

Bankruptcy Advisory

Trademark Licensees May Be Protected in a Licensor's Bankruptcy Even After a "Free and Clear" Sale

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BY [KEVIN J. WALSH](#) AND [ERIC R. BLYTHE](#)

The Bankruptcy Code generally permits intellectual property licensees to continue using licensed property despite a licensor's bankruptcy filing. However, because the "intellectual property" definition in the Bankruptcy Code does not include "trademarks," courts have varied on whether trademark licensees receive similar protection. A New Jersey bankruptcy court recently grappled with this issue, concluding that trademark licensees may retain their trademark rights. The court further concluded that such protections remain intact despite a section 363 "free and clear" sale to a third party.

In *In re Crumbs Bake Shop, Inc.*, 2014 Bankr. LEXIS 4568 (Bankr. D.N.J. October 31, 2014), Crumbs Bake Shop, Inc. and its affiliates (collectively, the "Debtors") had entered into licensing agreements with third parties (collectively, the "Licensees"), which allowed the Licensees to utilize the Debtors' trademarks and trade secrets and sell products under the Debtors' brand. After their bankruptcy filing, substantially all of the Debtors' assets were sold to Lemonis Fischer Acquisition Company, LLC ("LFAC") free and clear of all liens, claims, encumbrances, and interests, pursuant to section 363 of the Bankruptcy Code (the "363 Sale"). Following court approval of the 363 Sale, the Debtors moved to reject the Licensees' licensing agreements, which were not included in the assets the Debtors were selling in the 363 Sale.

Bankruptcy Code section 365(n) provides certain protections of the rights of an intellectual property licensee when its debtor-licensor files for bankruptcy and then seeks to reject the license. One such protection is the right to continue using the licensed intellectual property, as embodied on the filing of the bankruptcy, in exchange for royalty payments due under the license. However, 365(n)'s protections are limited to the rights of an "intellectual property" licensee. Section 101(35A)'s definition of "intellectual property" omits "trademarks." Some courts have read the omission to mean that trademarks are not protected under section 365(n). The *Crumbs* court disagreed.

In ruling that trademarks could be protected under section 365(n), the court reviewed legislative history and concluded that trademarks were omitted from the "intellectual property" definition "to allow the development of equitable treatment of [trademarks] by bankruptcy courts." The court also noted that recent legislative action sought to revise the "intellectual property" definition to include trademarks — an attempt to "remedy the omission." Accordingly, the court concluded that courts had the power to decide, on a case-by-case basis, whether trademark licensees could retain their rights under section 365(n). The court ruled that the equities in the present case favored the Licensees since the trademark rights had been bargained away by the Debtors (e.g., were part of the intellectual property license at issue). Thus the Licensees were able to retain their rights under the licensing agreements.

In so holding, the court dismissed LFAC's argument that the "free and clear" 363 Sale trumped or extinguished the Licensees' 365(n) rights. The court held that, absent consent, "nothing in section 363(f) [i.e., the "free and clear" section] trumps, supersedes, or otherwise overrides the rights granted to Licensees under section 365(n)." To LFAC's further detriment, the court also concluded that, because the license agreements were not sold (or assumed and assigned) to LFAC as part of the 363 Sale, LFAC did not receive any rights under the agreements, including the right to receive associated royalties, which were the quid pro quo for the Licensees' continued use of the intellectual property under the licenses. Instead, the court held that the post-closing royalties belonged to the Debtors.



[Kevin J. Walsh](#), Member



[Eric R. Blythe](#), Associate

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This decision outlines important considerations for trademark licensors and licensees, and affects potential bankruptcy sale purchasers. If you have any questions about this advisory or its implications, please call your principal Mintz Levin attorney or one of the attorneys noted on this advisory.

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