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ALERT MEMORANDUM

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Eighth Circuit Holds that Trademark License Granted As Part of Sale Agreement is Not Executory

On June 6, 2014, the United States Court of Appeals for the Eighth Circuit held that a trademark license agreement that Interstate Bakeries Corporation ("IBC") entered with Lewis Brothers Bakeries, Inc. ("LBB") as part of a sale of certain business lines was not executory and that IBC therefore could not reject the agreement under § 365(a) of the Bankruptcy Code. *See Lewis Bros. Bakeries, Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, No. 11-1850, 2014 WL 2535294 (8th Cir. June 6, 2014) ("*Interstate II*"). An eleven-judge *en banc* panel reversed the earlier holding of the same court[1] and held that the license agreement was part of an integrated asset-sale agreement that was no longer executory because both parties had substantially performed their obligations thereunder. The *Interstate II* opinion demonstrates a high burden for establishing "executoriness" of trademark license agreements and adds to the decisions in this evolving area of law.

Background

Interstate II is the latest in a series of cases directly or indirectly addressing the proper treatment of trademark licenses in bankruptcy. Unlike many other forms of intellectual property, trademarks are not covered by § 365(n) of the Bankruptcy Code, which provides in relevant part that if a debtor rejects an executory contract under which the debtor is a licensor of intellectual property, the licensee has the option "to retain its rights . . . under such contract."[2] As a result of the omission of trademarks from the intellectual property protected under § 365(n), courts continue to debate the effect of rejection of executory trademark license agreements,[3] and the possibility that such rejection will operate as a termination of the agreement puts additional pressure on the threshold question whether the agreement under review is executory.

[1] *Lewis Bros. Bakeries, Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, 690 F.3d 1069 (8th Cir. 2012) ("*Interstate I*").

[2] 11 U.S.C. § 365(n)(1)(B). § 365(n) was passed to overwrite *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers, Inc.)*, 756 F.2d 1043 (4th Cir. 1985), which held that rejection of a patent license terminated the licensee's rights in the patent. Given the definition of "intellectual property" set forth in § 101(35A) of the Bankruptcy Code, § 365(n) covers, among other things, patents and copyrights, but does not cover trademarks. Legislative history discloses that the omission was not intended to "address the rejection of executory trademark," even though the consequences of such rejection were of concern after decisions like *Lubrizol*. S. Rep. No. 100-505, 5, reprinted in 1988 U.S.C.C.A.N. 3200, 3204. Congress, at that time, believed further study of trademarks was needed because trademark licensing agreements generally included provisions regarding "control of the quality of the products or services sold" that were beyond the scope of the legislation. *Id.*

[3] *Compare e.g.*, *Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC*, 686 F.3d 372 (7th Cir.), *cert. denied*, 133 S. Ct. 790 (2012) (holding that rejection of an executory trademark license does not terminate the licensee's rights in the license) *and In re Exide Techs.*, 607 F.3d 957 (3d. Cir. 2010) (Ambro, J., concurring) (same), *with In re Old Carco LLC,* 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009) (rejection of executory trademark license terminates licensee's rights in the license) *and In re HQ Global Holdings, Inc.,* 290 B.R. 507, 513 (Bankr. D. Del. 2003) (same).

Prior to entering bankruptcy, and in order to comply with an antirust divestiture decree, Interstate had entered into a $20 million Asset Purchase Agreement and License Agreement with LBB, under the terms of which LBB purchased the business operations of Butternut Bread and Sunbeam Bread from IBC in certain territories. The License agreement granted LBB a "perpetual, royalty-free, assignable, transferable, exclusive" license to use those brands and trademarks in the relevant territories. The Purchase Agreement and the License Agreement were executed together on the same day, reference each other, and define the "Entire Agreement" to comprise both agreements. The parties agreed to allocate $8.12 million of the total sale price to intangible assets, including the trademark licenses, and the remaining $11.88 million to the various tangible assets.

When Interstate Bakeries filed for bankruptcy under Chapter 11, LBB commenced an adversary proceeding in bankruptcy court, seeking a declaratory judgment that the License Agreement was not executory.[4] In keeping with universal practice, the bankruptcy court applied the "Countryman" test of executoriness, under which a contract is executory if the obligations of both the debtor 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.[5] The bankruptcy court identified 17 ongoing obligations that it deemed material, including mutual obligations to maintain the quality of goods produced under the trademarks, and held that the License Agreement was executory. On appeal, the district court affirmed on largely the same grounds, laying special emphasis on the fact that the parties had agreed that failure to maintain quality standards (by LBB) would constitute a "material breach" of the agreement.[6]

On further appeal in *Interstate I*, the Eighth Circuit again affirmed on largely the same grounds. The *Interstate I* court concluded, consistent with the district court, that LBB's obligation to maintain quality standards was material because the parties had declared it to be material. Notably, the *Interstate I* panel examined the License Agreement in isolation rather than as part of an integrated agreement with the Purchase Agreement.[7]

Thereafter, LBB moved for rehearing en banc. The bases for LBB's motion for rehearing were (1) the conflict with the Third Circuit's majority opinion in *In re Exide Techs.*, which had held in arguably analogous circumstances that a license agreement that was properly viewed as

[4] *Lewis Bros. Bakeries, Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, No. 04-45814, 2010 WL 2332142 (Bankr. W.D. Mo. June 4, 2010).

[5] *See* Vern Countryman, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 460 (1973).

[6] *Lewis Bros. Bakeries, Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, 447 B.R. 879 (W.D. Mo. 2011).

[7] Judge Colloton authored a lengthy dissent, *Interstate I*, 690 F.3d at 1076, that argued that the contracts at issue should have been reviewed as a single, integrated asset-sale agreement and that, in that context, the alleged ongoing obligations were relatively minor.

part of an integrated asset-sale agreement was not executory;[8] (2) the "exceptional[] importance" of the issue for the structuring of intellectual property transactions, and (3) Judge Colloton's dissent.[9] The Federal Trade Commission, at the invitation of the court, filed an amicus brief to present "the government's views on the proper application of the executory contract doctrine . . . to contracts that implement antitrust divestiture decrees."[10] The Commission argued primarily that allowing a debtor to reject, and thereby terminate, a license that had been granted as part of an antitrust decree would thwart the remedial purpose of such decrees. The Eighth Circuit granted rehearing *en banc*.

Eighth Circuit's *En Banc* Opinion

The *Interstate II* panel reversed, holding that (1) the relevant agreement was the integrated asset-sale agreement comprising the License Agreement and the Purchase Agreement, (2) the Countryman test of executoriness is the same as a test whether the parties have rendered substantial performance under the relevant agreement, and (3) both parties had substantially performed under the integrated agreement, such that it was no longer executory. *Interstate II*, 2014 WL 2535294 at *5-7.

In holding that the License Agreement and the Purchase Agreement constituted a single integrated agreement, the *Interstate II* panel relied on relevant state law for the proposition that "where two or more instruments are executed by the same contracting parties in the course of the same transaction, the instruments will be considered together . . . because they are, in the eyes of the law, one contract." *Id*. at *5. In light of this principle and the facts that the agreements were entered contemporaneously, referenced each other, and referred to each other as part of the "Entire Agreement," the panel concluded that the two agreements must be evaluated together as an integrated asset-sale agreement. *Id.*

The panel then held that "the doctrine of substantial performance . . . is inherent in the Countryman definition of executory contract." *Id.* at *6. Again looking to state law, the panel defined substantial performance as "performance in all the essential elements necessary to the accomplishment of the purposes of the contract." *Id.* Thus, in order for a contract to be executory, both parties must have performed less than all of the essential elements for accomplishment of the purpose of the agreement. *Id.*

The panel concluded that IBC had substantially performed its obligations under the integrated agreement, rendering the License Agreement, non-executory. The panel stated:

[8] *See Exide*, 607 F.3d at 964.

[9] Appellants' Petition for Rehearing En Banc, *In re Interstate Bakeries Corp.*, No. 11-1850 (8th Cir. filed Jan. 2, 2013).

[10] Brief for the United States and the Federal Trade Commission as Amici Curiae in Support of Rehearing, *In re Interstate Bakeries Corp.*, No. 11-1850 (8th Cir. filed May 31, 2013).

> IBC has transferred all of the tangible assets and inventory to LBB, executed the License Agreement, and received the full $20 million purchase price. . . . IBC's remaining obligations concern only one of the assets included in the sale—the license. They involve such matters as . . . notice and forbearance with regard to trademarks . . . maintenance and defense of the marks, and other infringement-related obligations. When considered in the context of the entire agreement, these remaining obligations are relatively minor and do not relate to the central purpose of the agreement to sell the Butternut and Sunbeam bread operations to LBB in certain territories."

Id. at 7. The panel then explicitly aligned itself with the Third Circuit's similar analysis in *Exide* and stated, "[f]or similar reasons, we conclude that the License Agreement between IBC and LBB is not executory." *Id.* Given the panel's holding, it declined to consider whether rejection of an executory license operates as a termination or whether a special rule should be adopted for license agreements that implement antitrust divestiture decrees. *Id.* at nn.1-2.

Three judges of the panel filed a separate opinion dissenting from most of the majority's analysis. *Id.* at 8-10. The dissent argued that both parties had ongoing material obligations under the License Agreement, even when the License Agreement was properly viewed as part of the integrated agreement. Specifically, the dissent argued that LBB's quality control obligation—made explicitly "material" in the agreement—was material, and that IBC's obligation to refrain from marketing its products under the licensed marks in the relevant territories was also material. *Id.* at 9. The dissent made reference to—but denied that it relied for its conclusions upon—the fact that the purpose of the integrated agreement was to comply with an antitrust divestiture decree, which decree would be violated by IBC's continued use of the licensed marks. *Id.*

Significance of the Opinion

The *Interstate II* opinion, especially when taken together with *Exide*, indicates that at least some courts impose a high standard for finding license agreements executory when such agreements arise as parts of larger asset sales. This standard may offer some comfort to parties contemplating license agreements in the context of asset sales. However, in any context, the executoriness inquiry remains fact-specific and thus an uncertain source of guidance. Even in cases where trademark license agreements are found to be executory, courts continue to grapple with the effect of a rejection of a license on the licensee's continued right to use licensed trademark.

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