Sunbeam Products, Inc., v. Chicago American Manufacturing, LLC 686 F.3d 372 (7th Cir. 2012)

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BACKGROUND

Plaintiff Sunbeam Products, Inc. ("Sunbeam"), doing business as Jarden Consumer Solutions ("Jarden") is a producer of many small household appliances such as blenders, toasters, and box fans. Sunbeam manufactures these appliances for sale throughout the United States.

Defendant Chicago American Manufacturing, LLC ("CAM"), is a manufacturing company that produces a wide range of products. Many outside companies contract with CAM for production of these products as a more cost-efficient way of manufacturing.

In 2008, Lakewood Engineering & Manufacturing Co. ("LEM") produced and sold a large variety of consumer products to many different retailers such as Sears, Wal-Mart, and Ace Hardware. All of LEM's products were covered by its patents and trademarks. LEM contracted the manufacture of box fans to CAM because LEM was losing money making the box fans itself. The contract authorized CAM to make fans that practice LEM's patents and to use the LEM mark on them. CAM would then ship the products directly to retailers per LEM's instructions. CAM was hesitant to invest the money required to gear up for production because LEM had not assured CAM payment due to being in financial distress. LEM provided assurance for CAM by authorizing CAM to sell the 2009 run of its box fans for its own account if LEM did not purchase them.

In February 2009, three months into the contract, LEM was involuntary placed into bankruptcy proceedings by some of LEM's creditors. The court-appointed trustee sold LEM's patents and trademarks to Plaintiff Sunbeam, doing business as Jarden. Jarden did not want the LEM-branded fans that CAM had in inventory, nor did Jarden want CAM to sell those fans in competition with Jarden's own products. The court-appointed trustee for LEM rejected the executory portion of the contract with CAM under 11 U.S.C. § 365(a). CAM continued to produce and sell LEM-branded fans. In response, Jarden filed an adversary action. In district court, the bankruptcy judge concluded that CAM was entitled to make the estimated number of box fans required under the contract. This led to judgment in favor of CAM, and Jarden appealed.

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ISSUE

The United States Court of Appeals for the Seventh Circuit faced one issue: whether rejection of Lakewood's trademark license through bankruptcy deprived CAM, the licensee, of utilization and right to use the licensed mark.

DECISION

The trustee's rejection of LEM's contract with CAM did not abrogate CAM's contractual rights. The court found that a bankruptcy trustee's rejection of a contract did not limit a licensee's contractual rights. Under Section 365(g) of the Bankruptcy Code, rejection of a contract constitutes a breach of a contract, not a termination. The court held in favor of CAM.

REASONING

The bankruptcy court determined that the LEM-CAM contract was ambiguous and decided that CAM could make the 1.2 million box fans to meet its estimated need. The court of appeals held that the bankruptcy court did not err in the reading of the contract.

When an intellectual property license is rejected in bankruptcy, courts have relied on *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). *Lubrizol* held that the licensee cannot use any licensed intellectual property after the contract has been rejected. In 1988, Congress added § 365(n) to the Bankruptcy Code, which allowed licensees to use the intellectual property after the contract is rejected in bankruptcy under certain conditions. The addition to the Bankruptcy Code defined intellectual property to include only patents, copyrights, and trade secrets. 11 U.S.C. § 101(35A) (2006). Although it must not be read further or seen as codifying *Lubrizol*, trademark was omitted from the definition.

The court decided that it was necessary to determine whether *Lubrizol* had understood § 365(g) correctly. Section 365(g) specifies consequences of a rejection under § 365(a). Here, the court found that *Lubrizol* was mistaken in its belief that if a contract had been eligible for rejection under § 365(a), the licensee could have continued using the trademarks. The belief is proven incorrect by § 365(g), which states that a rejection of the trademark license constitutes a breach of such contract, and not a termination. By classifying the rejection as a breach, the other party's rights remain, and a debtor is not subject to an order of specific performance.

The court noted that LEM's trustee never asserted that the contract could be avoided through rescission under 11 U.S.C. §§ 544–51 (2006). The trustee's rejection of the contract under § 365(a) was not "the functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions they occupied before the contract was formed." *Thompkins v. Lil' Joe Records, Inc.*, 476 F.3d 1294, 1306 (11th Cir. 2007). Instead, a rejection "frees the estate from the

obligation to perform" and "has absolutely no effect upon the contract's continued existence." *Id.*

Lubrizol has been widely criticized and did not persuade the court here. The court held that "[b]ecause the trustee's rejection of Lakewood's contract with CAM did not abrogate CAM's contractual rights, this adversary proceeding properly ended with a judgment in CAM's favor." *Sunbeam Products*, 686 F.3d at 378.