

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re)	Case No. 01-32164-DM
)	
CENTURA SOFTWARE CORPORATION,)	Chapter 11
dba Mbrane, aka Mbrane)	
Incorporated, Raima, Centura)	
Solutions, Vista Development)	
Corporation,)	
)	
Debtor.)	
<hr/>		
RAIMA UK LIMITED,)	Adversary Proceeding
an English corporation,)	No. 01-3239
)	
Plaintiff,)	
)	
v.)	
)	
CENTURA SOFTWARE CORPORATION,)	
dba Mbrane, aka Mbrane)	
Incorporated, Raima, Centura)	
Solutions, Vista Development)	
Corporation,)	
)	
Defendant.)	
<hr/>		

MEMORANDUM DECISION ON MOTIONS FOR PARTIAL SUMMARY JUDGMENT

I. INTRODUCTION

The court has been asked to decide what appears to be a question of first impression: following a debtor's rejection of a license agreement that grants a counter-party a license to use the debtor's software and trademarks, may the counter-party continue

1 to use the trademarks after electing to retain its rights in the
2 software? While the result may appear harsh to the counter-party,
3 the court concludes that once a license has been rejected, the
4 counter-party may not continue to use the trademarks.

5 Two motions have been filed in this adversary proceeding
6 involving a dispute over rights asserted by Plaintiff Raima UK
7 Limited ("Raima UK") to continue to market and sell software
8 products under trademarks owned by Debtor/Defendant Centura
9 Software Corporation ("Centura US"). Raima UK filed its motion
10 for partial summary judgment ("Setoff Rights Motion"), requesting
11 a determination that (1) its exercise of setoff rights was proper,
12 (2) Centura US' termination of Raima UK's license agreement
13 ("Raima UK Trademark Agreement") was therefore invalid and
14 improper, and (3) Raima UK is entitled to the fees and costs it
15 has incurred in obtaining the order invalidating the termination.
16 Centura US and the Committee of Unsecured Creditors ("Committee")
17 filed their joint motion for partial summary judgment pursuant to
18 11 U.S.C. § 365(n)¹ ("365(n) Motion"). They requested a
19 determination that, under § 365(n), Raima UK could not retain any
20 trademark or obtain specific performance rights under the rejected
21 Raima UK Trademark Agreement.

22 The matter came on for hearing on June 14, 2002. Dillon E.
23 Jackson, Esq. appeared for Raima UK. David Caplan, Esq. and
24 Michael B. Schwarz, Esq. appeared for Centura US and Committee,
25 respectively. For the reasons set forth below, the court will

26
27 ¹ Unless otherwise indicated, all chapter, section and rule
28 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330 and
to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036.

1 grant the 365(n) Motion and deny the Setoff Rights Motion.

2 **II. FACTS²**

3 Raima UK was a wholly-owned English subsidiary of Raima
4 Corporation ("Raima US"). Under the Raima UK Trademark Agreement,
5 Raima US granted Raima UK the exclusive right to market and sell
6 its software ("Raima Software") under its trademarks ("Raima
7 Trademarks") in the United Kingdom, Channel Islands, and the
8 Republic of Ireland ("the UK market"). In return, during the term
9 of the agreement, Raima UK was to pay a minimum of \$100,000.00 in
10 license fees for each fiscal year ending March 31. In December
11 1995, Raima UK was sold to a third party. Subsequently, in a
12 reverse triangular merger in June 1999, Centura US acquired all
13 Raima US' rights, title, and interest in Raima Software and Raima
14 Trademarks, including its rights under the Raima UK Trademark
15 Agreement. Centura UK was, and still is, a wholly-owned
16 subsidiary of Centura US.

17 On November 30, 2000, in order to exploit the UK market,
18 Centura UK entered into an agreement ("Centura UK Agreement") with
19 Raima UK. The Centura UK Agreement was a sublicense which
20 provided Centura UK the right to sell Raima Software under Raima
21 Trademarks in the UK market. Centura UK was to pay Raima UK the
22 license fees for its sales, and Raima UK would in turn pay Centura
23 US pursuant to the Raima UK Trademark Agreement. Section 10.5 of
24 the Centura UK Agreement ("Section 10.5") also provided that, in
25 the event that Centura UK delays or fails to pay Raima UK any fees
26 resulting from its sale, Raima UK "will have the right to set off

27
28 ² The following discussion constitutes the court's findings
of fact and conclusions of law. Fed. R. Bankr. P. 7052(a).

1 such delayed or unpaid amounts against any amounts payable by
2 Raima UK to Centura [US] or Centura UK.”

3 Raima UK asserts that, because of Centura UK’s sale of Raima
4 Software, Centura UK became obligated in December 2000 to pay
5 Raima UK approximately \$38,000.00 in license fees. When Centura
6 UK failed to pay, Raima UK held back \$20,000.00 from its First
7 Quarter 2001 license fees payment due Centura US. After the
8 setoff, it paid Centura US approximately \$82,000. Raima UK
9 contends that by exercising its right of setoff, pursuant to
10 Section 10.5 and making the payment, it satisfied its obligation
11 to pay Centura US the annual minimum license fee of \$100,000.

12 In June 2001, Centura UK went into liquidation in England.
13 Subsequently, in August 2001, Centura US filed its Chapter 11
14 petition in this court. It then terminated the Raima UK Trademark
15 Agreement on November 5, 2001, on the grounds that Raima UK had
16 failed to pay the minimum license fees.

17 On November 18, 2001, this court issued a Stipulated Order
18 Approving Rejection of License Agreements. The order provided for
19 the rejection of the Raima UK Trademark Agreement, with Raima UK
20 retaining any rights it may have under § 365(n).

21 On November 21, 2001, Raima UK filed a complaint against
22 Centura US commencing this adversary proceeding. It alleged that
23 it was not in breach of any obligation under the Raima UK
24 Trademark Agreement and it was entitled to market and sell Raima
25 Software under Raima Trademarks in the UK market. It also prayed
26 for an order directing Centura US or its predecessors to provide
27 software updates and documentation. In addition, it requested
28 attorney fees and costs incurred for filing the complaint. On

1 January 17, 2002, Centura US filed its answer and counterclaims.
2 Its counterclaims included a request for the determination that
3 Raima UK does not retain any rights to use the trademarks under
4 the rejected Raima UK Trademark Agreement. After this court
5 granted Committee's Stipulation to Intervene, Committee also filed
6 similar counterclaims on May 10, 2002.

7 On March 29, 2002, Raima UK filed the Setoff Rights Motion,
8 seeking partial summary judgment that the termination was invalid
9 because the setoff of \$20,000 was a proper exercise of its rights
10 under Section 10.5. It requested a determination that, although
11 Centura US was not a signatory to the Centura UK Agreement, it was
12 nonetheless bound by Section 10.5 (among other provisions) because
13 Centura UK was its agent. Centura US and the Committee denied any
14 agency relationship and opposed this Setoff Rights Motion.

15 On May 17, 2002, Centura US and Committee filed the 365(n)
16 Motion, seeking partial summary judgment requesting the court to
17 determine that § 365(n) does not protect Raima UK's rights to
18 Raima Trademarks in the rejected agreement.

19 **III. DISCUSSION**

20 A. Setoff Rights Motion

21 1. Burden of Proof

22 Under Rule 7056, incorporating Federal Rules of Civil
23 Procedure Rule 56, the moving party must come forward with
24 evidence which would entitle it to a directed verdict if the
25 evidence went uncontroverted at trial. Houghton v. South, 965
26 F.2d 1532, 1537 (9th Cir. 1992). Once that burden is met, it
27 shifts to the non-moving party, "who must present significant
28 probative evidence tending to support its claim or defense."

1 Intel Corp. v. Hartford Accident & Indem. Co., 952 F.2d 1551, 1558
2 (9th Cir. 1991). Summary judgment should only be granted where
3 the evidence shows "no genuine issue as to any material fact and
4 that the moving party is entitled to a judgment as a matter of
5 law." Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986).

6 2. Whether Centura UK was Centura US' Agent Is a Question
7 of Fact

8 The first question is whether an agency relationship existed
9 between Centura US and Centura UK. If undisputed facts establish
10 that one existed, then Centura US was bound by the Centura UK
11 Agreement and Section 10.5. The court would then determine if it
12 was proper for Raima UK to have exercised its setoff rights
13 against the minimum payment required by the Raima UK Trademark
14 Agreement. If the court determines that the exercise was proper,
15 it would grant the Setoff Rights Motion. However, if the facts
16 fail to establish that Centura UK was an agent, the court will not
17 be able to reach a conclusion as to whether Centura US was indeed
18 bound as a matter of law, and would therefore deny the motion.
19 Because Section 16 of the Raima UK Trademark Agreement states that
20 the agreement shall be governed and construed in all respects by
21 English law, English law applies in the court's determination of
22 the existence of agency.

23 Under English law, an agency relationship may be established
24 in many ways, including actual or apparent authority. 2 Chitty on
25 Contracts ¶ 32-020.³ One of the ways to establish actual

26
27 ³ The relevant English substantive law on the creation of
28 agency is similar to U.S. law. Under U.S. law, agency may be
established by an express or implied agreement between the
principal and the agent. Restatement (Second) of Agency § 1

1 authority is by presenting proof of express authorization by the
2 principal. Id. ¶ 32-025. To establish ostensible agency, the
3 party asserting the existence of the relationship must prove that
4 the principal, (1) by its conduct, created an appearance of
5 agency, (2) made a representation of such authority to a third
6 party, and (3) caused him or her to rely on the appearance of
7 agency.⁴ Guenter Treitel, The Law of Contract, pp. 658-60 (10th
8 ed. 1999).

9 Raima UK alleged that Centura UK had express or ostensible
10 authority to act on Centura US' behalf. Therefore, for its
11 partial summary judgment motion to be granted, Raima UK must
12 establish, without any genuine issue of material fact, one of the
13 following: either Centura US had expressly authorized Centura UK
14 to be its agent, or Centura US had, (1) by its conduct, created
15 the appearance that it had authorized Centura UK to be its agent,
16 (2) made a representation of such authority to Raima UK, and (3)
17 caused Raima UK to rely on the appearance of agency. See id.

18
19
20
21
22

23 (1958). It can also be established by apparent or ostensible
24 authority. 3 Am. Jur. 2d *Agency* § 342 (2002).

25 ⁴ These elements constituting ostensible authority are again
26 comparable to the elements in U.S. agency law. Under U.S. law,
27 the party asserting the relationship must demonstrate that the
28 principal, (1) by its conduct, created an appearance of agency,
(2) caused him or her to reasonably believe that the putative
agent is either an employee or an agent of the principal, and that
(3) he or she thereby justifiably relied on the appearance of
agency. 3 Am. Jur. 2d *Agency* § 342.

1 3. Raima UK Did Not Carry Its Burden of Proof Under Its
2 Actual Agency Theory Because Material Facts Regarding
 Centura US' Conduct Are In Dispute

3 Whether Centura US had expressly authorized Centura UK to be
4 its agent is a disputed fact. It is also material because, had
5 there been in fact an express authorization, Centura US would be
6 bound by the Centura UK Agreement. To make a prima facie showing
7 that Centura US had expressly authorized Centura UK to be its
8 agent, Raima UK relied on the declaration of Mr. James Bush
9 ("Bush"), a former Centura UK employee. In his declaration, Bush
10 testified that he was expressly directed by Mr. John Bowman
11 ("Bowman"), who was at the time both Chief Operating Officer of
12 Centura US and director of Centura UK, to represent both Centura
13 UK and Centura US in the negotiations with Mr. Don Wood ("Wood")
14 of Raima UK. He testified that Bowman had asked him and Wood to
15 formulate a proposal for the Centura UK Agreement. This evidence
16 was corroborated by Wood's declaration. However, the existence of
17 express authority was called into question by Bowman. In his
18 declaration, Bowman testified that he did not give Bush any
19 authority to act on behalf of Centura US. He declared that he did
20 not suggest to anyone, including Wood, that Bush had the authority
21 to bind Centura US. In addition, he stated that he had authorized
22 Bush to negotiate the agreement only in his capacity as Director
23 of Centura UK, not as Chief Operating Officer of Centura US.

24 Bowman's declaration was probative and supportive of Centura
25 US' and Committee's defense that Centura US had never expressly
26 authorized Centura UK to be its agent in the negotiations.
27 Viewing the evidence in a light most favorable to Centura US, the
28 declaration has raised a factual dispute whose materiality

1 precludes a determination that Centura US had expressly authorized
2 Centura UK to be its agent, thereby binding itself to the Centura
3 UK Agreement. Accordingly, Raima UK's partial summary judgment
4 motion based on an actual agency theory must be denied.

5 4. Raima UK Did Not Carry Its Burden of Proof Under Its
6 Ostensible Agency Theory Because Material Facts
7 Regarding Centura US' Representation Are In Dispute

8 As stated above, in order for its partial summary judgment
9 motion based on ostensible authority to be granted, Raima UK must
10 prove, with no material facts in dispute, that Centura US had, (1)
11 by its conduct, created the appearance that it had authorized
12 Centura UK to be its agent, (2) made a representation of such
13 authority to Raima UK, and (3) caused Raima UK to rely on the
14 appearance of agency. See id. Here, facts regarding Centura US'
15 conduct remain controverted.

16 To support elements (1) and (2), Raima UK relied on the Wood
17 and Bush declarations. Wood testified that Bowman had told him
18 that he was responsible for Centura US' relationship with Raima UK
19 and that he would oversee all negotiations. Wood and Bush both
20 testified that Bush needed Bowman's approval before signing the
21 Centura UK Agreement and that the roles of the Centura companies
22 were blurred.⁵ If Raima UK could establish without dispute that
23 Bowman, in his capacity as an officer of Centura US, had delegated
24 the actual negotiations to Bush and expressly represented to Wood
25 that he was to oversee the process, Centura US would have, by its

26 ⁵ Wood's declaration stated that the roles of the Centura
27 companies were blurred by Centura US' delegation to Centura UK the
28 handling of license fee reports, sales reports, orders, and
collections under the Raima UK Trademark Agreement. In addition,
the two companies shared the same e-mail address,
"@centurasoft.com."

1 conduct, represented to Raima UK that it was the principal behind
2 the negotiations. Elements (1) and (2) would thus be satisfied.
3 Likewise, if the roles of the companies were indeed obscure in
4 every respect, those facts could reasonably establish that Centura
5 US had created the appearance that it had appointed Centura UK as
6 its agent.⁶ However, such facts are in dispute. As stated
7 earlier, Bowman testified that he did not represent to Wood, Bush,
8 or anyone that Bush had the authority to negotiate on Centura US'
9 behalf. He also testified that the roles of Centura US and
10 Centura UK were distinct because they were two separate
11 corporations, with Bush working only for the latter. He further
12 stated that no representative of Centura US, in an official
13 capacity, had reviewed the agreement prior to signing. Therefore,
14 because the evidence brought forth by Raima UK is both material
15 and disputed by Centura US, the court must also deny Raima UK's
16 summary judgment motion based on the theory of ostensible
17 authority. See American Cas. Co. v. Krieger, 181 F.3d 1113, 1121
18 (9th Cir. 1999) (unless only one conclusion may be drawn,
19 existence of an ostensible agency is a question of fact and should
20 not be decided on summary judgment). See also C.A.R.
21 Transportation Brokerage Co. v. Darden Restaurants, Inc., 213 F.2d
22 474, 479 (9th Cir. 2000) (summary judgment is inappropriate in
23 ostensible agency cases unless only one conclusion can be implied
24 from the circumstances).

25
26 ⁶ Under the doctrine of ostensible authority, representation
27 of authority can be express or implied. Treitel, The Law of
28 Contract, pp. 658. It could be implied from a course of dealing
or by placing the agent in such a position that it is reasonable
for third parties to assume that the agent has the principal's
authority. Id.

1 5. If Centura US was bound by the Centura UK Agreement,
2 Raima UK Was Entitled to Set Off Centura UK's Unpaid
3 License Fees Against the Minimum License Fees It Owed
4 Centura US

5 In their opposition to the motion, Centura US and the
6 Committee argued that, even if the Centura UK Agreement was
7 binding on Centura US, and Raima UK did have the right to setoff,
8 it did not have the right to set off against its \$100,000.00
9 minimum license fee obligation to Centura US. They alleged that,
10 because the setoff provision does not change the Raima UK
11 Trademark Agreement's requirement of a minimum payment of
12 \$100,000.00, and Raima UK had only paid approximately \$82,000.00,
13 its termination of the agreement was therefore proper. The court
14 disagrees. Because when interpreting a contract, "[t]he court
15 will look first at the literal terms of the written document and
16 determine what the terms mean from the ordinary language used,"⁷
17 this court looks to the language of the setoff provision. Section
18 10.5 states:

19 In the event that Centura UK delays or fails to make any
20 of the payments due to Raima UK hereunder, Raima UK will
21 have the right to set off such delayed or unpaid amounts
22 against any amounts payable by Raima UK to Centura [US] or
23 Centura UK from time to time including such amounts
24 arising out of the UK Rights Agreement [Raima UK Trademark
25 Agreement].

26 The language of the provision is unambiguous. It allows Raima UK
27 to setoff amounts owed by Centura UK against any amounts it owes
28 to Centura US, including any amounts arising out of the Raima UK

29 ⁷ Jason Chuah, The Factual Matrix in the Construction of
30 Commerical Contracts - The House of Lords Clarifies, I.C.C.L.R.,
31 12(12), 294, 295 (2001) (analyzing the principles of contract
32 interpretation under English contract law, stating that courts
33 should look to the natural reading of the contract and delve into
34 facts regarding surrounding circumstances if the contract is
35 ambiguous).

1 Trademark Agreement. The ordinary meaning of the word "any"
2 therefore gives Raima UK the right to set off Centura UK's unpaid
3 license fees against the license fees Raima UK owes to Centura US,
4 regardless of what the amounts are.

5 In this motion, Wood's and Bush's testimony that Centura UK
6 sold Raima Software in the UK market and had thus obligated itself
7 to license fees due Raima UK is uncontroverted. However, whether
8 Centura UK was in arrears under the Centura UK Agreement was in
9 dispute. While Wood testified that Centura UK did not pay its
10 fees, Bowman stated that none of the directors or officers of
11 Centura US has any knowledge of any non-payment by Centura UK.
12 Therefore, although Raima UK may have had the right to set off,
13 because whether Centura UK indeed owed money is in dispute, the
14 court cannot determine whether Centura US' termination was proper
15 at this time.

16 Assuming, however, that Centura US was bound by Section 10.5
17 and that Centura UK did owe Raima UK license fees amounting to at
18 least \$18,000.00, Centura US' termination of the Raima UK
19 Trademark Agreement would have been improper. This is because, in
20 that case, not only had Raima UK properly exercised its setoff
21 rights, it had also exercised them in a timely manner. Before the
22 2000-2001 license fees payment deadline (28 days after March 31,
23 2001), Raima UK paid Centura US approximately \$82,000.00 after a
24 setoff of \$20,000.00. Because these amounts together exceed the
25 \$100,000.00 minimum required by the Raima UK Trademark Agreement
26 and because the payment was timely made, Raima UK's setoff did not
27 breach the Raima UK Trademark Agreement's minimum license fee
28 provision.

1 B. 365(n) Motion

2 Section 365 provides for the assumption or rejection of
3 executory contracts or leases in existence at the commencement of
4 a bankruptcy case. Lawrence P. King et al., Collier on Bankruptcy
5 ¶ 365.01 pp. 365-17 (15th ed. Rev. 2002). If the trustee or
6 debtor-in-possession assumes a contract, it is not interrupted and
7 the contracting parties' rights are undisturbed. Id. ¶
8 365.03[2]. If, however, a contract is rejected, the debtor is
9 deemed to have breached it, and the estate will lose any benefit
10 from the contract. Id. The result for the counter-party is a
11 prepetition claim under § 365(g). Id. Nevertheless, § 365 does
12 not always leave the counter-party with only a breach claim. Hon.
13 Joe Lee, 2B Bankr. Service L. Ed. § 21:2 (2002). Some provisions
14 within § 365 permit certain contracting parties more rights than
15 afforded by § 365(g). Id. For example, § 365(h) protects a non-
16 debtor lessee of a rejected real property lease or timeshare plan
17 by providing the lessee the option to remain in possession. Id.
18 § 365(i) deals with land and timeshare sale contracts, providing a
19 non-debtor purchaser the opportunity to either terminate or remain
20 in possession of the contract despite the rejection. Id. The
21 provision at issue in this motion is § 365(n) which gives the
22 rejection of intellectual property licenses special treatment.
23 Id.

24 In October 1988, in reaction to the harsh holding of Lubrizol
25 Enterprises, Inc. v. Richmond Metal Finishers, Inc. (In re
26 Richmond Metal Finishers, Inc.), 756 F.2d 1043 (4th Cir. 1985),
27
28

1 cert. denied, 106 S.Ct. 1285 (1986),⁸ Congress enacted the
2 Intellectual Property Licenses in Bankruptcy Act (IPLBA) to
3 protect licensees' rights to intellectual property in the event of
4 a bankruptcy.⁹ Pub. L. No. 100-506, 102 Stat. 2538 (1988). The
5 critical provisions of IPLBA were codified as § 365(n) and
6 § 101(35A), and their purpose is "to make clear that the rights of
7 an intellectual property licensee to use the licensed property
8 cannot be unilaterally cut off as a result of the rejection of the
9 license."¹⁰ S. Rep. No. 100-505, 100th Cong., 2d Sess. 5 (1988),
10 *reprinted in* 1988 U.S.C.C.A.N. 3200, 3207.

11 In this motion, if the court determines that Raima UK's
12 rights to use Raima Trademarks under the Raima UK Trademark
13 Agreement are protected under § 365(n), Raima UK, as the licensee,
14 will have two options. See William L. Norton, Jr., 6A Norton
15 Bankr. L. & Prac. 2d § 150:18 (2002). Raima UK can either treat

17 ⁸ The Lubrizol court allowed a Chapter 11 debtor to reject
18 a non-exclusive technology license agreement, leaving the non-
19 bankrupt party with only a money damage remedy, but no further
20 rights under the agreement to use the technology. Lubrizol does
not involve trademarks.

21 ⁹ See Patrick Law, Intellectual Property Licenses and
Bankruptcy - Has the IPLBA Thawed the "Chilling Effects" of
22 Lubrizol v. Richmond Metal Finishers?, 99 Com. L. J. 261 (1994)
23 ("Law, IPLBA") (IPLBA was enacted to reverse Lubrizol's chilling
effect on the development and licensing of intellectual property).

24 ¹⁰ See Robert T. Canavan, Comment, Recent Trends in
Bankruptcy Law, 21 Seton Hall L. Rev. 800, 802-03 (Congress
25 enacted IPLBA in order to prevent a technology licensor/debtor
from unilaterally terminating intellectual property interests of
26 the licensee). See also Law, IPLBA, at 264 (the purpose of
27 § 365(n) is "to encourage investment in intellectual property and
to protect the right of licensees who contribute financing,
28 research, development, manufacturing or marketing skill by
limiting the power of the licensor to reject executory
contracts").

1 the rejection as a breach and file a prepetition claim for
2 damages, or it can opt to retain its rights under the Raima UK
3 Trademark Agreement notwithstanding the rejection. See id. By
4 electing to retain its rights, under § 365(n)(1)(B), Raima UK will
5 continue to enjoy the exclusive rights to market and sell Raima
6 Software under Raima Trademarks in the UK market for the remaining
7 term of the agreement, plus any extension periods.¹¹ In return,
8 however, Raima UK will not have any right to seek specific
9 performance from Centura US regarding any post-rejection upgrades
10 or patches on Raima Software. See Joseph M. Bassano et al., 9C
11 Am. Jur. 2d Bankruptcy § 2209 (2002). In addition, under
12 § 365(n)(2)(B), Raima UK will continue to pay all license fees
13 under the agreement.¹² Also, pursuant to § 365(n)(2)(C), it will
14 waive its rights to setoff or administrative claim on any post-
15 rejection damages relating to the Raima UK Trademark Agreement.¹³
16 If the court determines that § 365(n) does not protect Raima UK's
17 trademarks rights, Raima UK will not be able to use Raima
18 Trademarks.¹⁴ Although it has elected to retain its § 365(n)-
19 protected rights to market and sell Raima Software (not disputed

21 ¹¹ See Canavan, Comment, Recent Trends in Bankruptcy Law, 21
22 Seton Hall L. Rev. at 803 (under IPLBA, licensees of intellectual
23 property are permitted to continue its use of the technology for
24 the duration of the contract, notwithstanding the rejection).

24 ¹² Noreen M. Wiggins, The Intellectual Property Bankruptcy
25 Protection Act: The Legislative Response to Lubrizol Enterprises,
26 Inc. v. Richmond Metal Finishers, Inc., 16 Ru. C. T. L. J. 603,
27 624 (1990) ("Wiggins, Legislative Response").

26 ¹³ See id.

27 ¹⁴ David M. Jenkins, Licenses, Trademarks, and Bankruptcy, Oh
28 My!: Trademark Licensing And The Perils of Licensor Bankruptcy, 25
J. Marshall L. Rev. 143, 144 (1991) ("Jenkins, Perils").

1 by Centura US), as far as Raima Trademarks are concerned, it will
2 be left with but a § 365(g) claim for damages resulting from being
3 unable to use the trademarks in its business.¹⁵

4 1. The Plain Language of § 365(n) Excludes Trademark Licenses

5 There are no reported cases which directly interpret § 365(n)
6 and analyze its effects on rejected trademark licenses. The plain
7 language of the statute, however, indicates that § 365(n) does not
8 include trademark licenses. In addition, as will be discussed
9 later, the scholarly writings in the subject matter weigh
10 significantly towards the exclusion of trademarks from § 365(n)
11 protection.

12 Section 365(n) states that a licensee may elect to retain its
13 rights if the rejected license is one of "intellectual property."
14 According to § 101(35A), intellectual property "means" (A) trade
15 secret, (B) invention, process, design, or plant protected under
16 title 35, (C) patent application, (D) plant variety, (E) work of
17 authorship protected under title 17, or (F) mask work protected
18 under chapter 9 of title 17. By using the more limiting term
19 "means" instead of "includes," Congress has deliberately limited §
20 365(n) protection only to the intellectual property enumerated by
21 the statute.¹⁶ It has expressly withheld § 365(n) protection from
22

23 ¹⁵ See id.

24 ¹⁶ William L. Norton, Jr., Norton Bankr. L. & Prac. 2d §
25 39:57 (2002) (the Code defines intellectual property broadly to
26 protect virtually all types of rights *other than trademarks*)
27 (emphasis added). See also Warren E. Agin, Drafting the
28 Intellectual Property License: Bankruptcy Considerations, 9 J.
Bankr. L. & Prac. 591 (2000) (§365(n) does not provide protection
for licenses for the use of a trademark); Richard F. Broude,
Executory Contracts and Unexpired Leases in Bankruptcy, SC 37 ALI-
ABA 553, 608 (1997) (§ 365(n) does not cover the rejection of

1 rejected executory trademark licenses.¹⁷

2 Consistent with the statutory language, 365(n)'s legislative
3 history also explicitly states that "the bill does not address the
4 rejection of executory trademark, trade name or service mark
5 licenses." S. Rep. No. 505 100th Cong., 2d Sess. 5 at 3206.
6 Although Congress admitted that the rejection of trademark
7 licenses is "of concern" because of the harsh interpretation of §
8 365 by the Lubrizol court, "such contracts raise issues beyond the
9 scope of this legislation." Id.

10 2. It Is Inappropriate to Resort to Legislative History When
11 the Statute Is Clear

12 Raima UK asked the court to weigh the equities and allow it
13 to retain its trademark rights under the rejected Raima UK
14 Trademark Agreement. It argued that, despite the clear language
15 of § 365(n), legislative history to that section reveals that
16 Congress intended to allow "the development of equitable treatment
17 of this [trademark licenses rejection] situation by bankruptcy
18 courts." S. Rep. No. 505 100th Cong., 2d Sess. 5 at 3206.
19 Legislation on the issue was "postponed" because trademark
20 licensing relationships depend "to a large extent on control of
21 the quality of the products or services sold by the licensee" and
22 was in need of more congressional study. Id.

23 Although the cited legislative history may suggest the
24 possibility that Congress intended an equitable treatment for

25 _____
26 executory trademark); Law, IPLBA, 99 Com. L. J. at 271 (Congress
27 explicitly chose to exclude trademarks, trade names, and service
marks from the protection of the IPLBA).

28 ¹⁷ Norton, Norton Bankr. L. & Prac. 2d § 39:57.

1 rejected trademarks, the language of § 365(n) is unambiguous. If
2 a statute can be interpreted on its face, it is not necessary to
3 delve into its legislative history. Lomas Mortg. USA v. Wiese,
4 998 F.2d 7642 (9th Cir. 1993). This is because, where the
5 language is clear, judicial inquiry is complete. Barnhart v.
6 Sigman Coal Co., Inc., 534 U.S. 438 (2002). Here, the clarity of
7 § 365(n) makes it unnecessary and inappropriate to look into its
8 legislative history. See id. Because Congress has unambiguously
9 indicated that trademark licenses are to be excluded from §
10 365(n), it does not allow the court to weigh the equities of this
11 case.

12 The court agrees with the dicta in Gucci v. Sinatra (In re
13 Gucci), 126 F.3d 380 (2d Cir. 1997). Although Gucci only
14 determined whether purchasers of a debtor's business had acted in
15 good faith and did not analyze directly the treatment of rejected
16 trademarks, the court suggested that the language of § 365(n)
17 excludes trademarks from its protection.¹⁸ Id. at 394. In its
18 discussion of public policies regarding debtor's intent to
19 terminate trademark licenses, it stated that "Congress
20 specifically excluded trademark licensees from this [§ 365(n)]

21
22 ¹⁸ At the same time, however, the court also stated that the
23 "effects of a rejection of a trademark licensing agreement are a
24 mater that remains to be litigated." Gucci, 126 F.3d at 394 n.1.
25 More significantly, it questioned whether the "transfer of rights
26 in a trademark should not be rescinded as a consequence of
27 rejection, but, should be subject to continued enjoyment by the
28 licensee." Id. (quoting Richard Lieb, The Interrelationship of
Trademark Law and Bankruptcy Law, 64 Am. Bankr. L.J. 1, 37
(1990)). Therefore, while stating that § 365(n) does not cover
trademarks, the Second Circuit also brought into question whether
the rejection of a trademark licensing agreement, even without
§ 365(n)'s protection, means that the licensee can still continue
to use the license. See id. This issue is further discussed in
section 3.

1 protection accorded other intellectual property licensees." Id.
2 at 394.

3 To support its argument that the court should balance the
4 equities in this case in its favor, Raima UK relies on In re
5 Matusalem, 158 B.R. 514, 521 (Bankr. S.D. Fl. 1993). In
6 Matusalem, the court refused to authorize the rejection of a
7 franchise agreement which included the exclusive right to make and
8 market rum using debtor's secret formula and trade name. Looking
9 beyond the language of § 365(n) into its legislative history, the
10 court stated that "the ball is back in the Court's court" and
11 proceeded to weigh the economic benefits of a rejection against
12 its costs. Id. Because the court found that rejection would
13 render not only no economic benefit to the estate but also a
14 certainty that the licensee's business would be destroyed, it
15 refused to authorize the rejection. Id. at 522. As a result the
16 licensee was allowed to enjoy its rights to both the secret
17 formula and the trademark. Id. Although Matusalem may, on its
18 surface, seem to support Raima UK's equitable treatment argument,
19 it is not persuasive for two reasons. First, Matusalem considered
20 § 365(n) in a pre-rejection context, not -- as here --
21 post-rejection. Secondly, Matusalem's dicta does not suggest an
22 extension of § 365(n) protection to trademarks upon a balancing of
23 equities.

24 The Raima UK Trademark Agreement and the franchise agreement
25 in Matusalem both involve trademarks and other protected
26 intellectual property (collectively, "bundle of rights"). There,
27 the court had before it an incredible history of inter-family
28 litigation and regarded the bankruptcy as a bad faith filing,

1 suspected the bona fides of the debtor's business prospects, and
2 most importantly, was asked to decide whether to allow rejection.
3 Here, that decision was made by the stipulated order. The only
4 question for the court to deal with now is what rights Raima UK
5 has in the Raima Trademarks following rejection.

6 Although § 365(n) is relevant to bankruptcy courts' decisions
7 both before and after rejection, its implications are
8 significantly different. Norton, 6A Norton Bankr. L. & Prac. 2d §
9 150:18. While, pre-rejection, § 365(n) is only used as a guide or
10 a factor in the determination of whether a contract should be
11 rejected, it controls the adjudication of the licensee's rights
12 once rejection is approved. Id. Although bankruptcy courts are
13 to determine whether contracts should be rejected in view of the
14 licensee's rights under § 365(n), § 365(n) dictates what happens
15 after rejection. Id. The court has little choice at that point.
16 The Code itself states that § 365(n) applies "[i]f the trustee
17 rejects an executory contract under which the debtor is a licensor
18 of a right to intellectual property." Therefore, because § 365(n)
19 governs intellectual property rights post-rejection and it
20 explicitly excludes trademarks, in order to protect their entire
21 bundle of rights, licensees like Raima UK "must assert their
22 rights early in the case, before the franchisor [licensor]
23 receives court approval of its rejection decision."¹⁹ Id. The

24
25 ¹⁹ To protect the entire bundle of rights under an
26 intellectual property contract, according to Norton, timing is
27 important. To shield its trademark rights, the licensee must
28 intervene before the court approves of the debtor's efforts to
reject the agreement. Assuming the bankruptcy court applies a
business judgment test in adjudicating whether a contract should
be rejected, the issue before the bankruptcy court at that time

1 licensees must at that time persuade the bankruptcy court to weigh
2 the equities and not to reject the agreement because its
3 trademarks are integrally linked to other intellectual property.

4 Id.

5 Here, unlike the Matusalem contract which was pending
6 rejection, the Raima UK Trademark Agreement has already been
7 rejected by stipulation. Therefore, while the Matusalem court
8 appropriately weighed the equities of the debtor's business
9 judgment, with an eye towards the licensee's § 365(n) rights, the
10 court has no such business judgment to evaluate here.²⁰ What is
11 before the court is only the application of § 365(n). Because of
12 the difference in timing, the issue before Matusalem is
13 distinguishable from the motion at bar.

14 More importantly, the court disagrees with Raima UK's
15 interpretation of Matusalem's dicta. Raima UK argued that the
16 Matusalem court looked beyond the plain meaning of the statute and

17
18
19 would be whether the debtor's business judgment supports the
20 rejection of the agreement in view of the licensee's right under
21 § 365(n), namely the right to continue using the protected
22 intellectual property without the related trade name. At that
23 time, the licensee should argue that the relatedness of the trade
24 name to the protected property should allow it to "bootstrap
25 ongoing trademark rights through an application of the business
26 judgment rule," notwithstanding the Bankruptcy Code's exclusion of
27 trademarks. Norton, 6A Norton Bankr. L. & Prac. 2d § 150:18.

28 ²⁰ When evaluating debtor's rejection request, the Matusalem
court properly considered the licensee's trademark rights under
§ 365(n) in its business judgment test. Explaining one of its
rationales for denying debtor's request, the court stated that
"the Debtor has failed to demonstrate good business judgment or
even mediocre business judgment. There is no economic benefit to
the estate and its unsecured creditors from a rejection of
[licensee's] franchise agreement either under the court's
interpretation of § 365(n) or under the Debtor's interpretation of
it." 158 B.R. at 522.

1 had, upon a weighing of equities, extended protection to rejected
2 trademark licenses. When discussing the licensee's post-rejection
3 rights, the court stated:

4 Even if rejection was permitted, it would not automatically
5 result in the termination of [licensee's] exclusive rights
6 within its territorial area to the secret process and
7 formulas used to make rum products or [licensee's] exclusive
8 rights to manufacture and sell these products within its
9 territorial area. . . . Thus, rejection under § 365(n) would
10 not deprive [licensee] of its rights under the franchise
11 agreement. Matusalem, 158 B.R. at 522.

12 Nowhere in the dicta, however, did the Matusalem court extend §
13 365(n) protection to trademarks. It only stated that, upon
14 rejection, the licensee could continue to use the § 365(n)-
15 protected secret recipe to exclusively manufacture and sell rum.
16 It did not mention that the licensee could retain any rights to
17 use its trademarks.²¹ In fact, later, it even stated that the
18 rejection would "make the Debtor potentially liable for a
19 rejection claim," implying that the licensee would be entitled to
20 file a breach claim for losing its trademark rights. Id.

21 In addition, because alternative grounds existed for its
22 holding, the court disagrees that the Matusalem court denied the

23 ²¹ Professor Klee interpreted Matusalem's dicta as a
24 conclusion that § 365(n) is controlling where a trademark is
25 integrally linked to a protected intellectual property. Kenneth
26 N. Klee, The Effects of Bankruptcy on Intellectual Property
27 Rights, SG001ALI-ABA 407, 412 (2001). His analysis appears to be
28 based on a misunderstanding of what the court said. He assumed
that the rights referred to included the licensee's trademark
rights. He stated, "These rights presumably included the
nondebtor licensee's right to the continued use of the debtor's
trademark." Id. Because the rights the Matusalem court referred
to included only the rights protected by § 365(n), Professor
Klee's reliance was misplaced.

1 rejection on the basis of § 365(n)'s legislative history.²² Other
2 reasons for the denial included the court's determination that a
3 rejection would be of bad business judgment. See id. at 522. It
4 could also have denied the rejection solely because the debtor had
5 filed for bankruptcy in bad faith. Id. Further, Matusalem did
6 not mention § 365(n)'s exclusion of trademarks or discuss any
7 post-rejection quality control concerns raised by Congress.²³ For
8 these reasons, Raima UK cannot rely on Matusalem's dicta to
9 protect its rejected trademark licenses. Because § 365(n) is
10 controlling post-rejection and it does not protect trademarks, the
11 court holds that Raima UK cannot retain any trademark rights under
12 the rejected Raima UK Trademark Agreement. It cannot continue to
13 use Raima Trademarks in its sale of Raima Software but, as
14 discussed in the next section, it is entitled to file an unsecured
15 pre-petition claim for damages resulting from not being able to
16 use such trademarks.

17
18 ²² See Stuart M. Riback, The Interface of Trademarks and
19 Bankruptcy, 387 PLI/Pat 53, 75 (1994) (cautioning that the
20 Matusalem court could have rested its holding that rejection was
21 improper entirely on alternative grounds articulated in the
opinion and the peculiar facts of the case, it is therefore
unclear if its holding will have any impact beyond the court that
decided it).

22 ²³ See Madlyn Gleich Primoff, E-Commerce and Dot-Com
23 Bankruptcies: Assumption, Assignment and Rejection of Executory
24 Contracts, 8 Am. Bankr. Inst. L. Rev. 307, 344 (2000) (the
25 Matusalem Court did not address the fact that trademarks are
plainly not subject to § 365(n) protection, so a trademark
licensee cannot rely exclusively on § 365(n) to prevent rejection
by a trustee from stripping it of its right under its license).
26 See also Stuart M. Riback, Intellectual Property Licenses: The
27 Impact of Bankruptcy, 672 PLI/Pat 201, 211 (2001) (the dictum did
28 not mention or discuss the issues of post-rejection quality
control and have "sunk without a trace. . . so it would seem that
the Lubrizol analysis continues to govern licensor rejection of
trademark licenses").

1 3. The Rejected Trademarks Entitle Raima UK to a § 365(q)
2 Claim For Breach

3 At the hearing, Raima UK partly relied on Gucci's footnote,
4 quoted in footnote 18 above, that despite the rejection of a
5 trademark license and lack of § 365(n) protection, the licensee
6 may still continue to use the trademark. See 126 F.3d at 394 n.1.
7 In an article cited by the Gucci court, Mr. Richard Lieb suggested
8 that "the transfer of rights in a trademark should not be
9 rescinded as a consequence of rejection, but, should be subject to
10 continued enjoyment by the licensee." Lieb, The Interrelationship
11 of Trademark and Bankruptcy Law, 64 Am. Bankr. L. J. at 37.
12 However, Mr. Lieb did not support his statement with any
13 authority. In fact, both pre and post-amendment cases as well as
14 scholarly writings suggest that, upon the rejection of a trademark
15 license, Lubrizol's harsh holding controls, and the licensee is
16 left with only a claim for breach.²⁴

17 For example, in In re Chipwich, Inc., 54 B.R. 427 (Bankr.
18 S.D.N.Y. 1985), a pre-§ 365(n) case, the court authorized the
19 rejection of licenses to produce and sell dairy products under
20 debtor's trademark. Notwithstanding "the obvious adverse
21 consequences for contracting parties thereby made inevitable," the
22 court followed Lubrizol and rejected the trademark, holding that

23 ²⁴ See Riback, Intellectual Property Licenses: The Impact of
24 Bankruptcy, 672 PLI/Pat at 211 (the Lubrizol analysis continues to
25 govern licensor rejection of trademark licenses"). See also
26 Jenkins, Perils, 25 J. Marshall L. Rev. at 144 (unprotected by §
27 365(n) from the harsh Lubrizol treatment, rejection of trademarks
28 extinguishes the licensee's rights to use them, giving rise to
 devastating consequences); Wiggins, Legislative Response, 16 Ru.
 C. T. L. J. at 613 (though not involving trademarks, Lubrizol has
 nonetheless been significantly relied upon both before and after
 the 1987 amendment, especially in cases dealing with rejection of
 technology agreements not covered by § 365(n)).

1 "equitable considerations may not be indulged by courts." Id. at
2 431 (quoting Lubrizol, 756 F.2d at 1048). Like Lubrizol, it
3 stated that the rejection left the licensee with only an allowable
4 claim for damages resulting from debtor's breach of agreement
5 under § 365(g)(1).²⁵ Id. at 431.

6 More significantly, Lubrizol's holding that rights under an
7 executory contract are terminated upon rejection was also followed
8 in a post-amendment trademark case. In Blackstone Potato Chip Co.,
9 Inc. v. Mr. Popper, Inc. (In re Blackstone Potato Chip Co., Inc.),
10 109 B.R. 557 (Bankr. D. R.I. 1990), the court authorized the
11 rejection of a trademark license, noting that any rejection will
12 inevitably entail the disappointment of legitimate expectations.
13 Without discussing § 365(n), the court approved the rejection
14 based on an application of the business judgment test. Id. It
15 then relied on Lubrizol and stated that, upon rejection, the
16 licensee was left with no rights to use the trademarks. Id. at
17 562. Rather, the court held that it was entitled to only a
18 general unsecured claim for the debtor's breach of its executory
19 contract.²⁶ Id.

21 ²⁵ See Wiggins, Legislative Response, 16 Ru. C. T. L. J. at
22 614 (although the Chipwich decision on trademarks was rendered
23 before the enactment of § 365(n), its practical result "remains
24 unaffected by the changes Congress made to section 365 since the
definition of intellectual property in the 1987 amendment does not
include trademarks").

25 ²⁶ There is significant consensus among courts and scholars
26 regarding the licensee's rights under a rejected trademark
27 license. See Michael T. Andrew, Executory Contracts in
28 Bankruptcy: Understanding 'Rejection', 59 U. Colo. L. Rev. 845,
919 (1988) (unless protected by § 365(n), the rejection of a
technology contract is to be treated as if the debtor has broken a
promise and will not perform its obligations, thereby giving the
non-debtor a basis for a breach claim under § 365(g)); Norton, 6A

1 **IV. CONCLUSION**

2 Because Raima UK had failed to bring forth undisputed
3 evidence that Centura UK was Centura US' actual or ostensible
4 agent, the court is unable to determine, as a matter of law, that
5 Centura US was bound by the Centura UK Agreement. Therefore,
6 despite the finding that, had Centura US been bound, Raima UK
7 would have been able to set off Centura UK's unpaid fees against
8 the minimum license fees it owed Centura US, the court must
9 nevertheless deny Raima UK's Setoff Rights Motion.

10 Because § 365(n) plainly excludes trademarks, the court holds
11 that Raima UK is not entitled to retain any rights in Raima
12 Trademarks under the rejected Raima UK Trademark Agreement. As a
13 result of the rejection, Raima UK's remedy was to file a claim
14 under § 365(g) for its damages resulting from the breach.

15 Therefore, the court hereby denies Raima UK's Setoff Rights
16 Motion and grants Centura and the Committee's 365(n) Motion.

17 The court is concurrently herewith entering orders disposing
18 of the two motions as set forth above. In view of the disposition
19 of these two motions, the court will conduct a status conference
20 to discuss with counsel the future of this adversary proceeding.
21 That status conference will take place on August 30, 2002, at 2:30
22 P.M. The parties do not need to file status conference statements

23
24 Norton Bankr. L. & Prac. 2d § 150:18. (because § 365(n) does not
25 apply to trademarks, once a trademark license is rejected, the
26 licensee cannot continue using the trademark and is left with a
27 general unsecured claim against the debtor's bankruptcy estate);
28 Riback, The Interface of Trademarks and Bankruptcy, 387 PLI/Pat at
66 (rejection of a trademark license can potentially destroy
licensee's business because it is deemed to be a prepetition
breach by the debtor and only gives rise to a prepetition claim
for damages under §§ 365(g) and 502(g); specific performance is
not an available remedy).

1 prior to the hearing.

2 Dated: July 24, 2002

3

S/
Dennis Montali
United States Bankruptcy Judge

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28