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Eighth Circuit, in Rehearing *en Banc*, Reverses Earlier Decision That Perpetual Royalty-Free Trademark License Was an Executory Contract

*Gregory G. Hesse and Matthew Mannering**

The authors of this article explain a recent U.S. Court of Appeals for the Eighth Circuit decision in the Interstate Bakeries Corporation bankruptcy case reversing its previous holding that a perpetual royalty-free trademark license constituted an executory contract that could be assumed or rejected in bankruptcy.

The U.S. Court of Appeals for the Eighth Circuit recently issued an opinion in the Interstate Bakeries Corporation bankruptcy case reversing its previous holding that a perpetual royalty-free trademark license constituted an executory contract that could be assumed or rejected in bankruptcy.¹ The Eighth Circuit, in a rehearing *en banc* on its earlier decision in *Interstate III*,² determined that the contract at issue should be considered part of an integrated agreement with another contemporaneously executed deal. When the Eighth Circuit expanded the parameters of the contract being considered, it determined that certain unperformed obligations by the bankrupt were not material and the contract was not executory.³

CASE BACKGROUND

In 1995, Interstate Bakeries, Inc. (“Interstate”) announced an acquisition of the Continental Banking Company; however, the U.S. Department of Justice

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¹ *In re Interstate Bakeries Corp.*, No. 11–1850 (8th Cir. 2014) (“*Interstate IV*”).

² *In re Interstate Bakeries Corp.*, 690 F.3d 1069 (8th Cir. 2012) (“*Interstate III*”). See also, Gregory G. Hesse & Matthew Mannering, “Eighth Circuit Affirms That Perpetual Royalty-Free Trademark Was an Executory Contract,” *Intellectual Property and Technology Law Journal* (February 1, 2013).

³ Three of the judges dissented, believing that the unperformed obligations on both sides of the integrated agreement were material and the contract was executory.

asserted that the proposed acquisition violated antitrust laws.⁴ In January 1996, the U.S. District Court for the Northern District of Illinois entered a final judgment that required Interstate to divest at least one of its brands in four geographic territories and grant one or more parties a perpetual, royalty-free, assignable, exclusive license to use the brand in the relevant territory.

On December 27, 1996, Interstate Brands Corporation⁵ (“IBC”), the Chicago Baking Co. (“CBC”) and Lewis Brothers Bakeries, Inc. (“LBB”) entered into an asset purchase agreement (the “APA”) and a License Agreement whereby LBB and CBC paid IBC \$20 million,⁶ plus the assumption of certain liabilities, for IBC’s Butternut Bread business operations in the Chicago market and the Sunbeam Bread business operations and assets in the Central Illinois market. Pursuant to the APA and the License Agreement, IBC granted LBB and CBC a “perpetual, royalty-free, assignable, transferable, exclusive license” (the “License”) to use the Butternut trademark, and other IBC trademarks, in the Chicago market.

On September 22, 2004, Interstate and eight related subsidiaries and affiliates, including IBC, filed voluntary petitions for relief under Chapter 11 of the U.S. Bankruptcy Code in the Western District of Missouri.

Interstate did not originally disclose the License as an executory contract in its Bankruptcy Schedules and Statement of Financial Affairs. The first time Interstate disclosed the License was in a November 21, 2008 filing of an amended exhibit to its proposed Plan of Reorganization (the “Plan”); the filing identified the License as an executory contract that Interstate intended to assume in connection with its Plan. In response, on December 1, 2008, LBB and CBC filed an adversary proceeding against Interstate, seeking a declaratory judgment that the License was not an executory contract that could be assumed or rejected under 11 U.S.C. § 365.

On December 4, 2008, Interstate filed a motion to reject the License, and on January 8, 2009, Interstate filed an Answer and Counterclaim to LBB and CBC’s complaint, which reiterated Interstate’s intent to reject the License. Both Interstate and LBB/CBC filed motions for summary judgment in the adversary proceeding; shortly after each side had responded to the other’s motion for summary judgment, Interstate filed a notice to withdraw its motion to reject the

⁴ *United States v. Interstate Bakeries Corp. & Cont’l Banking Co.* No. 95-C-4194 (N.D. Ill. Aug. 7, 1995).

⁵ IBC was a subsidiary of Interstate.

⁶ The parties allocated the \$20 million purchase price as \$8.12 million to intangible assets, including the License, and the remaining \$11.88 million to various tangible assets.

License and its Counterclaim seeking rejection.

THE BANKRUPTCY COURT'S DECISION

The issue before the bankruptcy court was whether the License Agreement was an executory contract pursuant to 11 U.S.C. § 365.⁷ The bankruptcy court focused the majority of its analysis on the “seminal” case of *In re Exide Technologies, Inc. Enersys Delaware, Inc. v. Exide Technologies, Inc.* (“*Exide I*”).⁸ Relying on *Exide II*,⁹ the bankruptcy court held that IBC and LBB both had material, outstanding obligations under the License Agreement and consequently, these obligations caused the License Agreement to be executory and subject to assumption or rejection under 11 U.S.C. § 365.¹⁰

THE DISTRICT COURT AFFIRMS

LBB and CBC appealed the bankruptcy court's decision to the U.S. District Court for the Western District of Missouri.¹¹ The district court concluded that it did not need to engage in the same materiality analysis of the unperformed obligations that the *Exide* court undertook because the explicit language of the License acknowledged that that character and quality of the trademark was material and LBB/CBC's obligations in this regard remained ongoing. Based on

⁷ Section 365 allows a debtor-in-possession to “assume or reject any executory contract or unexpired lease.” 11 U.S.C. § 365.

⁸ 340 B.R. 222 (Bankr. D. Del. 2006), *appeal denied, judgment aff'd*, *Enersys Delaware, Inc. v. Exide Technologies, Inc.*, Case No. 02-11125 (D. Del. Feb 27, 2008). In *Exide II*, the district court concluded that the contract at issue was executory because there were unperformed material obligations on both sides of the agreement. The debtor had a duty not to prosecute the purchaser for using the trademarks, the debtor was barred from granting licenses to third parties to use the trademarks in certain areas, and the debtor was required to indemnify the purchaser. The purchaser had a duty to maintain certain quality standards while using the debtor's trademarks, the purchaser was not allowed to use the debtor's trademarks outside of a defined industry, and the purchaser had a reciprocal obligation to indemnify the debtor.

⁹ When the bankruptcy court reached its decision, *Exide II* had not yet been appealed to the Third Circuit Court of Appeals. While the district court in *Exide II* affirmed the bankruptcy court and found that the contract at issue was executory, the Third Circuit Court of Appeals held that the purchaser of the debtor's assets had substantially performed its obligations under the contract and, therefore, the contract was not executory. *In re Exide Technologies*, 607 F.3d 957 (3d Cir. 2010) (“*Exide IIP*”).

¹⁰ *In re Interstate Bakeries Corp.*, No. 04-45814 (Bankr. W.D. Mo. June 4, 2010) (“*Interstate I*”).

¹¹ *See In re Interstate Bakeries Corp.*, 447 B.R. 879, 886 (W.D. Mo. 2011) (“*Interstate IP*”).

LBB/CBC's unperformed material obligations, the district court affirmed the bankruptcy court.

A THREE-JUDGE PANEL OF THE EIGHTH CIRCUIT AFFIRMS

After the district court's ruling, LBB and CBC appealed to the U.S. Court of Appeals for the Eighth Circuit.¹² A divided panel of the Eighth Circuit affirmed the ruling of the district court, holding that LBB and CBC had unperformed material obligations under the License Agreement and that IBC had its own unperformed material obligations, including: notice and forbearance related to the trademarks, as well as maintaining and defending the trademarks and other infringement-related obligations.¹³ Finding that both sides to the License Agreement had at least one unperformed material obligation, the Eighth Circuit affirmed the district court's holding that the License Agreement was an executory contract. LBB filed a petition for a rehearing *en banc*, which was granted.¹⁴

THE EIGHTH CIRCUIT REVERSES IN REHEARING *EN BANC*

The Eighth Circuit was requested to rehear the appeal *en banc*.¹⁵ After deciding that the issue of whether the License Agreement was an executory contract was not moot,¹⁶ the Eighth Circuit revisited what was the proper

¹² While this appeal was pending, Interstate changed its name to Hostess Brands, Inc. ("Hostess") and in January 2012 filed a bankruptcy petition in the Southern District of New York (the "Hostess Bankruptcy").

¹³ *In re Interstate Bakeries Corp.*, 690 F.3d 1069, 1075.

¹⁴ The Eighth Circuit invited the Antitrust Division of the Department of Justice (the "Antitrust Division") and the Federal Trade Commission (the "FTC") to express their views on whether the License Agreement was an executory contract that could be assumed or rejected. The Antitrust Division and the FTC, as *amici curiae*, expressed concerns that allowing Interstate to reject the License Agreement would vitiate the remedial intent of the 1996 antitrust decree; however, because the Eighth Circuit ultimately held that the License Agreement was not an executory contract, it did not rule on the *amici's* assertion that the License Agreement "has the force of law separate and apart from contract law."

¹⁵ Cases before the U.S. Courts of Appeals, including the Eighth Circuit, are handled by a three-judge panel. Parties, such as LBB in this case, can request a rehearing *en banc*. If the request is granted, all the judges in a particular circuit will hear the case at the *en banc* hearing. The decision rendered at the *en banc* hearing is controlling over the earlier decision by the three-judge panel.

¹⁶ IBC claimed that the case was moot because it had sold the Butternut Bread assets covered by the License Agreement to an unrelated third party in the Hostess Bankruptcy on July 13, 2013, or, alternatively, that it would not seek to reject the License Agreement as executory. The

agreement at issue for the executory contract analysis and concluded that it was not solely the License Agreement, but the License Agreement and the APA. Under Illinois law, whether the APA and the License Agreement should be considered separate agreements or a single agreement depends on the intention of the parties as evidenced by the terms of the agreement. Noting, among other factors, that the APA and the License Agreement were entered into contemporaneously, that the APA lists the License as an asset sold pursuant to the APA, that the APA directs the parties to enter into the License Agreement, and that both the APA and the License Agreement define the "Entire Agreement" to include both documents, the Eighth Circuit determined the issue before it was whether the integrated agreement—the APA and the License Agreement—was an executory contract.

After determining that the License Agreement and the APA should be examined as a single agreement, the Eighth Circuit analyzed the unperformed obligations of IBC and LBB through the lens of the doctrines of substantial performance and material breach¹⁷ to determine whether the License Agreement and the APA were an executory contract under Professor Countryman's standard.¹⁸ The Eighth Circuit concluded, relying on the Third Circuit's holding in *Exide III*, that the contract was not executory because IBC had substantially performed its obligations under the APA and that IBC's remaining obligations under the License were relatively minor.¹⁹

Eighth Circuit found neither of these arguments persuasive and determined that the issue of whether the bankruptcy court properly determined that the License Agreement was executory was ripe for review.

¹⁷ Under the doctrine of substantial performance, the nonbreaching party's performance is not excused if the breaching party has "substantially performed." *In re Exide*, 607 F.3d at 963. On the other hand, "[s]ubstantial performance is the antithesis of material breach; if it is determined that a breach is material, or goes to the root or essence of the contract, it follows that substantial performance has not been rendered, and further performance by the other party is excused." 15 Richard A. Lord, *Williston on Contracts* § 44:55 (4th ed. 2000).

¹⁸ Countryman defines an executory contract to be "a contract under which the obligations of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other." *In re Craig*, 144 F.3d 593, 596 (8th Cir. 1998) (internal quotes omitted); see Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973).

¹⁹ IBC's remaining obligations under the License Agreement included notice and forbearance related to trademarks, maintenance and defense of trademarks, and related infringement obligations. In *Interstate III*, the Eighth Circuit, analyzing the License Agreement independently from the APA, found these obligations material in affirming the district court.

CONCLUSION

Since the Eighth Circuit reached opposite conclusions—on the same set of facts (indeed, in the same case)—as to whether certain unperformed obligations under the contract—limited to the License Agreement or expanded to include the APA and the License Agreement—demonstrates that even the same court can easily reach different conclusions on the question of whether a contract is executory or nonexecutory. Consequently, parties to a contract with a bankrupt entity, where any unperformed obligations on both sides of the agreement remain, should be prepared that different courts and in fact, sometimes the same court, may reach divergent conclusions about whether a contract is executory based on the scope of the entire agreement and the unperformed obligations.