



News & Types: Commercial, Competition & Trade Update

Bankruptcy of Licensor Threatens Twenty Year Old Trademark License in M&A Transaction

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Practices: Commercial, Competition & Trade

Merger and acquisition transactions frequently have included ongoing obligations of the parties to each other. In a recent decision by the Third Circuit Court of Appeals, a trademark licensee in a 1991 acquisition survived an effort by the bankrupt licensor to overturn the license. (*In re: Exide Technologies*, U.S. Third Circuit Court of Appeals, No. 08-1872 filed June 2, 2010) The case illustrates that the time in which agreements in a merger and acquisition transaction remain at issue can be longer than would be expected.

In 1991, Yuasa Battery (America), Inc. (now known as EnerSys Delaware, Inc.) acquired the industrial battery business of Exide Technologies. (Yuasa Battery, after some of its own separate mergers and restructurings, became known as EnerSys Inc. and then EnerSys Delaware, Inc.) As part of the acquisition, Exide granted to EnerSys a perpetual, royalty-free license to use the "Exide" trademark in the industrial battery business. But Exide retained license rights to the "Exide" trademark outside of the industrial battery business.

In 2000, Exide decided it wanted to return to the North American industrial battery market. It tried, unsuccessfully, to regain the trademark from EnerSys. EnerSys's refusal to return the trademark rights to Exide thwarted Exide's strategy to unify its corporate image under a single name and trademark.

Exide returned to the industrial battery market by purchasing the industrial battery business of GNB Industrial Battery Company. In one of the ironies that M&A transactions often create, Exide was forced to compete with industrial batteries sold by EnerSys under its former "Exide" trademark. But Exide's 2002 bankruptcy gave it an opportunity to regain the "Exide" trademark in the industrial battery business.

The opportunity arose from the ability of a debtor under Chapter 11 of the Bankruptcy Code to reject an "executory contract." (11 U.S.C. 365(a)). Since the goal of a Chapter 11 bankruptcy is the rehabilitation of the debtor, the Bankruptcy Code permits a debtor, subject to court approval, to reject an executory contract, thus permitting a debtor to avoid the burden of contracts it considers to be hindrances to its rehabilitation. As defined by the court, an "executory contract" is one under which "the obligation of both 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."

Exide argued that the 1991 license was an executory contract that represented unperformed obligations on the part of both Exide and EnerSys. Therefore, Exide was free to reject the license agreement and restore the

"Exide" trademark to itself. Both the U.S. Bankruptcy Court and the U.S. District Court agreed with Exide. EnerSys appealed.

The Appeals Court reversed, finding that the license agreement was not "executory" because EnerSys had "substantially performed" its obligations under its agreement with Exide. Although Exide asserted that EnerSys had remaining unperformed obligations, the Appeals Court determined that these were not material obligations, some of which had even expired in 1994, three years after the acquisition. As a result of the Appeals Court decision, Exide's efforts to regain its trademark remained unsuccessful.

There was a concurring opinion by Judge Ambro which provided another interesting basis under which EnerSys could retain the "Exide" trademark. Under a 1985 case, a licensor's bankruptcy resulted in the termination of a licensee's rights under a technology license. (*Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.* 756 F.2d 1043 (4th Cir. 1985)). At the time, even the *Lubrizol* court acknowledged that permitting rejection could have a "chilling effect" on the willingness of parties to contract with parties in financial difficulty. Congress apparently agreed and, in response, amended the Bankruptcy Code to permit an intellectual property licensee, faced with a bankrupt licensor attempt's to reject the contract, to either treat the contract as terminated or to retain rights under the contract. Therefore, if the amendment could be applied to the *Exide* situation, then EnerSys could still retain its rights to the "Exide" trademark. But, in a notable omission, the definition of "intellectual property" in the amendment did not include trademark rights.

Judge Ambro noted cases reasoning, by negative inference, that the omission of trademark licenses meant that bankrupt licensors could still reject these license agreements and take back trademark rights. But Judge Ambro did not agree with these cases. He cited the Senate report that accompanied the Bankruptcy Code amendment stating that the omission of trademarks was not because Congress felt trademark licenses should not be protected. Rather, it was because trademark licenses depend on quality control of the products sold by the licensee and this is an area beyond the scope of the amendment. The Senate report went on to say that Congress intended to allow development of "equitable treatment" of this situation by bankruptcy courts. From this, Judge Ambro concluded that the court could have used its equitable power to deny Exide's efforts to reject the trademark license.

Therefore, if there is an appeal, EnerSys could have two bases to argue for its retention of the trademark rights - first, that the trademark license is not an executory contract and second, that the court has equitable power, endorsed by Congress, to continue the trademark license agreement.

In either case, it is very interesting to read a case that deals with a merger and acquisition transaction nearly twenty years earlier and that is based on a series of events that the parties almost certainly did not anticipate.