Supreme Court Weighs in on Trademark Licenses in Bankruptcy

By Michael K. O'Neil

What are the rights of trademark licensee whose license to use the mark is rejected in bankruptcy? Near the end of its most recent term, the United States Supreme Court weighed in on a fascinating dispute concerning the rights of counter parties to trademark license contracts under the bankruptcy code, holding that a licensee can retain its rights under the license despite a debtor/licensor's rejection in bankruptcy.

Background

Tempnology, LLC, with operations based in Portsmouth, New Hampshire, developed and manufactured fabrics designed to remain at low temperatures when worn during exercise. The fabrics were marketed under the "Coolcore" and "Dr. Cool" brands. Tempnology's products and business were supported by an intellectual property portfolio which included two patents, four pending patents, research studies and numerous registered and pending trademarks.

In 2012, Tempnology entered into a Co-Marketing and Distribution Agreement with Mission Products Holdings Inc., which granted to Mission, among other things, certain licenses to use Tempnology's IP, including its trademarks Tempnology suffered losses from 2013 through 2015, which it alleged were largely due to Mission's performance, and various related disputes, under the Agreement. Faced with increasing losses, Tempnology filed a voluntary petition for Chapter 11 relief on September 1, 2015 in the United States Bankruptcy Court for the District of New Hampshire.

Rejecting Intellectual Property Contracts in Bankruptcy

Section 365(a) of the Bankruptcy Code provides that, subject to the court's approval, a debtor may assume or reject any executory contract. While the Code does not define "executory contract," a contract is considered to be executory if both parties have material obligations remaining under the contract. Accordingly, the Bankruptcy Code allows for a debtor, as part of its ability to reorganize its financial affairs, to "assume" (i.e., accept the benefits and obligations of) those contracts that are beneficial to its business and "reject" (i.e., relieve itself of the obligations of) those contracts that contain onerous terms and may hinder the debtor's reorganization efforts. The ability to assume or reject executory contracts is one of the most unique, powerful, and essential tools available to debtors in bankruptcy.

A debtor's rejection of an executory contract typically leaves the counterparty with a claim for damages resulting from the debtor's nonperformance since, pursuant to Code Section 365(g) "rejection of an executory contract [] constitutes a breach of such contract." However, the Code specifically provides the counterparty with certain additional rights when the rejected contract, like the Tempnology-Mission Agreement, is a license of intellectual property rights. Bankruptcy Code Section 365(n) provides that, if the debtor rejects a contact under which the debtor is a licensor of a right to "intellectual property," then the licensee under that contract may elect to (A) treat the contract as terminated, or (B) retain its rights to the applicable intellectual property for the duration of the contract.

The licensee must, of course, continue to pay any royalties due in exchange for the use of the intellectual property post-rejection. The Code defines "intellectual property" to include trade secrets, inventions, patent applications, and other forms of IP, but *not* trademarks.

The Tempnology-Mission Trademark Dispute Winds through the Courts

In its bankruptcy case, Tempnology quickly moved to reject its Agreement with Mission, and the bankruptcy court approved the rejection. The parties then disputed the effect of that rejection. They agreed that Mission could elect to retain its rights to use certain of Tempnology's intellectual property but disputed whether Mission could retain its use of Tempnology's trademarks, since those are not covered by Section 365(n).

The bankruptcy court ruled that Mission could not retain its use of the trademarks. The Bankruptcy Appellate Panel for the First Circuit (BAP) reversed, following a Seventh Circuit Court of Appeals ruling in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, 686 F.3d 372 (7th Cir. 2012).

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The Supreme Court Continues Review of FDCPA

By Christopher Candon

In this past term, the United States Supreme Court took action on several cases that may significantly shape bankruptcy and/or insolvency law. Notably, the Supreme Court handed down another significant decision concerning the Fair Debt Collection Practices Act (FDCPA) (15 U.S.C. § 1692–1692p) that will influence the application of that law: *Obduskey v. McCarthy & Holthus LLP*, (2019). In *Obduskey*, the Court held that a business engaged in a nonjudicial foreclosure proceeding is not a "debt collector" under the FDCPA. The *Obduskey* case is the third Supreme Court ruling on the application of the FDCPA in the past few terms, joining *Midland Funding, LLC v. Johnson*, 137 S. Ct. 1407 (2017) and *Henson et al. v. Santander Consumer USA Inc.*, 137 S. Ct. 1718 (2017).

"The *Obduskey* decision confirms that nonjudicial foreclosures are not subject to the broader regulation of the FDCPA. The decision is, however, limited to actions required by state law."

The FDCPA

The FDCPA prohibits a debt collector from using a "false, deceptive, or misleading representation or means in connection with the collection of any debt" and prohibits a debt collector from using "unfair or unconscionable means to collect or attempt to collect any debt." 15 U.S.C. §§ 1692e, 1692f.

The FDCPA applies only to the collection of debt incurred by a consumer primarily for personal, family, or household purposes. It does not apply to the collection of corporate debt or debt owed for business or agricultural purposes.

In Section 1692a(6), the FDCPA sets forth a primary definition of a debt collector as any person who regularly collects, or attempts to collect, consumer debts for another person or institution or uses some name other than its own when collecting its own consumer debts. That section goes on to provide a limited-purpose definition of a "debt collector," saying that "[f]or the purposes of section 1692f(6) … such term also includes any person … in any business the principal purpose of which is the enforcement of security interests." Section 1692f(6) prohibits taking or threatening to take nonjudicial action with respect to property under certain circumstances.

The Supreme Court Decisions

On March 20, the Court issued the decision *Obduskey v. McCarthy & Holthus LLP*. McCarthy & Holthus LLP, a law firm, was hired by a lender to carry out a nonjudicial foreclosure on a home owned by Dennis Obduskey. The firm provided notice to Obduskey that it was retained to conduct the nonjudicial foreclosure under Colorado law. Obduskey responded in writing by disputing the amount of the debt and invoking his rights under 1692g(b), a section of the FDCPA that requires a "debt collector" to cease its attempts to collect the debt until it provides the debtor with "verification of the debt."

Notwithstanding Obduskey's demand to stay the action, McCarthy continued to proceed with the nonjudicial foreclosure. Obduskey brought an action alleging a violation of the FDCPA, asserting that McCarthy was a "debt collector" subject to the provisions of the FDCPA for all purposes, including the debt-verification provision of the law. The district court dismissed the lawsuit, holding that McCarthy was not a "debt collector" for purposes of 1692g(b). The Tenth Circuit affirmed, ruling that the enforcement of a security interest through a nonjudicial foreclosure does not fall under the FDCPA.

Writing for a unanimous Court, Justice Breyer applied traditional statutory construction principles to resolve the matter. There was no dispute that McCarthy was enforcing a security interest and, thus, subject to the specific prohibitions contained in 1692f(6). But the question was whether the other provisions of the FDCPA also applied to McCarthy's actions, including the debt-verification requirement. The Court concluded that they did not because McCarthy did not fall within the scope of the FDCPA's primary definition of "debt collector."

The Court distinguished what it referred to as the primary and limited-purpose definitions of "debt collector." Justice Breyer called the limited-purpose definition "an insurmountable obstacle" to subjecting firms, such as McCarthy, to the main coverage of the FDCPA.

[The limited-purpose definition] says that ***"[f]or the purpose of section 1692f(6)"*** *a debt collector "****also*** *includes" a business, like McCarthy, "the principal purpose of which is the enforcement of security interests." §1692a(6) (emphasis added). This phrase, particularly the word "also," strongly suggests that one who does no more than enforce security interests does not fall within the scope of the general definition. Otherwise why add this sentence at all?*

The *Obduskey* decision confirms that nonjudicial foreclosures are not subject to the broader regulation of the FDCPA. The decision is, however, limited to actions required by state law.

As Justice Breyer warned, "given that we here confront only steps required by state law, we need not consider what other conduct (related to, but not required

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for, enforcement of a security interest) might transform a security-interest enforcer into a debt collector subject to the main coverage of the [FDCPA]."

In *Midland Funding, LLC. v. Johnson*, the Court tackled another controversial element of the FDCPA. The *Midland* case stems from Aleida Johnson's personal Chapter 13 Bankruptcy proceeding. In that case, Midland — a company that purchases and collects distressed debt — filed a proof of claim claiming Johnson owed $1,879.71 in credit card debt. Midland's claim also noted that no charge appeared on Johnson's account within the past 10 years — far outside Alabama's relevant six-year statute of limitations. Johnson objected to the claim, Midland did not respond, and the Bankruptcy Court disallowed the claim.

Johnson then sued Midland, alleging that Midland's claim violated the FDCPA. The District Court found Midland's actions did not fall within the bounds of the FDCPA. The Eleventh Circuit reversed. The Supreme Court granted certiorari to consider whether Midland's conduct — filing a claim in a Chapter 13 proceeding, that on its face falls outside the relevant statute of limitations — constitutes "false," "deceptive," "misleading," "unconscionable," or "unfair" conduct within the meaning of the FDCPA.

The majority, in an opinion delivered by Justice Breyer, found that it did not. Under Alabama law, after the statute of limitations period expired, a creditor has the right to payment of a debt, but cannot enforce collection through law. Rather, once the statute of limitations has expired, should a creditor seek to enforce the claim through legal proceedings, a debtor may assert the expiration of the statute of limitations as an affirmative defense.

Therefore, the majority concluded that Midland's claim on Johnson's credit card debt was indeed a "claim" within the meaning of the Bankruptcy Code, and it was "reasonably clear that Midland's proof of claim was not 'false, deceptive, or misleading.'"

The majority also did not believe that Midland's conduct was either "unconscionable" or "unfair." Despite precedent in a civil context indicating asserting a time-barred claim is "unfair," the majority believed in a bankruptcy proceeding — where the consumer initiates the proceeding, a trustee is available, and different procedural rules apply — "unfairness," and the resultant harm to the consumer, was less of a concern. Furthermore, the allowance of time-barred claims was not "unconscionable" because the filing and disallowance of the claim "discharges" the debt, meaning that debt will not remain on the debtor's future credit reports.

In a dissent, Justice Sotomayor, joined by Justices Ginsburg and Kagan, disagreed. In their view, when debt collectors file stale claims in bankruptcy proceedings, they are hoping that the bankruptcy system will fail and that claims that otherwise would be barred by statute of limitations are incorporated in Chapter 13 plan for payment. Such conduct, in their opinion, is not good-faith conduct, and qualifies as "unfair" and "unconscionable" under the FDCPA.

The *Midland Funding* decision should end FDCPA lawsuits for time-barred claims in bankruptcy cases. It leaves open, however, the related question of whether debt collectors can be liable under the FDCPA for filing lawsuits to collect time-barred debt. The Court noted that several lower courts have found that filing suit for a time-barred claim is "unfair," and assumed "for argument's sake" that these lower courts were correct. But the Court added that it "has not decided" and "does not now decide" that FDCPA issue.

Later in that term, the Supreme Court did decide another FDCPA matter. In *Henson v. Santander*, Santander — a large financial institution — did not issue the plaintiff's debt, but rather purchased defaulted loans from CitiFinancial Auto and then sought to collect in ways the petitioners alleged violated the FDCPA. A Circuit split had emerged regarding the correct characterization of whether parties like Santander qualify as "debt collectors" under the FDCPA. The Fourth Circuit, following the Ninth and Eleventh Circuits, agreed with the district court's finding that Santander was not a debt collector subject to the FDCPA, while the Third, Fifth, Sixth, Seventh, and D.C. circuits had adopted the opposite view.

The Court unanimously ruled that a company may collect debts that it purchased for its own account, like Santander, without violating the FDCPA. As in *Obduskey*, at issue was the FDCPA's definition of "debt collector." The statute defines the term to cover anyone who "regularly collects or attempts to collect … debts owed or due … another."

"Everyone agrees that the term embraces the repo man — someone hired by a creditor to collect an outstanding debt," remarked Justice Gorsuch. "But what if you purchase a debt and then try to collect it for yourself — does that make you a 'debt collector' too?" The parties agreed that those who seek to collect for themselves loans they originated do not qualify as debt collectors. Thus, the narrow issue taken up by the Court was how to "classify individuals or entities who regularly purchase debts for their own account. Does the [FDCPA] treat the debt purchaser in that scenario more like the repo man or the loan originator?"

The Court ruled with Santander and the Fourth, Ninth, and Eleventh Circuits. The Court held that the FDCPA does not "care how a debt owner came to be a debt owner — whether the owner originated the debt or came by it only through a later purchase. All that matters is whether the target of the lawsuit regularly seeks to collect debts for its own account or does so for 'another.'"

Whether the FDCPA should be applied more broadly, to all businesses attempting to collect debts, regardless of ownership, the Court said that was a matter for Congress, not the Court, to resolve. The petitioners asserted that the FDCPA was intended by Congress to cover debt purchasers, like Santander, but the legislators simply did not foresee the industry when the FDCPA was enacted in 1978. The Court dismissed the argument as "a lot of speculation."

In the end, reasonable people can disagree with how Congress balanced the various social costs and benefits in this area. We have no difficulty imagining, for example, a statute that applies the Act's demands to anyone collecting any debts, anyone collecting debts originated by another, or to some other class of persons still. . . Constant competition between constable and quarry, regulator and regulated, can come as no surprise in our changing world. But neither should the proper role of the judiciary in that process — to apply, not amend, the work of the People's representatives.

Importantly, the decision does not foreclose future litigation on the "debt collector" issue. The FDCPA also defines a debt collector as a person whose business has as its principal purpose the "collection of any debts." Because this was not raised in the *certiorari* petition, the Court declined to decide whether Santander would meet this alternative definition. With this significant issue unresolved, businesses that purchase and collect debt may still be found subject to the FDCPA.

Chris Candon is a Shareholder and the Chair of the Corporate Department at Sheehan Phinney. He focuses his practice on the problems of financially distressed companies, assisting clients with transactional and litigation matters involving commercial law and insolvency issues.