LOEB & LOEB LLP

Advanced Media and Technology Law

ALERT

FEBRUARY 2012

LOEB & LOEB adds Knowledge.

Federal Appellate Court Addresses Assignment of Trademark Licenses in Bankruptcy

A recent decision by the Seventh Circuit Court of Appeals contains two important lessons for anyone drafting documents which contain a trademark license. In *In re XMH Corporation*, the Seventh Circuit held that a licensee may not assign a trademark license in a bankruptcy case over the licensor's objection unless there is an express provision in the agreement containing the license which authorizes an assignment.[1] However, the Court also held that "service contracts" relating to the production of trademarked goods, but not expressly stated to be a license of the trademark, are fully assignable in bankruptcy.

In the wake of *In re XMH Corporation*, trademark owners, licensees, and their advisors must carefully consider whether to include a provision in a licensing agreement allowing the assignment of trademark license. Licensees will need to negotiate for the inclusion of such a provision for any critical trademark licenses that they would wish to convey in the event of a sale of their business. For trademark owners, however, such a provision would override default rules protecting trademark owners and allow debtor-licensees or their successor bankruptcy trustees to assign trademark license agreements to the highest bidder even over the trademark owner's objections. Importantly, given the weight the Seventh Circuit accorded to the labels the parties used, parties must consider how to characterize their agreements: agreements designated as "service contracts" are likely to remain fully assignable in bankruptcy notwithstanding any provisions in the agreement to the contrary, while agreements denominated as "trademark licenses" will likely not be assignable absent an express provision otherwise.

Overview of the XMH Case

After filing for bankruptcy protection under chapter 11 of the Bankruptcy Code, XMH Corporation (formerly Hartmarx), a clothing firm, sought permission from the bankruptcy court to sell the assets of one of its subsidiaries, Simply Blue. As part of such sale, XMH sought to assign an executory contract between Simply Blue and Western Glove Works, another clothing firm. The contract consisted of two phases. During the initial phase, Western Glove granted Simply Blue a license to sell women's jeanswear bearing the trademark "Jag Jeans" in exchange for a 12.5% royalty. The second phase, which only commenced after the license expired, provided that Western Glove would resume selling the trademarked apparel for its own account while Simply Blue would continue to provide various support services, including sourcing, marketing and sales, and merchandising services to Western Glove in exchange for 30% of Western Glove's net sales.

The Seventh Circuit Holds the License Agreement Is Not Assignable

In determining whether XMH could assign the contract at issue, the Seventh Circuit first noted that Section 365(c)(1) of the Bankruptcy Code barred a debtor (here XMH/Simply Blue) from assigning an executory contract if "applicable law" (*i.e.*, any non-bankruptcy law that would otherwise govern the contract) allowed the other party (Western Glove in this case) to refuse to accept performance from the assignee (*i.e.*, the proposed purchasers) irrespective of whether the contract itself prohibited such assignment.[2] It was not surprising that the Seventh Circuit held that trademark law constituted such "applicable law." But the Court went further, holding that in the absence of a contract provision expressly authorizing

[1] *In re XMH Corp*, 647 F.3d 690 (7th Cir. 2011)

[2] Ordinarily, absent some applicable law entitling a party to refuse to accept performance from a substitute party, bankruptcy courts may override contract provisions that limit the assignment of executory contracts. *See XMH Corp.*, 647 F.3d at 695 (citing 11 U.S.C. § 365(f)).

assignment, federal and state trademark law universally barred a licensee from assigning a trademark license over a licensor's objection. The Seventh Circuit explained that such a "default rule" was consistent with the ordinary expectations of a trademark owner because trademarks reflect a shorthand designation of the trademark owner's brand that consumers will use to associate certain characteristics such as a product's quality. Accordingly, in order to ensure the product continues to reflect the expected quality and prevent a deceptive use of the trademark, transfers of trademarks without the owner's consent are barred. Because the contract between Simply Blue and Western Glove omitted any provision authorizing assignment, the Seventh Circuit held that to the extent the contract was a trademark license, it was not assignable – even in bankruptcy – over Western Glove's objection.

However, the Seventh Circuit found that the first phase of the contract, under which Simply Blue licensed the trademark from Western Glove, had already expired, so that by the time the issue of assignability arose, the agreement was nothing more than an ordinary services contract. Therefore, the Seventh Circuit found no reason to preclude the assignment of the agreement.

Western Glove argued that the services portion of the agreement constituted an "implied" license making it unassignable. The Seventh Circuit flatly rejected this argument. While acknowledging that in some circumstances a trademark owner may cede so much responsibility over the trademarked product to a service provider as to constitute a "naked license," the Seventh Circuit found that Western Glove had, to the contrary, retained nearly exclusive control over the product and trademark.

The Court also placed significant weight on the fact that the parties themselves had expressly distinguished the first phase of the contract as a trademark license agreement and the second phase as a services agreement. Had Western Glove wanted to prevent Simply Blue from assigning the service contract without its permission, the Seventh Circuit counseled, Western Glove would merely have had to get Simply Blue to agree to designate it as a trademark sublicense. In the absence of such a designation, however, the Seventh Circuit found the services agreement was assignable.

Advanced Media and Technology Group

KENNETH A. ADLER	KADLER@LOEB.COM	212.407.4284
ROBERT M. ANDALMAN	RANDALMAN@LOEB.COM	312.464.3168
ALISA C. BERGSTEIN	ABERGSTEIN@LOEB.COM	312.464.3155
IVY KAGAN BIERMAN	IBIERMAN@LOEB.COM	310.282.2327
CHRISTIAN D. CARBONE	CCARBONE@LOEB.COM	212.407.4852
TAMARA CARMICHAEL	TCARMICHAEL@LOEB.COM	212.407.4225
NATASHA CHAMILAKIS	NCHAMILAKIS@LOEB.COM	212.407.4853
MARC CHAMLIN	MCHAMLIN@LOEB.COM	212.407.4855
CRAIG A. EMANUEL	CEMANUEL@LOEB.COM	310.282.2262
KENNETH R. FLORIN	KFLORIN@LOEB.COM	212.407.4966
DANIEL D. FROHLING	DFROHLING@LOEB.COM	312.464.3122
DAVID W. GRACE	DGRACE@LOEB.COM	310.282.2108
THOMAS A. GUIDA	TGUIDA@LOEB.COM	212.407.4011
NATHAN J. HOLE	NHOLE@LOEB.COM	312.464.3110
MELANIE HOWARD	MHOWARD@LOEB.COM	310.282.2143
THOMAS P. JIRGAL	TJIRGAL@LOEB.COM	312.464.3150
IEUAN JOLLY	IJOLLY@LOEB.COM	212.407.4810
MICHAEL RIDGWAY JONES	MJONES@LOEB.COM	212.407.4042
JULIE LAND	JLAND@LOEB.COM	312.464.3161
MICHAEL MALLOW	MMALLOW@LOEB.COM	310.282.2287
DOUGLAS N. MASTERS	DMASTERS@LOEB.COM	312.464.3144
NERISSA COYLE MCGINN	NMCGINN@LOEB.COM	312.464.3130
ANNE KENNEDY MCGUIRE	AMCGUIRE@LOEB.COM	212.407.4143
DOUGLAS E. MIRELL	DMIRELL@LOEB.COM	310.282.2151
DANIEL G. MURPHY	DMURPHY@LOEB.COM	310.282.2215
DANIEL O'CONNELL OFFNER	DOFFNER@LOEB.COM	310.282.2252
SETH A. ROSE	SROSE@LOEB.COM	312.464.3177
ROBERT MICHAEL SANCHEZ	RSANCHEZ@LOEB.COM	212.407.4173
ALISON POLLOCK SCHWARTZ	ASCHWARTZ@LOEB.COM	312.464.3169
STEVE A. SEMERDJIAN	SSEMERDJIAN@LOEB.COM	212.407.4218
BARRY I. SLOTNICK	BSLOTNICK@LOEB.COM	212.407.4162
REGAN A. SMITH	RASMITH@LOEB.COM	312.464.3137
BRIAN R. SOCOLOW	BSOCOLOW@LOEB.COM	212.407.4872
WALTER STEIMEL, JR.	WSTEIMEL@LOEB.COM	202.618.5015
AKIBA STERN	ASTERN@LOEB.COM	212.407.4235
JAMES D. TAYLOR	JTAYLOR@LOEB.COM	212.407.4895
MICHAEL A. THURMAN	MTHURMAN@LOEB.COM	310.282.2122
JILL WESTMORELAND	JWESTMORELAND@LOEB.COM	212.407.4019
MICHAEL P. ZWEIG	MZWEIG@LOEB.COM	212.407.4960

Bankruptcy, Restructuring and Creditors' Rights Practice Group

DANIEL B. BESIKOF	DBESIKOF@LOEB.COM	212.407.4129
KARL E. BLOCK	KBLOCK@LOEB.COM	310.282.2225
ERIK W. CHALUT	ECHALUT@LOEB.COM	312.464.3182
DARLENE M. CHO	DCHO@LOEB.COM	310.282.2168
WALTER H. CURCHACK	WCURCHACK@LOEB.COM	212.407.4861
THERESA L. DAVIS	TDAVIS@LOEB.COM	312.464.3188
BERNARD (BARNEY) R. GIVEN II	BGIVEN@LOEB.COM	310.282.2235
WILLIAM M. HAWKINS	WHAWKINS@LOEB.COM	212.407.4126
LANCE JURICH	LJURICH@LOEB.COM	310.282.2211
BENJAMIN KING	BKING@LOEB.COM	310.282.2279
MELISSA A. MICKEY	MMICKEY@LOEB.COM	312.464.3160
DEBRA MINOFF	DMINOFF@LOEB.COM	212.407.4828
MICHAEL L. MOLINARO	MMOLINARO@LOEB.COM	312.464.3166
VADIM J. RUBINSTEIN	VRUBINSTEIN@LOEB.COM	212.407.4092
P. GREGORY SCHWED	GSCHWED@LOEB.COM	212.407.4815
DERRICK M. TALERICO	DTALERICO@LOEB.COM	310.282.2198
JEANNE C. WANLASS	JWANLASS@LOEB.COM	310.282.2399
BLAIR R. ZANZIG	BZANZIG@LOEB.COM	312.464.3128