

Rejection of Perpetual, Royalty-Free, Exclusive Trademark License Permitted by Eighth Circuit Ruling: *Lewis Brothers Bakeries Inc. v. Interstate Brands Corp.*

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The U.S. Bankruptcy Code generally limits a Chapter 11 debtor-licensor's ability to reject intellectual property licenses, but trademark licenses are not subject to such limitations.¹ Trademark license agreements that are "executory" may be assumed or rejected like other executory contracts pursuant to Section 365 of the Bankruptcy Code.²

In 2010, the U.S. Court of Appeals for the Third Circuit held that a perpetual, royalty-free, exclusive trademark license subject to New York law was not executory and, therefore, could not be rejected. *See In re Exide Tech.*, 607 F.3d 957 (3d Cir. 2010). A recent decision by the Eighth Circuit reached the opposite conclusion, holding that a similar perpetual, royalty-free trademark license subject to Illinois law was executory and could be rejected. *Lewis Brothers Bakeries Inc. v. Interstate Brands Corp. (Interstate Brands)*, No. 11-1850, 2012 U.S. App. LEXIS 18403 (8th Cir. Aug. 30, 2012). A strong dissent argued that the *Interstate Brands* appellate panel should have followed *Exide* and found the license agreement not executory. Both licenses were entered into in connection with the sale of a business.

Background

The trademark license agreement in *Interstate Brands* (the License Agreement) came into being after the U.S. Department of Justice challenged on antitrust grounds a proposed acquisition of a baking company by Interstate Bakeries Corporation (Bakeries). In 1996, to comply with a federal district court divestiture order that governed the acquisition, Bakeries caused its subsidiary, Interstate Brands (Brands), to sell certain Chicago-area business assets and related rights to Lewis Brothers Bakeries (Buyer). Brands and Buyer entered into an asset purchase agreement and the related License Agreement. Under the License Agreement, Buyer received a "perpetual, royalty-free, assignable, transferable, exclusive" license to use certain trademarks and brands in a designated territory. *Id.* at *3.

In late 2004, Bakeries, Brands and certain of their affiliates commenced voluntary Chapter 11 cases in Missouri. When Brands, as Chapter 11 debtor, sought to reject the License Agreement, Buyer filed an adversary proceeding in the bankruptcy court seeking a declaratory judgment that the License Agreement was not "executory" within the meaning of Section 365 of the Bankruptcy Code and, therefore, could not be rejected. The bankruptcy court determined that each of Brands and Buyer had continuing obligations to the other under the license (including a quality control

1 See 11 U.S.C. § 365(n) and 11 U.S.C. § 101(35A) ("intellectual property" includes trade secrets, copyrights, mask work, and patents and other intellectual property protected under Title 35, but does not include trademarks).

2 See, e.g., *In re Old Carco LLC*, 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009); *In re HQ Global Holdings, Inc.*, 290 B.R. 507, 513 (Bankr. D. Del. 2003); *In re Centura Software Corp.*, 281 B.R. 660, 674-75 (Bankr. N.D. Cal. 2002).

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obligation that the License Agreement expressly provided was “material”) and that those continuing obligations rendered the License Agreement executory. The bankruptcy court therefore approved rejection of the License Agreement, and the district court affirmed.

The Eighth Circuit Decision

The Eighth Circuit affirmed the lower rulings that the License Agreement was executory and properly rejected by the Chapter 11 debtor. Relying on its prior decisions, the Eighth Circuit instructed that an executory contract is one “under which the obligation of 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 *6. The Eighth Circuit’s determination centered on “whether any material obligations remain for the parties under the License Agreement.” *Id.* at *12. The Eighth Circuit concluded that “both parties maintain at least one remaining material obligation” because the “plain language” of the License Agreement provided that a “material breach shall include ... a failure ... to maintain the character and quality of goods sold” under the trademarks licensed to Buyer under the License Agreement. *Id.* at *11-14.

The Eighth Circuit recognized the License Agreement’s similarity to the trademark license agreement at issue in the Third Circuit’s decision in *Exide*, including that both license agreements required the licensee to adhere to licensor quality control standards. *Interstate Brands* at *7. However, the Eighth Circuit distinguished the *Exide* agreement and decision. It noted that the Third Circuit had concluded in *Exide* that the parties had not exchanged or even discussed quality standards; as a result, the Third Circuit determined the contractual obligation to adhere to such standards was insufficient to render the *Exide* license executory. *Interstate Brands* at *8-9; *Exide*, 607 F.3d at 964. In *Interstate Brands*, the Eighth Circuit ruled differently on the grounds that the License Agreement expressly provided that the Buyer-licensee’s failure to maintain the quality and character of licensed goods would constitute a material breach. *Interstate Brands*, at *11. The Eighth Circuit concluded that such an express contractual provision is “clearly relevant” to the determination of whether a quality control provision is material and, therefore, supportive of executory status. *Id.* at *12. The Eighth Circuit also concluded that Brands’ ongoing obligations as licensor to maintain and defend the trademarks “are material, thus rendering the agreement executory as to [Brands].”³ *Id.* at *13.

The *Interstate Brands* dissenting opinion asserted that the appellate panel majority focused solely on the License Agreement but should have analyzed the asset purchase agreement and License Agreement together as one unified transaction, as it was in *Exide*. Under such an expanded analysis, “materiality” should be assessed in light of the core purpose of the overall transaction (the sale of Brands’ Chicago-area business operations) rather than solely in the context of the trademark License Agreement.⁴ The dissent argued that because all the tangible assets of the business had been transferred to Buyer and the full purchase price had been paid by Buyer, the remaining obligations under the License Agreement “when considered in the context of the entire agreement ... are relatively minor” and the “integrated agreement is not executory.”⁵

3 The Buyer also argued that the doctrine of judicial estoppel applied and prevented Brands from arguing that the License Agreement was executory. The Buyer contended that Brands had failed to list the License Agreement as an executory contract in its bankruptcy schedules, and had instead treated the transaction as a completed sale. The Eighth Circuit rejected that argument, finding that estoppel requires an underlying promise, and that Brands had not made a promise to sell the trademark.

4 *Id.* at *15.

5 *Id.* at *25, *16.

Implications

The *Interstate Bakeries* and *Exide* decisions highlight the uncertainties in bankruptcy outcomes for parties to perpetual, royalty-free trademark licenses that are rejected by the licensor. Whether a particular license agreement will be deemed “executory” and, therefore, subject to rejection, depends on the facts and circumstances. Where such an agreement is part of larger acquisition transaction, the Third Circuit considered the materiality of the unperformed obligations in light of the overall deal while the Eighth Circuit examined the license on a stand-alone basis.

In either case, the quality control obligations were the primary remaining obligation of the licensee. Such obligations are more likely to be considered material, and, therefore, the basis for a finding that the license is executory, when they are diligently enforced and expressly stated to be material obligations under the license agreement. Accordingly, trademark licensors seeking to preserve their rights to later reject the license agreement may consider including express contractual acknowledgements of materiality similar to those relied upon by the Eighth Circuit in *Interstate Bakeries*, while licensees may consider the opposite tack.