("Sale Motion") seeking, *inter alia,* Court approval of the APA, certain bidding procedures, and authorizing Debtors to sell substantially all their assets free and clear of liens, claims, encumbrances, and interests. Attached to the Sale Motion was a Proposed Order ("Proposed Order") for the sale of Debtors' assets to LFAC. On July 25, 2014, the Court entered an Order approving certain bidding procedures which contemplated an auction process. Debtors did not receive any higher or better offers other than the stalking horse bid from LFAC. On August 27, 2014, this Court entered the Sale Order, approving the sale of substantially all of Debtors' assets free and clear of liens, claims, encumbrances, and interests to LFAC.

On August 28, 2014, the day following approval of the sale, Debtors filed a motion ("Rejection Motion") to reject certain executory contracts and unexpired leases, including the License Agreements held with the aforementioned Licensees. Shortly thereafter, a response was filed by BSL asserting that Licensees could elect, under § 365(n), to retain their rights under their respective License Agreements. BSL also sought entitlement to royalties in the event Licensees elected to continue using the licensed intellectual property. On September 19, 2014, Debtors withdrew the Rejection Motion only to the extent that it related to the License Agreements with Licensees. This Court entered an order on October 1, 2014 authorizing the rejection of a number of executory contracts, unexpired leases and licenses, but excluding those involving Licensees. At this juncture, the parties seek a determination of the effect of the Sale Order on their respective rights.

DISCUSSION

(1) Trademark licensees to rejected intellectual property licenses fall under the protective scope of 11 U.S.C. § 365(n), notwithstanding that "trademarks" are not explicitly included in the Bankruptcy Code definition of "intellectual property."

[1] Prior to the enactment of 11 U.S.C. § 365(n), the Fourth Circuit issued a decision ***770** in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.,* 756 F.2d 1043 (4th Cir.1985), in which a debtor-licensor

moved to reject the intellectual property license it had granted to a particular licensee. The court permitted the rejection under § 365, and held that the rejection of an intellectual property license deprives the licensee of the rights previously granted under the licensing agreement. *Id.* at 1048. The court stated that the rejection constituted a breach and, as such, the licensee would be entitled to monetary damages under § 365(g). However, the Fourth Circuit maintained that the licensee could not retain its contractual rights, and thus the licensee was stripped of the rights it previously held under the licensing agreement. *Id.* The decision in *Lubrizol* caused concern that "any patent or trademark licensor could go into Chapter 11 and invalidate a license perfectly valid under contract law." *In re Exide Technologies,* 607 F.3d 957, 965 (3d Cir.2010) (Ambro, J., concurring) (citation omitted). This Court is not persuaded by the decision in *Lubrizol* and is not alone in finding that its reasoning has been discredited. *See Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC,* 686 F.3d 372, 377–78 (7th Cir.2012) ("Scholars uniformly criticize *Lubrizol,* concluding that it confuses rejection with the use of an avoiding power.").

Three years after *Lubrizol,* Congress enacted 11 U.S.C. § 365(n). The relevant portion of § 365(n) reads as follows:

> (1) If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—
>
> (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or
>
> (B) to retain its rights (including the right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property ..., as such rights existed immediately before the case commenced for—
>
> (i) the duration of such contract; and
>
> (ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.
>
> (2) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, under such contract—
>
> (A) the trustee shall allow the licensee to exercise such rights;
>
> (B) the licensee shall make all royalty payments due under such contract for the duration of such contract and for any period described in paragraph (1)(B) of this subsection for which the licensee extends such contract; and
>
> (C) the licensee shall be deemed to waive—
>
> (i) any right of setoff it may have with respect to such contract under this title or applicable nonbankruptcy law; and
>
> (ii) any claim allowable under section 503(b) of this title arising from the performance of such contract.

11 U.S.C. § 365(n). "Through this provision, Congress sought 'to make clear that the rights of an intellectual property licensee to use the licensed property cannot be ***771** unilaterally cut off as a result of the rejection of the license pursuant to Section 365 in the event of the licensor's bankruptcy.' " *In re Exide Technologies,* 607 F.3d at 965 (quoting S.Rep. No. 100–505, at 1 (1988)). Congress professed that courts allowing the use of § 365 to strip intellectual property licensees of their rights "threaten 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." S.Rep. No. 100–505, at 3 (1988). In response to this problem, Congress provided that when a debtor-licensor rejects an intellectual property license, the licensee is permitted to make an election under § 365(n). If the licensee chooses to retain its rights, the licensor is not bound by any continuing obligations under § 365(n). [2]

While § 365(n) applies to intellectual property licenses, the definition of "intellectual property" is not found within that section of the Bankruptcy Code; rather, the definition is found in § 101(35A). Therein, Congress

failed to include explicitly trademarks. The definition of "intellectual property" reads as follows:

> (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.

11 U.S.C. § 101(35A). Some courts have reasoned by negative inference that the omission of trademarks from the definition of intellectual property indicates that Congress intended for the decision in *Lubrizol* to control when a debtor-licensor rejects a trademark license. *See, e.g., In re HQ Global Holdings, Inc.,* 290 B.R. 507, 513 (Bankr.D.Del.2003) ("[S]ince the Bankruptcy Code does not include trademarks in its protected class of intellectual property, *Lubrizol* controls and the Franchisees' right to use the trademark stops on rejection."). LFAC adopts this same line of reasoning in arguing that, in the event of a rejection, the trademark Licensees would not be protected by § 365(n).

This Court adopts a position which differs from LFAC's limited view of § 365(n), and holds that reasoning by negative inference is improper in the context of the rejection of trademark licenses. As detailed in his concurring opinion in *In re Exide Technologies,* 607 F.3d at 966, Judge Ambro affirmed, "I believe such reasoning is inapt for trademark license rejections." In support for this approach, the Court directs its attention to Congress's explanation in the Senate committee report on the bill for § 365(n). Therein, Congress stated:

> [T]he bill does not address the rejection of executory ***772** trademark, trade name or service mark licenses by debtor-licensors. While such rejection is of concern because of the interpretation of section 365 by the *Lubrizol* court and others, *see, e.g., In re Chipwich, Inc.,* 54 Bankr. Rep. 427 (Bankr. S.D.N.Y. 1985), such contracts raise issues beyond the scope of this legislation. In particular, trademark, trade name and service mark licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee. Since these matters could not be addressed without more extensive study, it was determined to postpone congressional action in this area and **to allow the development of equitable treatment of this situation by bankruptcy courts**.... Nor does the bill address or intend any inference to be drawn concerning the treatment of executory contracts which are unrelated to intellectual property.

S. Rep. No. 100–505, at 5 (emphasis added). The Court shares Judge Ambro's perspective that Congress intended the bankruptcy courts to exercise their equitable powers to decide, on a case by case basis, whether trademark licensees may retain the rights listed under § 365(n). Here, the Court finds that it would be inequitable to strip the within Licensees of their rights in the event of a rejection, as those rights had been bargained away by Debtors.

> **[2]** Courts may use § 365 to free a bankrupt trademark licensor from burdensome duties that hinder its reorganization. They should not ... use it to let a licensor take back trademark rights it bargained away. This makes bankruptcy more a sword than a shield, putting debtor-licensors in a catbird seat they often do not deserve.

In re Exide Technologies, 607 F.3d at 967–68. LFAC argues that such equitable considerations should not come into play when, as here, Debtors have sold their assets to a bona fide purchaser. While some courts have suggested that § 365(n) rights of third parties should succumb to the interests of maximizing the bankruptcy estate in liquidation contexts, this Court finds no basis for such a distinction. Bankruptcy estates, whether reorganizing or liquidating, benefit already from the ability to assume

or reject executory agreements. There is no reason to augment such benefits at the expense of third parties and a licensing system which Congress sought to protect by means of preserving certain rights under § 365(n). Indeed, in sale cases, which currently dominate the retail Chapter 11 landscape, monetary recoveries primarily benefit the pre-petition and post-petition lenders and administrative claimants. Minimal distributions to general unsecured creditors are the norm. It is questionable that Congress intended to sacrifice the rights of licensees for the benefit of the lending community. Rather, as noted by Judge Ambro, Congress envisaged the Bankruptcy Courts as exercising discretion and equity on a case by case basis.

Finally, LFAC submits that, in the event Licensees were to make an election under § 363(n) to continue using the trademarks, LFAC would be placed in a licensor-licensee arrangement that it never intended to assume. Yet, LFAC or any other purchaser, has come into this transaction with eyes wide-open, after engaging in due diligence, and can adjust their purchase price to account for such existing License Agreements. The Court does not conclude that Licensees' trademark rights should be vitiated completely to aid in LFAC's recovery under its credit bid.

Putting equitable considerations aside, the Seventh Circuit in *Sunbeam Products, Inc., supra,* iterated that rejection of a trademark license did not strip away the licensee's right to use the trademark.[3] ***773** 686 F.3d at 377. The Seventh Circuit focused on the text of § 365(g), under which rejection is deemed a breach of contract, and the unfulfilled obligations of a debtor-licensor are turned into a damages award. *Sunbeam Products, Inc.,* 686 F.3d at 377. The Seventh Circuit noted that "[o]utside of bankruptcy, a licensor's breach does not terminate a licensee's right to use intellectual property." *Id.* at 376. Moreover, in the real estate context "a lessor that enters bankruptcy could not, by rejecting the lease, end the tenant's right to possession and thus re-acquire premises that might be rented out for a higher price. The bankrupt lessor might substitute damages for an obligation to make repairs, but not rescind the lease altogether." *Id.* at 377. The court specifically noted that "nothing about this process implies that any rights of the other contracting party have been vaporized." *Id.*

LFAC further argues that this result would leave LFAC with little ability to control the quality of products or services, as is notably important in trademark licensing. However, the Court recognizes that there are protections in place, outside of bankruptcy, that give rise to the incentive for Licensees to maintain a certain standard of quality in using the licensor's trademark.

> [A] licensee's sale of trademarked goods of a quality differing from the licensor's set standards constitutes trademark infringement and unfair competition. As a result, "there are already incentives for licensees to maintain the licensor's quality control provisions lest a court find the licensee liable for infringement. The licensee is also, in effect, warranting to the public that its goods are of the same level of quality that the trademark signifies. Thus, the 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."

David M. Jenkins, Comment, *Licenses, Trademarks, and Bankruptcy, Oh My: Trademark Licensing and the Perils of Licensor Bankruptcy,* 25 J. Marshall L.Rev. 143, 162–64 (1991) (citations omitted).

The Court is cognizant of a bill recently passed by the U.S. House of Representatives, which seeks to include "trademarks" in the Bankruptcy Code definition of "intellectual property," and further seeks to add language to § 365 which would provide that "in the case of a trademark ... the trustee shall not be relieved of a contractual obligation to monitor and control the quality of a licensed product or service." Innovation Act of 2013, H.R. 3309, 113th Cong. § 6(d) (2013). Although not dispositive to this Court's decision[4], the fact that this ***774** legislation is pending suggests that Congress is aware of the prejudice to trademark licensees from the approach espoused by LFAC, and is attempting to remedy the omission of "trademarks" from its definition of "intellectual property".

(II) A sale of Debtors' assets pursuant to 11 U.S.C. §§ 363(b) and (f) does not trump nor extinguish the rights of third party licensees under § 365(n), in the absence of consent.

[3] Sections 363(b) and (f) of the Bankruptcy Code permit a debtor-in-possession to make a sale of a debtor's assets free and clear of any interest in property. LFAC contends that the sale of Debtors' assets pursuant to these Code sections effectuated a free and clear conveyance of Licensees' trademark rights to LFAC, such that the

dictates of § 365(n) no longer come into play. The Court disagrees and rules that the interests held by Licensees were *not* extinguished by the sale because in the absence of consent, a sale under § 363(f) does *not* trump the rights granted to Licensees by § 365(n).

(A) Consent

LFAC argues that Licensees impliedly consented to the vitiation of their § 365(n) rights by failing to object to the Sale Motion. The Court disagrees. LFAC relies on a line of cases which set forth the notion that failure to object equates to consent for purposes of § 363(f). However, integral to the decision in each of those cases was the fact that the non-objecting parties were provided with adequate notice. *FutureSource, LLC v. Reuters,* 312 F.3d 281, 285 (7th Cir.2002) ("[L]ack of objection (**provided of course there is notice**) counts as consent."); *In re Tabone, Inc.,* 175 B.R. 855, 858 (Bankr.D.N.J.1994) ("The Notice of Private Sale issued by the trustee **clearly states** that the sale was to be free and clear of all liens"); *In re Elliot,* 94 B.R. 343, 345 (E.D.Pa.1988) ("Citicorp consented to the sale by failing to make any timely objection **after receiving notice of the sale**.") (emphasis added). By contrast, and for the reasons below, the Court finds that Licensees were not provided with adequate notice that their rights were at risk of being stripped away as a consequence of the sale.

At the outset, the Court notes that a party in interest must first traverse a labyrinth of cross-referenced definitions and a complicated network of corresponding paragraphs with annexed schedules in order to discern exactly what has been offered for sale in this matter. As noted by BSL's counsel:

> Annexed to the Debtors motion for the approval of the APA is a copy of the APA itself, annexed thereto as "Exhibit A." In the motion itself the Debtor refers, at paragraph 13, to the "Purchased Assets," which, in turn, refers to section 2.1 of the APA for its definition. The term and paragraph itself then refer to those items as more particularly described in schedule 2.1 of the "Seller Disclosure Schedule." The purchased assets again refer to a term defined in the purchase agreement at paragraph 2.1 called the "Purchased Intellectual Property." The excluded assets defined in subparagraph (c) of paragraph 13 of the motion for approval of the sale list a number of items including "Excluded Contracts" and "any Assumed Contract that requires the consent of a third-party to be assumed and assigned hereunder as to which, by the Closing Date, such consent has not been obtained...." All capitalized terms are defined in the APA.
>
> On page 8 of the APA, the Debtors and LFAC define the "Purchased Assets." ***775** These include "all Assumed Contracts" and, at subparagraph (n) of paragraph 2.1, they provide for the "Purchased Intellectual Property." The term "Purchased Intellectual Property" is, in turn, defined on page 6 of the APA, as among other things, "all of the following intellectual property owned by Sellers: the recipes used in the business or otherwise listed on section 1.1(d) of the Seller Disclosure Schedule ... the Trademarks listed on section 5.7(a) of the Seller Disclosure Schedule". The "Seller Disclosure Schedule" is defined as "the disclosure schedule delivered by Sellers to Purchaser not later than five (5) business days following the date hereof." The term "Assumed Contracts" is, in turn, defined on page 2 of the APA as those contracts that are set forth in section 2.1(a) of the Seller Disclosure Schedule and "have not been rejected (or are the subject of a notice of rejection or a pending rejection motion) by Sellers or designated as Excluded Contracts pursuant to section 2.6(b)."
>
> Paragraph 2.2 of the APA, on page 9 thereof, refers to Excluded Assets as including at subparagraph (f) "all Excluded Contracts". That term, in turn, is defined at page 3 of the APA, " 'Excluded Contracts' means the Contracts set forth on Section 1.1(a) of the Seller Disclosure Schedule...." As further discussed below, the Seller Disclosure Schedule, placed before the Court by LFAC for the first time with its moving papers, specifically lists the subject license agreements as among the "Excluded Contracts."

Docket No. 282, Response of BSL, p. 3–4. This Court must admit, candidly, that it has difficulty following the definitional maze put in place under the APA. Not only is it unclear as to what was being sold, there is no clear discussion as to what rights were purported to be taken away as a result of the sale. Thus, Licensees had no apparent reason to believe that an objection would be necessary in order to retain their rights under § 365(n).[5] Indeed, the inclusion of the specific License Agreements on the Seller Disclosure Schedule as "Excluded Assets" only adds to the confusion facing Licensees attempting to discern their rights and suggests to a reasonable person that their interests will be unaffected by the Sale Motion.

In *In re Lower Bucks Hospital,* 571 Fed.Appx. 139 (3d Cir.2014), the Third Circuit excised a third party release from a Chapter 11 plan on the basis that it was not adequately disclosed to the affected parties. The Third Circuit stated:

> **[T]he reference to the Release in the disclosure statement was contained in a single paragraph in a 62–page document. No use was made of underlined, italicized or boldfaced text to emphasize the Release or to distinguish it from the more typical releases between the parties to the settlement.**
>
> **The reference in the proposed plan of reorganization was even less direct and similarly obscured by myriad other information disclosed. The Release was also omitted from numerous sections of the disclosure statement where it was arguably relevant**, including: (1) Summary of Key Terms of the Plan; (2) Summary of Distributions Under the Plan; (3) The Bond Trustee Litigation; (4) Treatment of Claims Against the Debtors; and (5) Conditions Precedent to Confirmation of the Plan ***776** and the Occurrence of the Effective Date. As Judge Frank explained, "[i]n both presentation and placement, the documents sent to the Bondholders did not differentiate the Third[–]Party Release from any of the other information provided, and **no effort was made to bring the existence of the Third–Party Release to the eyes and attention of the Bondholders.**" Far from an abuse of discretion, the record in this case amply supports Judge Frank's conclusion about the inadequacy of disclosure.

In re Lower Bucks Hosp., 571 Fed.Appx. at 143 (emphasis added) (citations omitted). In the case at hand, the Court is cognizant of what is missing from Debtors' pleadings. Nowhere in Debtors' Sale Motion or supporting submissions did Debtors state anything about the treatment of the Licensees in particular, or the effect that the sale would have on their rights. The APA also lacked any lucid and specific language that would place Licensees on notice that their rights were to be vitiated upon the execution of the contemplated sale.[6] Granted, the Proposed Order, attached as part of Debtors' moving papers, addressed that the sale was to be clear of licensees' rights. Embedded in the Proposed Order was the following language:

> Except to the extent otherwise provided for in the [APA], title and interest in and to the Purchased Assets shall pass to the Purchaser at Closing free and clear of all liens (as that term is defined in section 101(37) of the Bankruptcy Code), claims (including, but not limited to, any "claim" as defined in Section 101(5) of the Bankruptcy Code), interests, and encumbrances, including, but not limited to, any lien (statutory or otherwise), hypothecation, encumbrance, liability, security interest, interest, mortgage, pledge, restriction, charge, instrument, license, preference, priority, security agreement, easement, covenant, reclamation claim, pledge, hypothecation, cause of action, suit, contract, right of first refusal, offset, recoupment, right of recovery, covenant, encroachment, option, right of recovery, alter-ego claim, environmental claim, successor liability claim, tax (including foreign, federal, state and local tax), Governmental Order, of any kind or nature (including (a) any conditional sale or other title retention agreement and any lease having substantially the same effect as any of the foregoing, (b) any assignment or deposit arrangement in the nature of a security device, (c) any claim based on any theory that the Purchaser is a successor, transferee or continuation of any of the Debtors, or (d) any leasehold interest, **license or other right, in favor of a third party** or the Debtors, to use any portion of the Purchased Assets), whether secured or unsecured, choate or inchoate, filed or unfiled, scheduled or unscheduled, noticed or unnoticed, recorded or unrecorded, contingent or non-contingent, perfected or

> unperfected, allowed or disallowed, liquidated or unliquidated, matured or unmatured, disputed or undisputed, material or non-material, known or unknown ... pursuant to Section 363(f) of the Bankruptcy Code, with all such Liens and Claims upon the Purchased Assets to be unconditionally released, discharged and terminated"

Docket No. 22, Proposed Order, p. 10 (emphasis added). However, the reference to the third party licenses was a mere ten words, buried within a single twenty-nine page document, which itself was affixed to a CM/ECF filing totaling one hundred ***777** twenty-nine pages. Debtors' moving papers collectively failed to direct attention specifically to the proposition that the sale would strip Licensees of their rights or to bring such consequence to Licensees' attention.[7] The Sale Motion did not identify individual Licensees, reference § 365(n) rights, or reflect that assumption/rejection of the License Agreements was unnecessary as a result of the § 363 sale. Certainly, no mention of these issues was brought before this Court at the hearing on the Sale Motion.

The Court posits that the content of the Sale Motion was a calculated effort to camouflage the intent to treat the License Agreements as vitiated without raising the specter of § 365(n) rights. Thus, it would be inequitable for this Court to find that Licensees consented to the termination of their rights. The Court is confident that had Licensees not been deprived of adequate notice regarding the extinguishment of their rights, they very well would have objected in a timely fashion, and the Court would have found that their rights under § 365(n) were intact.

(B) Interplay of 11 U.S.C. §§ 363 and 365

Since there has been little discussion on the interplay between § 363 and § 365(n), the Court is guided by cases that have interpreted the relationship between § 363 and § 365(h), as there are notable similarities between §§ 365(n) and 365(h).[8] The Court holds that in the absence of consent, nothing in § 363(f) trumps, supersedes, or otherwise overrides the rights granted to Licensees under § 365(n). This conclusion is based on two factors: the principle of statutory construction that the specific governs the general; and the legislative history of § 365.

[4] It is well established that the appropriate way to construe a statute is to conclude that the specific governs over the general.

[5] **[6]** An accepted principle of statutory construction is that the specific prevails over the general. *See Matter of Nobelman* [*Nobleman*], 968 F.2d 483, 488 (5th Cir.1992), *aff'd,* 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993) ("General language of a statute does not prevail over matters specifically dealt with in another part of the same enactment"); *In re Pacific Far East Line, Inc.,* 644 F.2d 1290, 1293 (9th Cir.1981). "When there is potential for conflict, specific provisions should prevail over the more general." *In re Nadler,* 122 B.R. 162, 166 (Bankr.D.Mass.1990) (citing ***778** *Jett v. Dallas Independent School Dist.,* 491 U.S. 701, 109 S.Ct. 2702, 105 L.Ed.2d 598 (1989)).

In re Churchill Properties III, Ltd. P'ship, 197 B.R. 283, 288 (Bankr.N.D.Ill.1996). In *Churchill*, the court recognized that § 365(h) is specific, as it grants a particular set of clearly stated rights to lessees of rejected leases. That is, Congress specifically gave lessees the option to remain in possession after a lease rejection. If the court were to allow a § 363(f) sale free and clear of the lessee's interest, "the application of [§ 365(h)] as it relates to non-debtor lessees would be nugatory." *In re Churchill Properties*, 197 B.R. at 288. Indeed, "it would make little sense to permit a general provision, such as [§] 363(f), to override [§ 365's] purpose. The Code is not intended to be read in a vacuum." *Id.*

Like § 365(h), subsection (n) is specific in granting certain rights to licensees of rejected intellectual property licenses. The specific language in § 365(n) should not be overcome by the broad text of § 363(f). Accordingly, the general provision of § 363(f) does not wipe away the rights granted to Licensees by § 365(n). "[T]he recognition of Section 365 is more compelling and should rule the day." *In re Churchill Properties,* 197 B.R. at 287.

Moreover, the legislative history of § 365(h) evinces that Congress had the desire to protect the rights of tenants.

> A 1978 Senate Report remarked that under the terms of § 365(h), "the tenant will not be deprived of his estate for the term for which he bargained." S.Rep. No. 95–989, at 60 (1978).... The Section–by–Section Analysis of

the 1994 amendments to the Bankruptcy Code further reflect a Congressional desire to protect the rights of those who are lessees of debtors:

> This section clarifies section 365 of the Bankruptcy Code to mandate that lessees cannot have their rights stripped away if a debtor rejects its obligation as a lessor in bankruptcy. This section expressly provides guidance in the interpretation of the term "possession" in the context of the statute. The term has been interpreted by some courts in recent cases to be only a right of possession (citations omitted). This section will enable the lessee to retain its rights that appurtenant to its leasehold. These rights include the amount and timing of payment of rent or other amounts payable by the lessee, the right to use, possess, quiet enjoyment, sublet and assign.

In re Zota Petroleums, LLC, 482 B.R. 154, 161–62 (Bankr.E.D.Va.2012) (citations omitted). The court in *In re Haskell L.P.,* 321 B.R. 1 (Bankr.D.Mass.2005) also noted the legislative history to § 365(h), and denied the debtor's motion to sell real property free and clear of a leasehold interest under § 363(f) because such a sale would permit the debtor to achieve under § 363 what it was proscribed from achieving under § 365(h), namely, stripping the lessee of its rights to possession. This line of reasoning fits squarely with Congressional intent, and with the principle of statutory construction that the specific governs over the general. [9]

In arguing that the § 363 sale cut off Licensees' rights, LFAC relies on *Precision Indus., Inc. v. Qualitech Steel SBQ, LLC,* 327 F.3d 537 (7th Cir.2003), wherein the Seventh Circuit held that a sale under § 363(f) stripped a lessee of its rights to possession under § 365(h). The Seventh ***779** Circuit reasoned: (1) the text of those sections of the Code does not suggest that one supersedes the other; (2) the language of § 365(h) is limited in scope since it only references rejection and does not mention anything about the sale of property of the estate; and (3) § 363 itself provides protection in the form of adequate protection to those who may be negatively affected by a sale. *Id.* at 547–48. For the aforementioned reasons, this Court is not persuaded by the reasoning set forth in *Qualitech.* [10]

LFAC also relies on *Compak Companies, LLC v. Johnson,* 415 B.R. 334, 342–43 (N.D.Ill.2009), where the court stated, "[a]s we interpret *Qualitech,* § 365(n) would not prevent the trustee or the debtor-in-possession from extinguishing a license in a sale of intellectual property free and clear of interests provided one of § 363(f)'s conditions was satisfied." However, the court in *Compak* noted that the sale may not have been permissible without the express or implied consent of the licensee. *Id.* at 343. "It is true that the Bankruptcy Code limits the conditions under which an interest can be extinguished by a bankruptcy sale, but one of those conditions is the consent of the interest holder, and lack of objection (provided of course there is notice) counts as consent." *Compak Companies, LLC,* 415 B.R. at 343, quoting *FutureSource, LLC v. Reuters,* 312 F.3d 281, 285 (7th Cir.2002). As established above, Licensees did not consent to the sale, neither expressly nor impliedly. Thus, Licensees' rights under § 365(n) shall remain in place.

(III) Debtors are the only party entitled to the collection of royalties generated as a result of Licensees' use of licensed intellectual property.

[7] There is no question that Debtors' trademark, among other intellectual property, was sold to LFAC. However, explicitly excluded from the sale were the License Agreements between Debtors and Licensees, and the contract between Debtors and BSL. *Docket No. 268, Asset Purchase Agreement and Seller Disclosure Schedule 1.1(a).* Since the License Agreements themselves were not sold, and were neither assumed nor assigned, LFAC did *not* receive any rights under the agreements. Thus, while the trademarks and other intellectual property themselves were sold to LFAC, the rights as to the License Agreements remain with Debtors. As such, post-closing royalties generated by licenses would be due and owing to Debtors, *not* LFAC. [11] The Third Circuit's decision in *In re CellNet Data Sys., Inc.,* 327 F.3d 242 (3d Cir.2003) dictates this very result.

In *In re CellNet,* a debtor sold its intellectual property to a buyer, but the licensing agreements debtors held with third parties were explicitly excluded from the sale. The debtor later rejected the licensing ***780** agreements and the licensees elected to continue using the intellectual property pursuant to § 365(n). The Third Circuit held that the debtor, *not* the buyer, was entitled to the royalties generated under the license agreements. The court noted, "[t]he plain language of § 365(n)(2)(B) indicates that the renewed royalties are directly linked to the rejected contract, not the intellectual property" and that "the

contract is the primary mechanism for determining where the royalties flow." *Id.* at 251. Accordingly, since LFAC did not purchase the License Agreements, the post-closing royalties belong to Debtors. However, LFAC did acquire "[a]ll accounts receivable related to the [b]usiness." *See Asset Purchase Agreement* ¶ *2.1(1).* Thus, unpaid pre-closing royalties would appear to fall within this purchased asset category.

This of course leaves open the question as to what happens to the License Agreements going forward. The Court is aware that BSL has offered to purchase an assignment of the rights under the agreements, yet the Court wonders how it can do so since it cannot perform the owners' obligations. LFAC owns the trademarks and other intellectual properties. The same stumbling block faces the Debtors. The Court surmises that only LFAC actually can perform under the License Agreements, and that rejection is necessary.

CONCLUSION

For the reasons stated above, LFAC's motion is denied. Trademark Licensees can be protected by § 365(n), notwithstanding the omission of "trademarks" from the Bankruptcy Code definition of "intellectual property." Furthermore, the sale under § 363(f) did not extinguish the rights afforded to Licensees by § 365(n) because Licensees did not consent to the sale. To the extent that Licensees' rights under § 365(n) were not vaporized by the sale, Licensees are entitled to elect to continue using the intellectual property granted under their respective License Agreements, for the duration of their terms. Royalties generated as a result of this use are payable to Debtors, because the agreements themselves have not been assumed, assigned or rejected, and thus continue to be Debtors' property.

All Citations

522 B.R. 766, 72 Collier Bankr.Cas.2d 1099, 60 Bankr.Ct.Dec. 92

Footnotes

1 To the extent that any of the findings of fact might constitute conclusions of law, they are adopted as such. Conversely, to the extent that any conclusions of law constitute findings of fact, they are adopted as such.

2 "[I]n the event that a bankrupt licensor rejects an intellectual property license, § 365(n) allows a licensee to retain its licensed rights—along with its duties—**absent any obligations owed by the debtor-licensor**." *In re Exide Technologies,* 607 F.3d at 966 (emphasis added). By way of analogy, when a debtor-licensor rejects a software license, § 365(n) would *not* require the licensor to provide continuing updates or maintenance to the licensee.

3 While Judge Ambro based his concurring opinion on the bankruptcy court's equitable powers, the Seventh Circuit rejected the notion that equity governs a licensee's rights, and based its decision on different grounds. Nevertheless, both approaches yield the same result: that *Lubrizol* 's holding is not persuasive in the context of rejected trademark licenses.

4 Indeed, several courts have referred to pending legislation to aid in rendering a decision. *See, e.g., In re Braman,* No. 02–21332, 2003 WL 25273839, at *4 n. 15 (Bankr.D.Idaho Mar. 31, 2003) ("The Court notes that pending bankruptcy legislation would remove the modifier "substantial" from the § 707(b) concept of abuse...."); *Phillips v. Hood River School District,* No. CV 98–1161–AS, 1999 WL 562682, at *6 (D.Or. Apr. 22, 1999) ("[T]he court also notes that legislation is pending with the Oregon Legislature that will resolve the precise issues faced by the court."); *Sherman v. Smith,* No. 92–6947, 1993 WL 433317 at *6 n. 2 (4th Cir. Oct. 27, 1993) ("[I]t may be appropriate to note that under legislation currently pending in Congress, 28 U.S.C. § 2254(d) would be amended to make clear that the State bears the burden of persuading the court that constitutional error was harmless on federal collateral review.").

5 For lack of notice, Licensees also missed the opportunity to request adequate protection pursuant to § 363(e).

6 Furthermore, the APA made many references to a Seller Disclosure Schedule, which Debtors failed to attach to the moving papers that were filed on July 14, 2014.

7 The parties clearly understand how to fashion such appropriate and unambiguous language placing Licensees on notice as to elimination of contractual rights. After the Sale Order was entered, Debtors filed the Rejection Motion, wherein Debtors explicitly sought to reject the License Agreements held with Licensees. While the Rejection Motion was later withdrawn in part, i.e., with respect to Licensees, Debtors' original attempt to reject the License Agreements at issue indicates a mutual belief that Licensees' rights were not extinguished as a result of the sale. Indeed, other license

agreements were rejected after the sale. The Court is left to wonder why the filing of the Rejection Motion even was necessary if §§ 363(b) and (f) do in fact trump § 365.

8 "Subsections (h) and (n) of § 365 apply to very different situations, but are somewhat similar in their approach to treating rejected lessees and licensees.... Thus, cases interpreting § 365(h) are helpful, if not persuasive, in addressing situations such as this one." *In re Dynamic Tooling Sys., Inc.,* 349 B.R. 847, 855–56 (Bankr.D.Kan.2006). Under § 365(h), the lessee to a rejected real property lease may either treat the rejection as a lease termination and sue for monetary damages, or remain in possession for the balance of the lease and continue to make rent payments.

9 *See also In re Taylor,* 198 B.R. 142 (Bankr.D.S.C.1996); *In re Samaritan Alliance, LLC,* 2007 WL 4162918 (Bankr.E.D.Ky. Nov. 21, 2007); and *In re LHD Realty Corp.,* 20 B.R. 717 (Bankr.S.D.Ind.1982).

10 "The rationale behind cases prohibiting the extinguishment of a sublessee's § 365(h) rights through a § 363 sale has been based in part upon the statutory construction principle that the more specific provision should prevail over the general.... Cases disapproving the § 363 sale of leases to extinguish § 365(h) rights also rely upon the legislative history of § 365(h)...." *In re Zota Petroleums, LLC,* 482 B.R. at 161.

11 Moreover, BSL has no ongoing or future rights under the Representation Agreement, which was simply an executory contract for services with Debtors. Upon rejection, BSL is left with only an unsecured claim. *See Sunbeam Products, Inc,* 686 F.3d at 377 ("[W]hen a debtor does not assume the contract before rejecting it, these damages are treated as a pre-petition obligation, which may be written down in common with other debts of the same class."). While the Court appreciates the extensive briefing and advocacy undertaken by BSL, its standing in this matter is highly questionable. BSL is not a party to any License Agreement.

End of Document

879 F.3d 389
United States Court of Appeals, First Circuit.

IN RE: TEMPNOLOGY, LLC,
n/k/a Old Cold LLC, Debtor.
Mission Product Holdings, Inc., Appellant,
v.
Tempnology, LLC, n/k/a Old Cold LLC, Appellee.

No. 16-9016
|
January 12, 2018

Synopsis

Background: Chapter 11 debtor moved for determination of what rights exclusive distributor of its products and licensee of its intellectual property retained as result of election that it made following debtor's rejection of underlying agreement between parties. The United States Bankruptcy Court for the District of New Hampshire, J. Michael Deasy, J., 541 B.R. 1, ruled that distributor/licensee had no remaining distribution rights or rights in debtor's trademarks or logo, and distributor/licensee appealed. The Bankruptcy Appellate Panel of the First Circuit, Hoffman, J., 559 B.R. 809, affirmed in part and reversed in part. Appeal was taken.

Holdings: The Court of Appeals, Kayatta, Circuit Judge, held that:

[1] exclusive right granted to counter-party under its rejected executory contract with debtor to sell certain products manufactured using debtor's patented cooling technology was not equivalent to an exclusive right to exploit the underlying intellectual property, and counter-party, by making statutory election, could not preserve its exclusive right to distribute these products;

[2] products produced using Chapter 11 debtor's patented cooling technology were neither "intellectual property" nor an "embodiment" of such intellectual property;

[3] on issue of first impression, trademarks which exclusive distributor of products produced using debtor's patented cooling technology was allowed to use pursuant to terms of rejected marketing and distribution agreement did not constitute "intellectual property"; and

[4] even assuming that adversary proceeding was required to determine scope of counter-party's continuing rights under its rejected marketing and distribution agreement with debtor, bankruptcy court's failure to require adversary proceeding, instead deciding scope of counter-party's continuing rights in connection with debtor's motion to reject agreement, was mere harmless error.

Bankruptcy court's decision affirmed.

Torruella, Circuit Judge, filed opinion concurring in part and dissenting in part.

West Headnotes (16)

[1] Bankruptcy
Assumption, Rejection, or Assignment

Debtor-in-possession, with bankruptcy court's approval, may reject any executory contract that, in debtor's business judgment, is not beneficial to the company. 11 U.S.C.A. § 365(a).

Cases that cite this headnote

[2] Bankruptcy
Conclusions of law;de novo review

Bankruptcy
Clear error

On appeal from decision of the Bankruptcy Appellate Panel (BAP), the Court of Appeals accords no special deference to determinations made by the BAP, but instead trains the lens of its inquiry directly on bankruptcy court's decision, reviewing bankruptcy court's factual findings for clear error and its conclusions of law de novo. Fed.Rules Bankr.Proc.Rule 8013, 11 U.S.C.A.

Cases that cite this headnote

[3] Bankruptcy
Executory nature in general

"Executory contracts," as that term is used in the Bankruptcy Code, are contracts on which performance is due to some extent on both sides. 11 U.S.C.A. § 365(a).

Cases that cite this headnote

[4] **Bankruptcy**
Assumption, Rejection, or Assignment

Bankruptcy statute governing debtor's executory contracts and unexpired leases permits trustee or debtor-in-possession to assume those contracts that are beneficial and reject those that may hinder debtor's recovery, thereby providing an elixir for use in nursing a business back to good health by allowing the trustee or debtor-in-possession to prescribe it as an emetic to purge the bankruptcy estate of obligations that promise to hinder a reorganization. 11 U.S.C.A. § 365(a).

Cases that cite this headnote

[5] **Bankruptcy**
Effect of Acceptance or Rejection

Parenthetical phrase "including a right to enforce any exclusivity provision of such contract," as used in bankruptcy statute allowing the licensee under rejected intellectual property agreement to elect to retain its rights to such intellectual property, could not be interpreted as allowing license to elect to retain its rights under any exclusivity provision in entire contract, whether or not that provision granted exclusive use of a pertinent intellectual property right; Congress did not intend that, as result of licensee's election, its post-rejection rights could extend beyond its bargained-for intellectual property rights. 11 U.S.C.A. § 365(n)(1)(B).

Cases that cite this headnote

[6] **Bankruptcy**
Effect of Acceptance or Rejection

Exclusive right granted to counter-party under its rejected executory contract with Chapter 11 debtor to sell certain products manufactured using debtor's patented cooling technology was not equivalent to an exclusive right to exploit the underlying intellectual property, and contract counter-party, by making statutory election following debtor's rejection of this executory contract, could not preserve its exclusive right to distribute these products. 11 U.S.C.A. § 365(n)(1)(B).

Cases that cite this headnote

[7] **Bankruptcy**
Effect of Acceptance or Rejection

Words "any embodiment of such intellectual property," as used in bankruptcy statute allowing the licensee under rejected intellectual property agreement to elect to retain its rights to such intellectual property, including any embodiment of such intellectual property, referred to a tangible or physical object which existed prepetition, and to which licensee had access pursuant to terms of rejected agreement; "embodiment of intellectual property," as used in statute, was something inherently limited in number, such as a prototype or example of product, but did not include all products produced using the intellectual property. 11 U.S.C.A. § 365(n)(1)(B).

Cases that cite this headnote

[8] **Statutes**
Terms of art

Statutes
Extrinsic Aids to Construction

When statutory language includes a term of art, resort to sources beyond the statutory text is particularly appropriate to make clear the intended meaning of that term.

Cases that cite this headnote

[9] **Bankruptcy**
Effect of Acceptance or Rejection

Purpose of Congress in specifying that licensee under rejected intellectual property agreement, by electing to retain its rights

to such intellectual property, would also preserve its rights in "any embodiment of such intellectual property," was to allow licensee to exploit its right to the underlying intellectual property. 11 U.S.C.A. § 365(n)(1)(B).

Cases that cite this headnote

[10] **Bankruptcy**
Effect of Acceptance or Rejection

Products produced using Chapter 11 debtor's patented cooling technology were neither "intellectual property" nor an "embodiment" of such intellectual property, and thus counter-party to rejected marketing and distribution agreement with Chapter 11 debtor, by making statutory election, could not preserve its exclusive to sell such products post-rejection. 11 U.S.C.A. § 365(n)(1)(B).

Cases that cite this headnote

[11] **Bankruptcy**
Presentation of grounds for review

By never raising argument in bankruptcy court as basis for preserving its exclusive product distribution rights following Chapter 11 debtor's rejection of executory marketing and distribution agreement, contract counter-party waived that argument as issue on appeal. 11 U.S.C.A. § 365(n)(1)(B).

Cases that cite this headnote

[12] **Bankruptcy**
Effect of Acceptance or Rejection

Trademarks which exclusive distributor of products produced using Chapter 11 debtor's patented cooling technology was allowed to use pursuant to terms of rejected marketing and distribution agreement did not constitute "intellectual property," within meaning of bankruptcy statute providing that licensee of debtor's intellectual property may elect to continue using such property following debtor's rejection of underlying agreement, and distributor, by making this election, could not preserve its right to continue using debtor's trademarks post-rejection.

1 Cases that cite this headnote

[13] **Bankruptcy**
Effect of Acceptance or Rejection

Rejection of executory contract does not "vaporize" the contract rights thereunder, but rather converts those rights into a prepetition claim for damages. 11 U.S.C.A. § 365(g).

Cases that cite this headnote

[14] **Bankruptcy**
Assumption, Rejection, or Assignment

Principal aim of Congress in providing for rejection of debtor's executory contracts and unexpired leases was to release the debtor's estate from burdensome obligations that can impede a successful reorganization. 11 U.S.C.A. § 365(a).

Cases that cite this headnote

[15] **Trademarks**
Function and purpose of trademarks in general

Trademarks, unlike patents, are public-facing messages to consumers about the relationship between the goods and the trademark owner; they signal uniform quality and also protect a business from competitors who attempt to profit from its developed goodwill.

Cases that cite this headnote

[16] **Bankruptcy**
Harmless error

Even assuming that adversary proceeding was required to determine scope of counter-party's continuing rights under its rejected marketing and distribution agreement with Chapter 11 debtor, as result of its statutory election to retain its rights in debtor's intellectual property, bankruptcy court's failure to require adversary proceeding, instead deciding scope of counter-party's continuing rights in

connection with debtor's motion to reject agreement, was mere harmless error, where bankruptcy court permitted debtor and contract counter-party to conduct discovery, and there was no evidence that either party had a need for, or in fact did conduct, discovery, and if they did, counter-party offered no explanation for how this discovery generated any factual dispute that need be resolved by testimonial hearing. 11 U.S.C.A. § 365(n)(1)(B); Fed. R. Bankr. P. 7001, 9014.

Cases that cite this headnote

APPEAL FROM THE BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

Attorneys and Law Firms

Robert J. Keach, with whom Lindsay K.Z. Milne and Bernstein, Shur, Sawyer & Nelson, P.A., Portland, ME, were on brief, for appellant.

Lee A. Harrington, Boston, MA, with whom Daniel W. Sklar and Nixon Peabody LLP, Manchester, NH, were on brief, for appellee.

Before Torruella, Lynch, and Kayatta, Circuit Judges.

Opinion

KAYATTA, Circuit Judge.

Generally speaking, when a company files for protection under Chapter 11 of the Bankruptcy Code, the trustee or the debtor-in-possession may secure court approval to "reject" any executory contract of the debtor, meaning that the other party to the contract is left with a damages claim for breach, but not the ability to compel further performance. 11 U.S.C. §§ 365(a), 1107(a); see NLRB v. Bildisco & Bildisco, 465 U.S. 513, 531–32, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984); Mason v. Official Comm. of Unsecured Creditors, for FBI Distrib. Corp. & FBC Distrib. Corp. (In re FBI Distrib. Corp.), 330 F.3d 36, 43–44 (1st Cir. 2003). When the rejected contract, however, is one "under which the debtor is a licensor of a right to intellectual property," the licensee may elect to "retain its rights ... to such intellectual property," thereby continuing the debtor's duty to license the intellectual property. 11 U.S.C. § 365(n)(1). In this case, Tempnology, LLC ("Debtor")—a debtor-in-possession seeking to reorganize under Chapter 11—rejected an agreement giving certain marketing and distribution rights to Mission Product Holdings, Inc. The parties agree that Mission can insist that the rejection not apply to nonexclusive patent licenses contained in the rejected agreement. They disagree as to whether the rejection applies to the agreement's grants of a trademark license and of exclusive rights to sell certain of Debtor's goods. In the case of the trademark license, resolving that disagreement poses for this circuit an issue of first impression concerning which other circuits are split. For the following reasons, we agree with the bankruptcy court that the rejection left Mission with only a pre-petition damages claim in lieu of any obligation by Debtor to further perform under either the trademark license or the grant of exclusive distribution rights.

I.

Debtor made specialized products—such as towels, socks, headbands, and other accessories—designed to remain at low temperatures even when used during exercise, which it marketed under the "Coolcore" and "Dr. Cool" brands. A significant intellectual property portfolio supported Debtor's products. This portfolio consisted of two issued patents, four pending patents, research studies, and a multitude of registered and pending trademarks.

On November 21, 2012, Mission and Debtor executed a Co-Marketing and Distribution Agreement, which serves as the focal point of this appeal. The Agreement provided Mission with three relevant categories of rights.

First, Debtor granted Mission distribution rights to certain of its manufactured ***393** products within the United States.[1] These products, called "Cooling Accessories," were defined in the Agreement as "products of the specific types listed on Exhibit A" and "manufactured by or on behalf of [Debtor]." They also included "additional products that are hereafter developed by [Debtor]." Exhibit A broke down the thirteen listed products into two categories: "Exclusive" and "Non-Exclusive" Cooling Accessories. For "Exclusive Cooling Accessories"—comprised of towels, wraps, hoodies, bandanas, multi-chills, and doo rags—Debtor agreed that "it will not license or sell" the products "to anyone other than [Mission] during the

Term." Mission's rights with respect to the remaining Cooling Accessories—comprised of socks, headbands, wristbands, sleeves, skullcaps, yoga mats, and baselayers—were nonexclusive because Debtor reserved for itself the "right to sell ... to vertically integrated companies as well as customers that are not Sports Distributors or retailers in the Sporting Channel."

Second, Debtor granted Mission a nonexclusive license to Debtor's intellectual property. This "non-exclusive, irrevocable, royalty-free, fully paid-up, perpetual, worldwide, fully-transferable license" granted Mission the right "to sublicense (through multiple tiers), use, reproduce, modify, and create derivative work based on and otherwise freely exploit" Debtor's products—including Cooling Accessories—and its intellectual property. This irrevocable license, however, expressly excluded any rights to Debtor's trademarks.

Trademarks were the subject of the third bucket of rights. Section 15(d) of the Agreement granted Mission a "nonexclusive, non-transferable, limited license" for the term of the Agreement "to use [Debtor's] trademark and logo (as well as any other Marks licensed hereunder) for the limited purpose of performing its obligations hereunder, exercising its rights and promoting the purposes of this Agreement." This license came with limitations. Mission was forbidden from using the trademarks in a manner that was disparaging, inaccurate, or otherwise inconsistent with the terms of the Agreement. Further, Mission was required to "comply with any written trademark guidelines" and Debtor had "the right to review and approve all uses of its Marks," except for certain pre-approved uses.

The Agreement also included a provision permitting either party to terminate the Agreement without cause. On June 30, 2014, Mission exercised this option, triggering a "Wind-Down Period" of approximately two years. Debtor, in turn, issued a notice of immediate termination for cause on July 22, 2014, claiming that Mission's hiring of Debtor's former president violated the Agreement's restrictive covenants. Pursuant to the Agreement's terms, Mission's challenge to Debtor's immediate termination for cause went before an arbitrator. The arbitrator determined that Debtor had waived any grounds for immediate termination under the restrictive covenant and that the Agreement remained in effect until the expiration of the Wind-Down Period. That ruling meant that Mission was contractually entitled to retain its distribution and trademark rights until July 1, 2016, and its nonexclusive intellectual property rights in perpetuity.

Intervening events, however, put an earlier end to the parties' contractual relationship. Although Debtor posted profits in 2012, its financial outlook dimmed. After ***394** accruing multi-million dollar net operating losses in 2013 and 2014, Debtor filed a voluntary petition for Chapter 11 bankruptcy on September 1, 2015. The following day, Debtor moved to reject seventeen of its contracts, including the Agreement, pursuant to 11 U.S.C. § 365(a).

[1] Section 365(a) permits a debtor-in-possession,[2] with the court's approval, to "reject any executory contract" that, in the debtor's business judgment, is not beneficial to the company. See Agarwal v. Pomona Valley Med. Grp., Inc. (In re Pomona Valley Med. Grp., Inc.), 476 F.3d 665, 669–71 (9th Cir. 2007); see also Bildisco & Bildisco, 465 U.S. at 520, 523, 104 S.Ct. 1188. In its memoranda supporting its motion, Debtor informed the bankruptcy court that it sought to reject the Agreement because it hindered Debtor's ability to derive revenue from other marketing and distribution opportunities. Debtor faulted Mission—and particularly the Agreement's grant of exclusive distribution rights—for its bankruptcy. It alleged that the Agreement "suffocated the Debtor's ability to market and distribute its products" after Mission failed to fulfill its obligations, "essentially starving the Debtor from any income."

Mission objected to the rejection motion, arguing that 11 U.S.C. § 365(n) allowed Mission to retain both its intellectual property license and its exclusive distribution rights. Section 365(n) provides an exception from section 365(a)'s broad rejection authority by limiting the debtor-in-possession's ability to terminate intellectual property licenses it has granted to other parties.

On September 21, 2015, the bankruptcy court granted Debtor's motion to reject certain executory contracts, except for the Agreement, for which it ordered further hearing. In a subsequent one-sentence order, the bankruptcy court granted the motion to reject the Agreement, "subject to Mission Product Holdings's election to preserve its rights under 11 U.S.C. § 365(n)." Debtor then moved for a determination of the applicability and scope of Mission's rights under section 365(n). In that motion, Debtor conceded that Mission

retained its nonexclusive, perpetual license to certain of Debtor's intellectual properties—which did not include its trademarks—but argued that section 365(n) did not cover either Mission's exclusive distribution rights or the trademark license. Mission again objected, arguing that the relief Debtor requested required an adversary proceeding pursuant to Rule 7001(2) of the Federal Rules of Bankruptcy Procedure.

After holding a nontestimonial hearing, the bankruptcy court concluded that Mission's election pursuant to section 365(n) did not preserve either the exclusive distribution rights or the trademark license. The court found that section 365(n) only protected intellectual property rights, and Mission's exclusive distributorship could not fairly be characterized as such. With respect to trademarks, the court reasoned that Congress's decision to leave trademarks off the definitional list of intellectual properties in 11 U.S.C. § 101(35A) left the trademark license unprotected from rejection. Finally, the court rejected Mission's argument that the Bankruptcy Code required an adversary proceeding to determine the issue. The court viewed "the Motion in the context of rejection under ***395** § 365, which is a contested matter under Fed. R. Bankr. P. 9014."

Mission appealed to the Bankruptcy Appellate Panel for the First Circuit ("BAP"). The BAP affirmed the bankruptcy court's order with respect to Mission's exclusive distribution rights, concluding that "Mission's attempt to re-characterize its exclusive product distribution rights under the Agreement as an intellectual property license [is] unsupported by either the letter or the spirit of the Agreement." Like the bankruptcy court, the BAP read section 365(n)'s protection of "exclusivity provision[s]" as encompassing only the exclusivity attributes, such as they might be, of intellectual property rights. The BAP also affirmed the bankruptcy court's determination that the section 365(n) motion did not require Debtor to commence an adversary proceeding under Bankruptcy Rule 7001.

Regarding trademarks, however, the BAP diverged from the bankruptcy court. Although the BAP agreed that section 365(n) failed to protect Mission's rights to Debtor's trademarks, it disagreed as to the effect of that conclusion. Rather than finding that rejection extinguished the non-debtor's rights, the BAP followed the Seventh Circuit's ruling in Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC, 686 F.3d 372 (7th Cir. 2012). The BAP held that, because section 365(g) deems the effect of rejection to be a breach of contract, and a licensor's breach of a trademark agreement outside the bankruptcy context does not necessarily terminate the licensee's rights, rejection under section 365(g) likewise does not necessarily eliminate those rights. Thus, the BAP reversed the bankruptcy court's determination that Mission no longer had protectable rights in Debtor's trademarks and trade names.

This appeal ensued. We affirm the bankruptcy court's determinations. We conclude that section 365(n) does not apply to Mission's right to be the exclusive distributor of Debtor's products, or to its trademark license. Unlike the BAP and the Seventh Circuit, we also hold that Mission's right to use Debtor's trademarks did not otherwise survive rejection of the Agreement.

II.

[2] On appeal from a decision by the BAP, "[w]e accord no special deference to determinations made by the [BAP]," and instead "train the lens of our inquiry directly on the bankruptcy court's decision." [3] Wheeling & Lake Erie Ry. Co. v. Keach (In re Montreal, Maine & Atl. Ry., Ltd.), 799 F.3d 1, 5 (1st Cir. 2015). In doing so, we review the bankruptcy court's factual findings for clear error and its conclusions of law de novo. DeGiacomo v. Traverse (In re Traverse), 753 F.3d 19, 24 (1st Cir. 2014).

III.

[3] **[4]** We begin with the statutory framework that defines the scope of Debtor's ability, "subject to the court's approval," to "assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a). Executory contracts, although not defined in the Bankruptcy Code, are generally considered to be contracts "on which performance is due to some extent on both sides." ***396** In re FBI Distrib. Corp., 330 F.3d at 40 n.5 (quoting Bildisco & Bildisco, 465 U.S. at 522 n.6, 104 S.Ct. 1188); see also Parkview Adventist Med. Ctr. v. United States ex rel. Dep't of Health & Human Servs., 842 F.3d 757, 763 n.12 (1st Cir. 2016). Section 365(a) permits the debtor-in-possession to assume those contracts that are beneficial and reject those that may

hinder its recovery. In re FBI Distrib. Corp., 330 F.3d at 42. It provides an "elixir for use in nursing a business back to good health" by allowing the trustee or debtor-in-possession to "prescribe it as an emetic to purge the bankruptcy estate of obligations that promise to hinder a reorganization." Thinking Machs. Corp. v. Mellon Fin. Servs. Corp. (In re Thinking Machs. Corp.), 67 F.3d 1021, 1024 (1st Cir. 1995). Section 365(a) thus furthers Chapter 11's "paramount objective" of rehabilitating debtors. In re FBI Distrib. Corp., 330 F.3d at 41. In lieu of the rejected obligation, a debtor is left with a liability for what the Code deems to be a pre-petition breach of the contract. 11 U.S.C. § 365(g) ("[T]he rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease ... immediately before the date of the filing of the petition....").

In 1985, the Fourth Circuit was tasked with applying this framework to an intellectual property license granted by a debtor. See Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985). The Fourth Circuit held that the term "executory contract" in section 365(a) encompassed intellectual property licenses, id. at 1045, and that under section 365(g) the effect of rejection was to terminate an intellectual property license, id. at 1048. The court based its reasoning on what it saw as the animating principles behind section 365(g), thus distinguishing "statutory breach" from common law breach:

> Even though § 365(g) treats rejection as breach, the legislative history of § 365(g) makes clear that the purpose of the provision is to provide only a damages remedy for the non-bankrupt party.... [T]he statutory "breach" contemplated by § 365(g) controls, and provides only a money damages remedy for the non-bankrupt party. ... Allowing specific performance would obviously undercut the core purpose of rejection under § 365(a).

Id.

Three years later, Congress responded. Rather than amending either section 365(a) or section 365(g), Congress enacted a brand new section 365(n). See S. Rep. No. 100-505, at 8 (1988). Section 365(n)(l) gives to a licensee of intellectual property rights a choice between treating the license as terminated and asserting a claim for pre-petition damages—a remedy the licensee held already under section 365(g)—or retaining its intellectual property rights under the license. It states, in full:

> If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—
>
> (A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or
>
> (B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such ***397** contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for—
>
> (i) the duration of such contract; and
>
> (ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.

11 U.S.C. § 365(n)(1).

Congress also amended the definition of intellectual property, thus defining the scope of the new section 365(n)(1). Under 11 U.S.C. § 101(35A),

> The term "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.

IV.

With the foregoing framework in mind, we turn now to Mission's arguments on appeal. We consider first its contention that its exclusive distribution rights remained unaffected by Debtor's rejection of the Agreement. We then address Mission's contention that its trademark license also remained in effect during the two-year Wind-Down Period. What is at issue for these parties, practically speaking, is whether to classify as prepetition or post-petition liability any damages caused by Debtor's failure to honor its executory obligations during the two-year Wind-Down Period.

A.

[5] Section 365(n)(1)(B) allows Mission "to retain its rights (including a right to enforce any exclusivity provision of such contract ...) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law)." Mission would have us read the words "any exclusivity provision of such contract" in the foregoing parenthetical as meaning any "exclusivity provision" in the entire contract (or any supplementary agreement), whether or not the provision grants exclusive use of a pertinent intellectual property right.

We disagree. We start in section 365(a) with the universe of all executory contracts that a debtor may seek to reject; section 365(n)(1) then focuses on a subset of that universe ("executory contract[s] under which the debtor is a licensor of a right to intellectual property"); subsection (n)(1)(B) then says what happens to intellectual property rights granted under such contracts (the licensee may "retain its rights"); and the parenthetical merely makes clear that those rights "to such intellectual property" include any exclusivity attributes of those rights. In this manner, subsection (n)(1)(B) protects, for example, an exclusive license to use a patent, but does not protect an exclusive right to sell a product merely because that right appears in a contract that also contains a license to use intellectual property.

Our reading aligns with the legislative record. In enacting section 365(n), Congress ***398** made clear that it was responding to a "particular problem arising out of recent court decisions." S. Rep. No. 100-505, at 5. The limited "purpose of the bill is to amend Section 365 of the Bankruptcy Code to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off." Id. at 1. The amendment is "not in any way intended to address broader matters under Section 365." Id. at 5. Congress, it seems, was focused on a narrow issue, and only intended its amendment to address that issue. It did not intend the scope of its amendment to extend beyond the licensee's bargained-for intellectual property rights post-rejection, as Mission's position would necessarily require. Further supporting our reading of the statutory text, Congress's description of the protected exclusivity rights in both relevant congressional reports is limited to license rights, and does not mention or imply the protection of exclusive rights other than those to intellectual property. The House Report, describing the House's version of the bill, [4] states that, "[u]nder the legislation, any right in the license agreement giving the licensee an exclusive license will still be enforceable by the licensee, but other rights of the licensee cannot be specifically enforced." H.R. Rep. No. 100-1012, at 6 (1988). Similarly, the Senate Report says that "if the contract granted exclusive use to the licensee, such exclusivity would be preserved to the license." S. Rep. No. 100-505, at 9.

[6] Mission's fallback position is to argue that, in this instance, its exclusive distribution right is, de facto, a provision that renders its right to use Debtor's intellectual property exclusive. The unstated premise is that because Mission has an exclusive right to sell certain of Debtor's products made using Debtor's intellectual property, no one else can use the intellectual property. Hence, Mission reasons, the exclusive distribution right is an "exclusivity provision" of the intellectual property right.

The most obvious defect in this argument is its premise. The Agreement and record are clear that Debtor can use its intellectual property to make and sell products other than those for which the Agreement grants Mission

exclusive distribution rights. The only thing that is exclusive is the right to sell certain products, not the right to practice, for example, the patent that is used to make those products. An exclusive right to sell a product is not equivalent to an exclusive right to exploit the product's underlying intellectual property.

But, argues Mission, because of its exclusive distribution rights, no one can use the Debtor's patent to make at least some products if those products are to be sold in Mission's territory. Perhaps. But this is simply a restriction on the right to sell certain products that, like many products, happen to be made using a patent. And the exclusivity Mission seeks to maintain would apply fully even if there were no patent license at all. Given that the right to sell a product is clearly not included within the statute's definition of intellectual property, we are not going to treat it as such merely because of a coincidental practical effect it may have in limiting the scope of the manner in which a patent might be exploited, especially where the Agreement itself expressly makes clear that any patent license is nonexclusive. To hold otherwise would be to find buried in a parenthetical to a statutory subsection an implied exception to rejection that would, ***399** in practical terms, likely cover as much commercial territory as do some of the rights expressly defined as protected. See Whitman v. Am. Trucking Ass'n, 531 U.S. 457, 468, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001) ("Congress ... does not, one might say, hide elephants in mouseholes."). The fact that Mission can cite no circuit court precedent for its effort to paint its exclusive distribution right as a de facto exclusive intellectual property right further buttresses our conclusion. [5]

Mission also argues that its nonexclusive license of intellectual property "lacks meaningful value" unless it retains an exclusive right to sell certain of Debtor's products. Why this is so is not apparent given that section 365(n) protects the nonexclusive license, hence Mission retained the right to use the intellectual property. The Agreement itself spells out myriad ways that Mission could exploit its nonexclusive intellectual property rights that were presumably unaffected by rejection of its exclusive distribution right: Mission could still "sublicense (through multiple tiers), use, reproduce, modify, and create derivative work based on" Debtor's intellectual property. And if those rights lacked meaningful value, that hardly becomes a reason for turning rights that are not intellectual property rights into intellectual property rights. Rather, it simply suggests that most of the contract's value was apparently in the exclusive distribution agreement.

[7] Nor does the reference in section 365(n)(1)(B) to "any embodiment of such intellectual property" help Mission. Embodiment is a term of art associated with intellectual property. The Senate Report includes a letter informing the Judiciary Committee of the Department of Commerce's view of the bill, which states that "[a]lthough 'embodiment' is not defined, we assume the term arises from the copyright law." S. Rep. No. 100-505, at 12. Black's Law Dictionary tags the term as belonging to patent law, and offers three alternate definitions: (1) "[t]he tangible manifestation of an invention"; (2) "[t]he method for using this tangible form"; or (3) "[t]he part of a patent application or patent that describes a concrete manifestation of the invention." *Embodiment*, Black's Law Dictionary (10th ed. 2014). Black's Law Dictionary further notes that while intellectual property "is a mental construct" without "physical structure," an embodiment "is a specific physical form of the invention" and thus "[e]ach embodiment exists in the real world." Id. (quoting Morgan D. Rosenberg, The Essentials of Patent Claim Drafting xvii (2012)).

[8] Where the statutory language includes a term of art, resort to sources beyond the text is particularly appropriate to make clear the intended meaning of that term. See Molzof v. United States, 502 U.S. 301, 307, 112 S.Ct. 711, 116 L.Ed.2d 731 (1992). Both the Senate Report and the Department of Commerce letter offer additional insight into the meaning of "embodiment" and its application to a licensee's rights. The Senate Report provides three examples of protected rights, and concludes with two traits that all protected rights must contain:

> [T]he parties might have agreed that the licensor would prepare a prototype incorporating the licensed intellectual property. If such a prototype was prepared prior to the filing of the petition for relief, but had not been delivered to ***400** the licensee at that time, then the licensee can compel the delivery of the prototype in accordance with the terms of the rejected license. Other examples of embodiments include genetic material needed

> to produce certain biotechnological products and computer program source codes. There are many other possible examples of embodiments, but critical to any right of the licensee to obtain such embodiments under this bill is the prepetition agreement of the parties that the licensee have access to such material and the physical existence of such material on the day of the bankruptcy filing.

S. Rep. No. 100-505, at 9-10 (emphasis added). The Department of Commerce letter states:

> Where the licensed intellectual property is not a work of authorship, we assume the term "embodiment" would be interpreted in a similar sense of enablement in a manner reasonable in the circumstances and would not necessarily include all physical manifestations of the intellectual property. For example, an embodiment of a licensed process might be interpreted to include technical data sufficient to enable the licensee to operate the process, but not a manufacturing facility using (or embodying) the process; and an embodiment of a licensed invention might be interpreted to include a sample of the invention, but not all inventory.

S. Rep. No. 100-505, at 12 (emphasis added).

[9] A few common themes appear in these explanations. First, the pre-petition agreement must give the licensee access to the embodiment of intellectual property. Second, an embodiment of intellectual property is a tangible or physical object that exists pre-petition. Third, an embodiment of intellectual property is something inherently limited in number—it is a prototype or example of a product, but does not include all products produced using the intellectual property. Finally, we can infer that the purpose of this provision is to allow the licensee to exploit its right to the underlying intellectual property.

[10] Here, we have no object to which Mission requires access in order to exploit an intellectual property right. Rather, we have a prosaic, nonexclusive right to use a patented process, and an unremarkable and entirely independent right to be the exclusive distributor of some but not all goods made with that process. There is simply no "embodiment" at issue in the relevant statutory sense.

Nor does this case, as Mission contends, bear on the enforceability of all negative covenants independent of an intellectual property license. If a party possesses an intellectual property license, perhaps the Code may protect from rejection certain negative covenants—such as confidentiality—that do not materially restrict the debtor's reorganization, are tied closely to the intellectual property license, and are necessary to implement its terms. See Biosafe Int'l, Inc. v. Controlled Shredders, Inc. (In re Szombathy), Nos. 94 B 15536, 95 A 01035, 1996 WL 417121, at *11 (Bankr. N.D. Ill. July 9, 1996) rev'd in part sub nom. Szombathy v. Controlled Shredders, Inc., Nos. 94 B 15536, 95 A 01035, 1997 WL 189314 (N.D. Ill. Apr. 14, 1997). But we are not presented with that situation here.

[11] Finally, we observe that Mission salts its brief with several undeveloped suggestions that rejection under section 365(a), even if allowed, might not extinguish a right to demand specific performance of the negative covenant implicit in the exclusive distribution rights. Mission attempts to support these suggestions by ***401** citing In re Szombathy, 1996 WL 417121, and by emphasizing that case's reliance on a quote from the Department of Commerce's letter to the Senate Judiciary Committee. Neither source seems to come close to carrying the meaning claimed by Mission. In any event, even as Mission tendered an analogous argument in connection with its trademark license (which we address, below), it never raised any such argument in the bankruptcy court as a basis for preserving its exclusive distribution rights. Hence, the argument is waived in this civil action. See Argentaria v. Wiscovitch-Rentas (In re Net-Velázquez), 625 F.3d 34, 40 (1st Cir. 2010) ("The proposition is well established that, 'absent the most extraordinary circumstances, legal theories not raised squarely in the lower court cannot be broached for the first time on appeal.' " (quoting Teamsters, Chauffeurs, Warehousemen & Helpers Union, Local No. 59 v. Superline Transp. Co., 953 F.2d 17, 21 (1st Cir. 1992))).

B.

[12] We next consider whether Mission retained its rights to use Debtor's trademarks post-rejection. In defining the intellectual property eligible for the protection of section 365(n), Congress expressly listed six kinds of intellectual property. 11 U.S.C. § 101(35A). Trademark licenses (hardly something one would forget about) are not listed, even though relatively obscure property such as "mask work protected under chapter 9 of title 17" is included. Id. Nor does the statute contain any catchall or residual clause from which one might infer the inclusion of properties beyond those expressly listed.

One might reasonably conclude that Congress's decision not to include trademark licenses within the protective ambit of section 365(n) must mean that such licenses are not exempt from section 365(a) rejection. On the other hand, the conclusion that an agreement finds no haven from rejection in section 365(n) does not entirely exhaust the possible arguments for finding that a right under that agreement might otherwise survive rejection. For example, we have held that a counterparty's right to compel the return of its own property survives rejection of a contract under which the debtor has possession of that property. See Abboud v. The Ground Round, Inc. (In re The Ground Round, Inc.), 482 F.3d 15, 19 (1st Cir. 2007). This case, though, does not present us with a request by a party following rejection to recover its own property temporarily in the hands of the debtor. Rather, it presents a demand by a party to continue using the debtor's property.

Regarding trademarks specifically, the Senate Report states that Congress "postpone[d]" action on trademark licenses "to allow the development of equitable treatment of this situation by bankruptcy courts." S. Rep. No. 100-505, at 5. The only circuit to address this issue squarely has resisted the temptation to find in this ambiguous comment outside the statutory text a toehold for unfettered "equitable" dispensations from section 365(a) rejection when it would otherwise apply. See Sunbeam, 686 F.3d at 375 ("What the Bankruptcy Code provides, a judge cannot override by declaring that enforcement would be 'inequitable.' "). We agree. See Law v. Siegel, —— U.S. ——, 134 S.Ct. 1188, 1194-95, 188 L.Ed.2d 146 (2014) ("We have long held that 'whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of' the Bankruptcy Code." (quoting Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988))).

***402** There is, though, an alternative argument for finding that a right to use a debtor's trademark continues post-rejection. That argument rests not on equitable dispensation from rejection, but instead on an exploration of exactly what rejection means. The argument, as accepted by the Seventh Circuit in Sunbeam, runs thus: Under section 365(g), section 365(a) rejection constitutes a breach of contract that "frees the estate from the obligation to perform." Sunbeam, 686 F.3d at 377 (quoting Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294, 1306 (11th Cir. 2007)). "But nothing about this process implies that any rights of the other contracting party have been vaporized." Id. Therefore, reasoned the Seventh Circuit, while rejection converts a debtor's duty to perform into a liability for pre-petition damages, it leaves in place the counterparty's right to continue using a trademark licensed to it under the rejected agreement. In so reasoning, the Seventh Circuit found itself unpersuaded by the contrary approach taken by the Fourth Circuit in Lubrizol. Sunbeam, 686 F.3d at 378; see also In re Exide Techs., 607 F.3d 957, 964–68 (3d Cir. 2010) (Ambro, J., concurring).

[13] **[14]** Of course, to be precise, rejection as Congress viewed it does not "vaporize" a right. Rather, rejection converts the right into a pre-petition claim for damages. Putting that point of vocabulary to one side, and leaving open the possibility that courts may find some unwritten limitations on the full effects of section 365(a) rejection, we find trademark rights to provide a poor candidate for such dispensation. Congress's principal aim in providing for rejection was to "release the debtor's estate from burdensome obligations that can impede a successful reorganization." Bildisco & Bildisco, 465 U.S. at 528, 104 S.Ct. 1188. Sunbeam therefore largely rests on the unstated premise that it is possible to free a debtor from any continuing performance obligations under a trademark license even while preserving the licensee's right to use the trademark. See Sunbeam, 686 F.3d at 377. Judge Ambro's concurrence in In re Exide Technologies shares that premise. See 607 F.3d at 967 (Ambro, J., concurring) (assuming that the bankruptcy court could allow the licensee to retain trademark rights even while giving the debtor "a fresh start").

[15] Careful examination undercuts that premise because the effective licensing of a trademark requires that the trademark owner—here Debtor, followed by any purchaser of its assets—monitor and exercise control over the quality of the goods sold to the public under cover of the trademark. See 3 J. Thomas McCarthy, McCarthy on Trademarks & Unfair Competition § 18:48 (5th ed. 2017) ("Thus, not only does the trademark owner have the right to control quality, when it licenses, it has the duty to control quality."). Trademarks, unlike patents, are public-facing messages to consumers about the relationship between the goods and the trademark owner. They signal uniform quality and also protect a business from competitors who attempt to profit from its developed goodwill. See Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633, 636 (1st Cir. 1992). The licensor's monitoring and control thus serve to ensure that the public is not deceived as to the nature or quality of the goods sold. Presumably, for this reason, the Agreement expressly reserves to Debtor the ability to exercise this control: The Agreement provides that Debtor "shall have the right to review and approve all uses of its Marks," except for certain pre-approved uses. Importantly, failure to monitor and exercise this control results in a so-called "naked license," jeopardizing the continued validity of the owner's own trademark rights. ***403** McCarthy, supra, § 18:48; see also Eva's Bridal Ltd. v. Halanick Enters., Inc., 639 F.3d 788, 790 (7th Cir. 2011) ("[A] naked license abandons a mark."); Restatement (Third) of Unfair Competition § 33 ("The owner of a trademark, trade name, collective mark, or certification mark may license another to use the designation. ... Failure of the licensor to exercise reasonable control over the use of the designation by the licensee can result in abandonment....").

The Seventh Circuit's approach, therefore, would allow Mission to retain the use of Debtor's trademarks in a manner that would force Debtor to choose between performing executory obligations arising from the continuance of the license or risking the permanent loss of its trademarks, thereby diminishing their value to Debtor, whether realized directly or through an asset sale. Such a restriction on Debtor's ability to free itself from its executory obligations, even if limited to trademark licenses alone, would depart from the manner in which section 365(a) otherwise operates. And the logic behind that approach (no rights of the counterparty should be "vaporized" in favor of a damages claim) would seem to invite further leakage. If trademark rights categorically survive rejection, then why not exclusive distribution rights as well? Or a right to receive advance notice before termination of performance? And so on.

Although claiming to follow Sunbeam, our dissenting colleague seems to reject its categorical approach in favor of what Sunbeam itself rejected—an "equitable remedy" that would consider in some unspecified manner the "terms of the Agreement, and non-bankruptcy law." See Sunbeam, 686 F.3d at 375-76. In so doing, our colleague gives great weight to a few lines in the Senate Report, treating them variously as "guidance," as a statement of Congress's "intent," and even as a mandate that "instruct[s]" the courts. In short, the dissent's interpretative approach seems to accord a line in the Senate Report the force of a line in the statute itself. Moreover, it does so by taking a line out of the Senate Report addressing section 365(n), which itself has no relevant ambiguity, and then uses that line to inform the dissent's interpretation of the previously enacted section 365(a). And while it is true that the Senate Report references equitable consideration, the dissent also seems to overlook the fact that when Congress otherwise intended to grant bankruptcy courts the ability to "equitably" craft exceptions to the Code's rules, it did so in the statute itself. See, e.g., 11 U.S.C. § 365(d)(5) (requiring the trustee to perform the obligations of the debtor until an unexpired lease is assumed or rejected "unless the court, after notice and a hearing and based on the equities of the case, orders otherwise"); id. § 552(b)(1) (stating that a security agreement may extend to proceeds or profits acquired after the commencement of the case "to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise"); see also id. § 502(j) ("A reconsidered claim may be allowed or disallowed according to the equities of the case."); id. § 557(d)(2)(D) (allowing the expedited disposition of grain by, inter alia, "such other methods as is equitable in the case"); id. § 723(d) ("[T]he court, after notice and a hearing, shall determine an equitable distribution of the surplus so recovered...."); id. § 1113(c) (listing whether "the balance of the equities clearly favors rejection of such agreement" as a factor for a court to consider in determining whether to approve an application for rejection of a collective bargaining agreement); id. § 1114(g) (requiring a court

to modify the payment of retirement benefits *404 if the court finds that "such modification is necessary to permit the reorganization of the debtor and assures that all creditors, the debtor, and all of the affected parties are treated fairly and equitably, and is clearly favored by the balance of the equities").

Even if we did sit in the chancellor's chair in applying section 365(a), we would likely hesitate to adopt our colleague's approach. Under such a case-specific, equitable approach, one might in theory preclude rejection only where the burden of quality assurance on the debtor will be minimal. The problem, though, is that in the bankruptcy context especially, where the licensor and licensee are at odds over continuing to deal with each other, the burden will likely often be greater than normal. Here, for example, the adversarial relationship between Debtor and Mission may portend less eager compliance. More importantly, in all cases there will be some burden, and it will usually not be possible to know at the time of the bankruptcy proceeding how great the burden will prove to be, as it will depend very much on the subsequent actions of the licensee. Conversely, the burden imposed on the counterparty of having its trademark right converted to a prepetition damages claim at a time when the relationship signaled by the trademark is itself ending will in most instances be less than the burden of having patent rights so converted. The counterparty may still make and sell its products—or any products—just so long as it avoids use of the trademark precisely when the message conveyed by the trademark may no longer be accurate. We therefore find unappealing the prospect of saddling bankruptcy proceedings with the added cost and delay of attempting to draw fact-sensitive and unreliable distinctions between greater and lesser burdens of this type. See RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 649, 132 S.Ct. 2065, 182 L.Ed.2d 967 (2012) ("[I]t is our obligation to interpret the Code clearly and predictably using well established principles of statutory construction."). There is, too, the public's interest in not being misled as to the origin and quantity of goods that consumers buy.

In sum, the approach taken by Sunbeam entirely ignores the residual enforcement burden it would impose on the debtor just as the Code otherwise allows the debtor to free itself from executory burdens. The approach also rests on a logic that invites further degradation of the debtor's fresh start options. Our colleague's alternative, "equitable" approach seems similarly flawed, and has the added drawback of imposing increased uncertainty and costs on the parties in bankruptcy proceedings. For these reasons, we favor the categorical approach of leaving trademark licenses unprotected from court-approved rejection, unless and until Congress should decide otherwise. See James M. Wilton & Andrew G. Devore, Trademark Licensing in the Shadow of Bankruptcy, 68 Bus. Law. 739, 771-76 (2013).

C.

[16] Mission's final argument is that the bankruptcy court erred by not holding an adversary proceeding under Bankruptcy Rule 7001. Mission contends that because the rule governing adversary proceedings includes within its ambit determinations of an "interest in property," the bankruptcy court was required to hold such a hearing to determine the scope of Mission's rights. The bankruptcy court instead treated the issue as a contested matter under Rule 9014. We need not address this argument directly, because we find that even if an adversary proceeding was required, any error was harmless.

*405 Mission contends that it was prejudiced because it was not given a fair opportunity to develop an evidentiary record. But the issues at stake can be resolved—and are resolved, in our de novo review—without reliance on any disputed facts outside the four corners of the Agreement. The logical leap Mission asks us to make—that extrinsic evidence would be both appropriate and lead to a different result—is unsupported by any possible extrinsic evidence to which Mission points. Further, the bankruptcy court permitted Mission and Debtor to conduct discovery following its September 21, 2015 order. There is no evidence, however, that either party had a need for or in fact did conduct discovery, and if they did, Mission offers no explanation for how this discovery generated any factual dispute that need be resolved in a testimonial hearing. Requiring Debtor to commence an adversary proceeding would only have delayed the resolution of critical issues without changing the bankruptcy court's ultimate determination.

V.

For the foregoing reasons, the bankruptcy court's decision is affirmed.

TORRUELLA, Circuit Judge (Concurring in part, dissenting in part).

I agree with the majority that 11 U.S.C. § 365(n) does not protect Mission's exclusive distribution rights or its nonexclusive trademark license. The plain language of this subsection identifies "intellectual property," which, for purposes of chapter 11, does not encompass trademarks. See 11 U.S.C. § 101(35A). However, I disagree with the majority's bright-line rule that the omission of trademarks from the protections of section 365(n) leaves a non-rejecting party without any remaining rights to use a debtor's trademark and logo. As Judge Easterbrook wrote, "an omission is just an omission," and simply implies that section 365(n) does not determine how trademark licenses should be treated—one way or the other. Sunbeam, 686 F.3d at 375. I would follow the Seventh Circuit and the BAP in finding that Mission's rights to use Debtor's trademark did not vaporize as a result of Debtor's rejection of the executory contract.

The majority focuses on the Bankruptcy Code's protection of debtors' ability to reorganize and to escape "burdensome obligations." But, as the majority acknowledges, in some situations, the Bankruptcy Code also provides protections to non-debtor parties of an executory contract, allowing the courts to determine an equitable remedy pursuant to the terms of a rejected contract. See Ohio v. Kovacs, 469 U.S. 274, 280, 105 S.Ct. 705, 83 L.Ed.2d 649 (1985); see also In re Nickels Midway Pier, LLC, 255 Fed.Appx. 633, 637-38 (3d Cir. 2007); Abboud, 482 F.3d at 19. Thus, to determine the effect of a section 365(a) rejection on a trademark license, we look to the plain text of section 365 as a whole, which dictates the parameters of such a rejection of an executory contract.

A plain language review reveals section 365's silence as to the treatment of a trademark license post-rejection. Where a statute is silent, we look to the legislative history for assistance. DiGiovanni v. Traylor Bros., Inc., 75 F.3d 748, 755 (1st Cir. 1996) (citing Cabral v. I.N.S., 15 F.3d 193, 194 (1st Cir. 1994)). Resultantly, our examination leads us back to Congress's intent when it enacted section 365(n). The Senate Committee report makes clear that Congress enacted section 365(n) as a direct response to the Fourth Circuit's decision in Lubrizol, 756 F.2d 1043, where the court found that rejection of a contract for an intellectual property license deprived the licensee of all rights previously granted under that license. See ***406** S. Rep. No. 100-505, at 2-3. In so doing, Congress intended to "correct[ ] the perception of some courts that Section 365 was ever intended to be a mechanism for stripping innocent licensee [sic] of rights central to the operations of their ongoing business." Id., at 4.

Specific to trademark licenses, the Senate Committee report explains that the purposeful omission of trademarks was not designed to leave trademark licensees unprotected, but rather was "designed to allow more time for study, not to approve Lubrizol." Sunbeam, 686 F.3d at 375. The relevant portion of the Senate report reads:

> [T]he bill does not address the rejection of executory trademark[s],.... While such rejection is of concern because of the interpretation of [§] 365 by the Lubrizol court and others, ... such contracts raise issues beyond the scope of this legislation. In particular, trademark ... relationships depend to a large extent on control of the quality of the products or services sold by the licensee. Since these matters could not be addressed without more extensive study, it was determined to postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts.

S. Rep. No. 100-505, at 5. This legislative history expresses congressional concern about the application of Lubrizol's holding to trademarks licenses until further studies are done, and, rather than continue to apply Lubrizol's holding, encourages "equitable treatment" by the courts to resolve disputes arising in the meantime. Id. Why would Congress have provided this guidance if it meant for Lubrizol—the very case Congress rejected—to apply to trademark licenses? Congress has yet to advise the courts about the results of any further studies; as such, the majority's judicially created bright-line rule contravenes congressional intent.

The majority's view infers that the omission of trademarks from section 101(35A)'s definition of "intellectual property," and therefore the protections of section 365(n), implies that section 365 categorically affords no protections to licensees of trademarks. Yet, Congress's own interpretation of section 365(n) informs us that the bill does not "address or intend any inference to be drawn concerning the treatment of executory contracts which are unrelated to intellectual property." Id. "In light of these direct congressional statements of intent, it is simply more freight than negative inference will bear to read rejection of a trademark license to effect the same result as termination of that license." In re Exide Techs., 607 F.3d at 967 (Ambro, J., concurring) (citation and internal quotation marks omitted).

Instead, like the BAP below, I find it appropriate to view a debtor's section 365(a) rejection through the broader lens of section 365, as the Seventh Circuit did in Sunbeam. Section 365(g) states that "the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease." 11 U.S.C. § 365(g). Similar to other contractual breaches outside of the bankruptcy context, a rejection pursuant to section 365(a) does not automatically terminate a non-rejecting party's rights under a contract. Sunbeam, 686 F.3d at 377. Admittedly, "[w]hat the Bankruptcy Code provides, a judge cannot override by declaring that enforcement would be inequitable." Id. at 375 (internal quotation marks omitted). Given the Bankruptcy Code's silence as to the post-rejection rights that a trademark licensee does or does not retain, and in accordance with principles governing breaches of contract, we must resolve the dispute by looking to the terms of the ***407** contract to which these sophisticated parties agreed, and other applicable non-bankruptcy law. While the majority mistakenly insists that that this approach rejects the one followed in Sunbeam, it is precisely what the Seventh Circuit called for in finding that rejection does not abrogate a contract. Id. at 377. The majority takes issue with this consideration in what it terms as "some unspecified manner," but ignores that "the development of equitable treatment" is precisely what Congress has instructed the courts to do. See S. Rep. No. 100-505, at 6. Instead, the majority's view that a section 365(a) rejection eliminates a licensee's rights to the bargained-for use of a debtor's trademark effectively treats a debtor's rejection as a contract cancellation, rather than a contractual breach, putting the court at odds with legislative intent. It also "makes bankruptcy more a sword than a shield, putting debtor-licensors in a catbird seat they often do not deserve." In re Exide Techs., 607 F.3d at 967-68 (Ambro, J., concurring).

I respect my colleagues' concern that following the Seventh Circuit's holding that a section 365(a) rejection does not categorically eviscerate the trademark rights that a debtor-licensor bargained away may "require[ ] that the trademark owner—here Debtor—monitor and exercise control over the quality of the goods sold to the public" post-rejection. However, licensees have trademark quality assurance obligations under the terms of their individual contracts which can be enforced through further legal action and the equitable remedy of specific performance. In the current case, Mission's obligations are laid out in Section 15(d) of the Agreement, which states that, inter alia, Mission shall not use the trademarks in a disparaging or inaccurate manner, shall comply with written trademark guidelines, and shall not create a unitary composite mark. The majority speculates that the remaining burden on the debtor will be too great in the bankruptcy context, and therefore, if it "were in the chancellor's chair," it would not follow this approach. However, we need not enter such a debate as it is not the role of the courts to legislate, as the majority's approach effectively does, through the creation of bright-line rules in the face of congressional intent. Congress contemplated the majority's concern when it enacted section 365(n), recognizing "that there may be circumstances in which the future affirmative performance obligations under a license cannot be performed in a manner that benefits the estate." S. Rep. No. 100-505, at 4-5. The legislative history indicates that treatment of trademark licenses is one such circumstance.

Accordingly, the BAP was correct to follow the Seventh Circuit's lead in finding that, even though 11 U.S.C. § 365(n) does not provide Mission protection of its license to use Debtor's trademarks, Debtor's rejection of the executory contract does not rescind the Agreement and eviscerate any of Mission's remaining trademark rights. Instead, as Congress has instructed the bankruptcy courts to do, the effect of Debtor's rejection on Mission's trademark license should be guided by the terms of the Agreement, and non-bankruptcy law, to determine the appropriate equitable remedy of the functional breach of contract. I respectfully dissent.

All Citations

879 F.3d 389, 65 Bankr.Ct.Dec. 23, Bankr. L. Rep. P 83,196

Footnotes

1 In addition to the United States, the exclusive geographic territory also included "other countries and territories that [Mission] acquires exclusive distribution rights to pursuant to its first rights of refusal and notice."

2 Although this provision of the statute only refers to the powers of a trustee, per 11 U.S.C. § 1107(a), a Chapter 11 "debtor in possession shall have all the rights ... and powers, and shall perform all the functions and duties, ... of a trustee serving in a case under this chapter." See also In re FBI Distrib. Corp., 330 F.3d at 42 n.8 (citing this provision).

3 We do nevertheless pay great attention to the considered opinion of the three experienced bankruptcy judges who sit on the BAP. Among other things, our consideration of such an opinion reduces the likelihood that our court of general appellate jurisdiction is blindsided by the effect that a decision might have on matters or issues of bankruptcy law and practice that are beyond the ken of the parties in a particular proceeding.

4 Congress ultimately adopted the Senate version, although the language of this section of the House bill is identical to its Senate counterpart.

5 Mission cites Encino Bus. Mgmt., Inc. v. Prize Frize, Inc. (In re Prize Frize, Inc.), 32 F.3d 426 (9th Cir. 1994), but the contract in that case granted an "exclusive license to utilize the proprietary rights." Id. at 427. This case is clearly distinguishable, as Mission was granted no such right.

End of Document