Intellectual Property and Tech Transactions Update

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Notable Developments

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Notable Developments

Supreme Court to Settle Circuit Split on Treatment of Trademark Licenses Following Brand Owner Bankruptcy

On October 26, 2018, the U.S. Supreme Court granted certiorari in *Mission Product Holdings Inc. v. Tempnology, LLC*, a case in which the Supreme Court is expected to resolve a circuit split as to whether a bankrupt trademark owner may revoke a licensee's right to use its trademark.

Under 11 U.S.C. § 365, the Bankruptcy Code allows a debtor to reject executory contracts to free itself from contractual obligations that interfere with its ability to reorganize. Interpreting Section 365, in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, the Fourth Circuit held that the rejection of an intellectual property license, which is considered an executory contract, by a debtor terminates the licensee's rights under the license, finding that Section 365 was intended to provide only a damages remedy to the licensee. However, in response to *Lubrizol*, Congress enacted Section 365(n) to protect licensees from being stripped of intellectual property rights following a debtor's rejection of a contract containing an intellectual property license. Section 365(n) gives the licensee a choice between retaining intellectual property rights under the license or treating the license as terminated and asserting a claim for damages. However, 11 U.S.C. § 101(35A) defines "intellectual property" to include patents, copyrights and trade secrets, among other forms of intellectual property, but omits trademarks.

Accordingly, courts have disagreed on whether the rejection of a trademark license under Section 365 terminates the licensee's rights under the contract and limits its remedy to damages or if the licensee may continue to use the licensed trademark. For example, in *In re Exide Technologies*, the Third Circuit held that a trademark license, when taken as part of an integrated collection of agreements, could be found to be non-executory and unable to be rejected under Section 365. Separately, in *Sunbeam Products, Inc. v. Chicago Manufacturing, LLC*, the Seventh Circuit held that rejection of a contract in bankruptcy under Section 365 is merely a breach and, in bankruptcy, as in general, a breach does not eliminate the other party's rights under the contract. Consequently, the licensee could continue to use the licensed trademarks. In another approach, in *In re Crumbs Bake Shop, Inc.*, the U.S. Bankruptcy Court for the

District of New Jersey held that the omission of "trademarks" was not decisive and that courts should apply equitable principles to Section 365(n) to determine whether a licensee could retain its trademark rights on a case-by-case basis.

In *In re Tempnology, LLC*, the First Circuit disagreed with these approaches. Mission Product Holdings Inc. was a licensee of Tempnology under a co-marketing and distribution agreement which provided Mission with exclusive distribution rights to certain of Tempnology's cooling accessories and a non-exclusive license to use Tempnology's trademarks to sell these products. After Tempnology filed a petition for Chapter 11 bankruptcy, it moved to reject a number of its contracts, including the agreement with Mission. The bankruptcy court allowed Tempnology to reject the agreement subject to Mission's election to preserve its rights under Section 365(n), but concluded that the omission of trademarks from the definition of intellectual property rights retainable under Section 365(n) meant that Mission's rights to use Tempnology's trademarks terminated.

On appeal, the First Circuit agreed with the bankruptcy court, finding that because the statutory definition of "intellectual property" includes such specific forms as "mask works" and "plant varieties" and lacks a catch-all or residual clause, the definition should be limited to those forms expressly included in the statute. Further, the court found that, unlike other forms of intellectual property, the survival of trademark rights requires a debtor-licensor to continue to "monitor and exercise control over the quality of the goods sold to the public under cover of the trademark" at the risk of "jeopardizing the continued validity of the owner's own trademark rights." The Court reasoned that this burden to the licensor is at odds with the intent of Section 365: to free debtors from their performance obligations under rejected contracts.

In its petition for certiorari, Mission argued that the First Circuit decision runs counter to the purposes of the Bankruptcy Code and Section 365(n), creating uncertainty on the part of trademark licensees that they will be able to exploit the rights in which they have invested. An amicus brief filed by The International Trademark Association ("**INTA**") urges the Supreme Court to adopt the Seventh Circuit's position, arguing that a clear and consistent rule in favor of trademark licensees' rights will strengthen the reliance interests of licensees and thereby enhance the value of trademark licenses for licensors. In INTA's view, rejection of contracts in bankruptcy is intended to allow a debtor to avoid onerous obligations, but not to allow it to reclaim legal rights it had earlier granted.

In addressing this question, the Supreme Court is expected to provide greater certainty for parties regarding their respective rights upon a trademark licensor's bankruptcy.

The First Circuit's decision can be found **here** and Mission's petition for certiorari can be found **here**.

Supreme Court to Consider Whether the Government May Challenge Patents as a "Person" Under the America Invents Act

On October 26, 2018, the U.S. Supreme Court granted Return Mail, Inc.'s petition for a writ of certiorari and will consider whether the U.S. government is a "person" who may seek post-issue review of patents under the Leahy-Smith America Invents Act ("**AIA**"). The Federal Circuit decision in *Return Mail, Inc. v. U.S. Postal Service* upheld the PTAB's decision that the U.S. Postal Service and the U.S. government were not barred from filing such a petition under the AIA.

In 2011, after attempts to license its patent for a method of processing undeliverable mail to the U.S. Postal Service failed, Return Mail sued the U.S. Postal Service and U.S. government in the U.S. Court of Federal Claims, alleging that the U.S. Postal Service's activities infringed Return Mail's patent and seeking compensation under 28 U.S.C. § 1498(a), an eminent domain statute. Sovereign immunity protects the government from suit under the Patent Act and 28 U.S.C. § 1498(a) provides the exclusive avenue by which the U.S. government has consented to be sued for the taking of patent licenses.

In response to the suit, the U.S. Postal Service filed a petition with the U.S. Patent and Trademark Office in which it sought Covered Business Method ("**CBM**") review of Return Mail's patent and raised grounds for unpatentability, including ineligible subject matter and obviousness. Return Mail responded to the patentability arguments, but also challenged the U.S. Postal Service's standing to seek CBM review. Unlike post-grant review and *inter partes* review, the two other administrative proceedings created by the AIA, a person must be sued or charged with infringement in order to be eligible to bring a petition for CBM review. Return Mail argued that a § 1498(a) suit against the government for compensation is not equivalent to an infringement suit between private parties, and therefore does not qualify as being "sued for infringement." The PTAB disagreed and interpreted the AIA's use of "infringement" broadly to encompass suits under § 1498(a), allowing the government to meet the AIA's requirements for standing. It then ultimately found the challenged patent claims invalid as covering ineligible subject matter.

On appeal to the Federal Circuit, Return Mail argued that allowing the government to bring CBM proceedings creates tension with the AIA's estoppel provisions. Under AIA § 18(a)(1)(D), a party who petitions for CBM review of a patent claim and then receives an adverse final decision may not re-litigate the issue in a civil action before a district court or a proceeding before the International Trade Commission. Such estoppel applies to Patent Act challenges but not § 1498(a) suits, as they arise in the U.S. Court of Federal Claims. Allowing the government to file a CBM petition and avoid estoppel, according to Return Mail, would frustrate the ability of CBM review to sufficiently quiet title for patent owners. The Federal Circuit ruled in a 2-1 decision that "infringement" for purposes of the AIA is to be given its ordinary meaning, which is broad enough to encompass suits under both the Patent Act and § 1498(a), and held that Return Mail's estoppel concern was an issue of policy best left for Congress.

In a dissenting opinion, Judge Pauline Newman first raised the argument that the AIA's use of "person" prohibits standing for the government because the common usage of "person" excludes the government and its agencies unless expressly provided. Though the parties had not developed arguments on the issue or raised it before the PTAB, the panel majority responded to the dissent and found that "person" is used throughout the AIA in a manner that does not exclude the government and that the government, like a private party, has interests in having a non-judicial forum for reconsidering a patent when sued for infringement.

In its petition to the Supreme Court, Return Mail argued that the statutory language must be interpreted to exclude the U.S. government, because allowing the government to bring AIA post-grant review petitions while exempt from estoppel upsets the trade-offs that otherwise balance the costs and benefits to those seeking AIA review. According to Return Mail, if CBM petitions by the government were to be permitted, the government would benefit from a unique advantage over private AIA petitioners. In its response to Return Mail's petition, the government argued that it is frequently found exempt from estoppel rules that apply to private litigants, making the application of the AIA in this manner unremarkable.

The Supreme Court granted review only to the question of whether the government is a "person" within the AIA, but not to the question of whether a § 1498(a) suit constitutes a suit for patent "infringement." A date for oral argument has not yet been set.

The Federal Circuit's opinion can be found **here** and the petition for certiorari can be found **here**.

Federal Circuit Affirms Registration of Surname as Trademark for Beer

On November 26, 2018, in *Schlafly v. The Saint Louis Brewery LLC*, the Federal Circuit ruled against the estate of prominent conservative activist and attorney Phyllis Schlafly, holding that Saint Louis Brewery could register SCHLAFLY as a trademark for beer, even though it is a surname, because it had acquired the requisite distinctiveness.

St. Louis Brewery, a Missouri craft brewery owned by Phyllis Schlafly's nephew, began selling "SCHLAFLY" brand beer in 1991 and applied to the United States Patent and Trademark Office to register SCHLAFLY as a trademark for beer in 2011. Phyllis Schlafly, together with her son, Bruce Schlafly, opposed the registration, arguing that the surname Schlafly is primarily associated with Phyllis Schlafly and her political work. Accordingly, Phyllis Schlafly argued that registration of the mark would violate Section 2(e)(4) of the Lanham Act, which prohibits the registration of a mark that is "primarily merely a surname."

In the opposition proceedings, the Trademark Trial and Appeal Board ("**TTAB**") decided in favor of St. Louis Brewery, stating that even a word that is primarily merely a surname can be registered as a trademark if it has acquired secondary meaning in trademark use. The TTAB found that the Schlafly surname had acquired such secondary meaning and that there was no evidence of "market proximity," or, in other words, there was no reason to believe that Phyllis Schlafly's activities have interfered with the ability of customers to associate the surname with the brewery's SCHLAFLY brand beer. The TTAB cited St. Louis Brewery's continuous use of the mark, the large sales volume of SCHLAFLY beer in recent years and its local and national media coverage.
On appeal, the Federal Circuit affirmed the TTAB ruling and the registration of the SCHLAFLY mark. The Schlafly's had urged the court to adopt a new test, referred to as the "change in significance" test, for determining whether a surname could be registered as a trademark. The "change in significance" test would only allow a surname to be registered if there was a "change in significance [of the name] to the public, from a surname to an identifying mark for specified goods." However, the Federal Circuit declined to adopt the Schlafly's interpretation of the Lanham Act's requirements, holding that the distinctiveness test is appropriate even for words that are primarily known as surnames. The Federal Circuit concluded that "no law or precedent suggests that surnames cannot be registered as trademarks if they have acquired distinctiveness in trademark use. Because the [TTAB] found that the SCHLAFLY mark for beers had acquired secondary meaning, [the Lanham Act] did not bar registration." In upholding the registration of the SCHLAFLY mark due to its acquired secondary meaning, the Federal Circuit has thus affirmed the applicability of the distinctiveness test for determining whether a surname qualifies for trademark registration.

The Federal Circuit's opinion is available **here**.

Music Modernization Act of 2018 Signed Into Law

On October 11, 2018, President Trump signed into law the Orrin G. Hatch-Bob Goodlatte Music Modernization Act (the "**Act**"). The Act updates the Copyright Act in three significant ways: by introducing mechanical royalties for streaming services, by providing protection to copyright owners of pre-1972 sound recordings, and by providing the means for music producers to receive a portion of royalties distributed under statutory licenses.

First, the Act streamlines the process by which copyright holders receive payment when their music is streamed online by allowing streaming services to pay for and obtain a blanket license to stream copyrighted material from a newly created centralized entity known as the Mechanical Licensing Collective ("**MLC**"). The MLC is governed by a board which will be responsible for, among other things, identifying copyrighted material embedded in sound recordings, locating copyright owners and processing their claims, administering the aforementioned blanket licenses, collecting and distributing royalties, and assisting with the adjustment of the royalties to reflect market rates and terms. The Act also provides certain protections for streaming services against lawsuits for past infringement.

In addition, the Act provides owners of pre-1972 sound recordings with a certain level of copyright protection. Before the Act, such copyright owners were not covered under federal copyright laws. The Act, however, introduces federal remedies for the unauthorized use of pre-1972 sound recordings as well as a statutory licensing scheme for streaming services. The Act also protects the lawful fair use of such recordings.

Furthermore, the Act enables additional individuals participating in the creative process to receive a portion of the royalties distributed under the statutory license provided by section 114 of the Copyright Act. Section 114 authorizes certain entities (currently SoundExchange) to collect and distribute digital performance royalties. The Act expands the scope of the provision to allow SoundExchange to distribute royalties, previously limited to rights owners and licensees, to producers, sound engineers and other creative participants when artists file a "letter of direction" with SoundExchange.

The underlying bill was passed unanimously by both the Senate and the House. The entire bill is available **here**.

Patent and Copyright Changes in the New NAFTA

On November 30, 2018, the United States, Canada and Mexico signed an agreement replacing the North American Free Trade Agreement. The United States-Mexico-Canada Agreement ("**USMCA**") will require the United States to enact certain reforms to intellectual property laws, such as increasing moral rights protections to comply with the 1989 Berne Convention's moral rights provisions. In turn, both Mexico and Canada are expected to implement a number of changes to local intellectual property laws.

The USMCA seeks to improve procedural uniformity and to harmonize intellectual property laws among the three countries. For instance, the USMCA requires the signatories to establish public online databases for trademarks, domain names and industrial designs, along with electronic filing systems for trademarks and industrial designs. Moreover, the USMCA requires the signatories to accede to and ratify international agreements such as the Patent Law Treaty, the Madrid Protocol, the Singapore Treaty, and the Hague Agreement.

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