

Icing on the Cupcake for Licensees: Bankruptcy Court Extends Bankruptcy Code § 365(n) Protection to *Crumbs* Trademarks

In the Chapter 11 case of *Crumbs Bake Shop, Inc.* (the “Debtor”), a New Jersey bankruptcy court recently issued an opinion¹ extending to trademark licensees certain protections already expressly available to other intellectual property licensees under Bankruptcy Code § 365(n).² In addition, the Court held that the Debtor could not sell its assets free and clear of such protections and found that any future royalties under the license agreement belonged to the Debtor’s estate.³

The Debtor, famous for its cupcakes, entered into trademark license agreements (the “License Agreements”) with several parties (the “Licensees”). During its bankruptcy case, the Debtor sold its assets to a credit-bidding lender (the “Purchaser”). Following the Court’s approval of the proposed sale, the parties sought a determination from the Court regarding the effect of the sale order on their respective rights under the License Agreements, including whether the Licensees were entitled to any protections after rejection under Bankruptcy Code § 365(n).⁴

Initially, in reaching its conclusion that the License Agreements were covered by Bankruptcy Code § 365(n), the Court declined to follow several prior cases that held that “the omission of trademarks from the definition of intellectual property[⁵] indicates that Congress intended” that a trademark licensee retain no rights to the trademark following rejection.⁶ Instead, the Court followed the reasoning of Judge Ambro in his concurring opinion *In re Exide Technologies*⁷ that relied upon the legislative history of section 365(n) “to allow the development of equitable treatment of [whether trademarks, trade names, and service marks should be covered by section 365(n)] by bankruptcy courts”.⁸ The Court noted that, in the context of “sale cases, which currently dominate the retail Chapter 11 landscape, monetary recoveries primarily benefit . . . lenders and administrative claimants[, where] [m]inimal 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.”⁹ Thus, the Court concluded that it “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)” and found that “it would be inequitable to strip the within Licensees of their rights in the event of a rejection”¹⁰

¹ *In re Crumbs Bake Shop, Inc., et al.*, Case No. 14-24287 (ECF No. 296) (Revised Opinion, dated 10/31/14; docketed 11/3/2014). All cites are to the Court’s opinion available on PACER or at <https://cases.primeclerk.com/crumbs/>.

² *Crumbs*, at 5-12.

³ *Crumbs*, at 12-21.

⁴ *Id.*, at 3-5. Bankruptcy Code § 365(n) allows a non-debtor licensee under a rejected intellectual property license agreement to elect either to treat the agreement as terminated and assert a claim for monetary damages, as with other rejected executory contracts, or to continue performing and paying royalties under the license agreement for its remaining term, minimizing adverse effects of rejection.

⁵ “Intellectual property” is defined in Bankruptcy Code § 101(35A) to mean a list of categories, such as patents, copyrights, and trade secrets, with no mention of trademarks.

⁶ *Id.*, at 8; *see, generally*, 5-9.

⁷ 607 F.3d 957, 966 (3d Cir. 2010).

⁸ *Crumbs*, at 8-9 (*quoting* S. Re. No. 100-505, at 5).

⁹ *Id.*, at 9.

¹⁰ *Id.*

CAHILL

Next, the Court found that the broad free and clear relief purportedly granted in the sale order under Bankruptcy Code § 363(b) and (f) did not nullify the Licensees' rights under Bankruptcy Code § 365(n).¹¹ Specifically, the Court emphasized that the Licensees had not impliedly consented to such relief because they did not receive sufficient notice to be bound by those provisions.¹² Moreover, the Court held that the specific provisions of section 365(n) overrode the more general language of section 363, relying in part on cases involving Bankruptcy Code § 365(h), which analogously provides tenants under leases with protections following rejection.¹³

Lastly, the Court found that the Debtor's estate, rather than the Purchaser, was entitled to any post-closing royalties under the License Agreements because the purchase agreement specifically excluded such agreements from the purchased assets.¹⁴ Presumably, the Purchaser had not anticipated that it would need to purchase the License Agreements that it thought would be rejected with no further licensee rights.

Although the *Crumbs* decision does appear to expand the application of Bankruptcy Code § 365(n) beyond the explicit statutory text, the underlying analysis is fact specific, and there are likely other situations where the Court might not have used its equitable powers to provide trademark licensees with such expanded protection. Nonetheless, the decision could serve as a basis for other courts to provide trademark licensees with rights that purchasers may not otherwise have expected. It would be prudent for parties to consider such a possibility when structuring a sale transaction. In addition, purchasers may consider making clear that royalty payments would be excluded assets only to the extent license agreements are rejected with no remaining licensee rights under section 365(n), but if it is determined that licensees have such rights, the licenses would be included in purchased assets.

* * *

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Joel H. Levitin at 212.701.3770 or jlevitin@cahill.com or Richard A. Stieglitz Jr. at 212.701.3393 or rstieglitz@cahill.com or Stephen J. Gordon at 212.701.3454 or sgordon@cahill.com.

¹¹ *See, generally, id.*, at 12-20.

¹² *Id.*, at 12-17.

¹³ *Id.*, at 17-20.

¹⁴ *Id.*, at 20-21.