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'Gotcha' For Trade Creditors? New Court Decision Warrants Heightened Caution When Trading with Bankrupt Customers

Suppliers in the last few years have done lots of nail-biting over the financial health of their customers. A recent appeals court decision suggests trade creditors also must be particularly careful when dealing with a bankrupt customer, even after the customer has filed for bankruptcy protection. In *Marathon Petroleum Co. v. Cohen* [In re *Delco Oil, Inc.*], 2010 U.S. App. LEXIS 5452 (March 16, 2010), the U.S. Court of Appeals for the Eleventh Circuit upheld a bankruptcy court ruling that a post-petition trade creditor had to return \$1.9 million in post-bankruptcy payments that it had received from its bankrupt customer as payment for goods supplied in the ordinary course of business.

Chapter 11 debtors may continue purchasing goods and services and operating in the ordinary course of their business after a Bankruptcy Code filing. Being paid cash for goods sold or services rendered post-filing traditionally was viewed as putting a creditor in the safest period to trade with an insolvent customer, thanks to the "administrative priority" given to such obligations by a debtor's bankruptcy estate. As a practical matter, a company hoping to emerge from bankruptcy would have to make good on its administrative claims. *Delco* warns that such payments may not be safe from disgorgement. Moreover, if a trade creditor is obligated by an "executory" or supply contract to continue providing goods or services to the bankrupt customer, the payments you receive may be recoverable by a subsequently appointed bankruptcy trustee.

In *Delco*, the customer filed for Chapter 11 bankruptcy protection and sought a bankruptcy court order to let it use cash collateral (such as cash realized from sales of its inventory) to pay for ordinary course, post-bankruptcy business operations. The debtor's secured lender, holding a lien on the cash collateral, opposed the debtor's request to use it. Approximately three weeks after the bankruptcy filing, the bankruptcy court denied the debtor's motion to use cash collateral. In the meantime, however, the debtor had paid the trade creditor approximately \$1.9 million for goods supplied after the bankruptcy filing.





Debtor payments to trade creditors can be clawed back unless the court or the Code blessed use of cash collateral.

After the bankrupt customer's Chapter 11 case was converted to Chapter 7 — a liquidation instead of a reorganization — the Chapter 7 trustee sued the trade creditor to recover the \$1.9 million as “unauthorized post-petition transfers” relying on Sections 549 and 363 of the Bankruptcy Code. The bankruptcy court held that the payments were recoverable as post-petition transfers of estate property that had not been authorized by the court or by the Bankruptcy Code. The Eleventh Circuit agreed that the transfers were recoverable even though the debtor had paid the trade creditor in the ordinary course of the debtor's business and even though the payments were for post-bankruptcy goods that the creditor had sold and delivered to the customer. So the customer's Chapter 7 bankruptcy estate retained the value of the goods but the trade creditor did not get to keep the payment for them. Instead, it winds up with only what is called an administrative claim against the prior Chapter 11 estate for the value of those goods but which amounts to something much less. The administrative claims in the Chapter 11 case are subordinate to and get paid after payment in full of the administrative claims in the Chapter 7 case, and there will be no pressure on the debtor to make good on such claims because there will be no emergence from bankruptcy.

Delco creates uncertainty for trade creditors selling goods and services to customers in bankruptcy, particularly in the Eleventh Circuit (Alabama, Florida and Georgia). Heightened due diligence is needed to avoid the risk that payments received after a customer's bankruptcy will be subject to a clawback claim by the customer's bankruptcy estate, even though it was always understood that such payments were protected so long as the creditor received payment on delivery. Under the Eleventh Circuit's decision, however, a creditor who sells goods and services to a bankrupt customer without certainty that the customer's use of cash collateral is permitted by the court or the Bankruptcy Code is at risk that the court may later deny the debtor use of cash collateral. In this case, all transfers would be “unauthorized” and the court could order the creditor to disgorge payments it may have received.

The Eleventh Circuit did not consider relevant what the trade creditor did or did not know regarding the debtor's authority to use cash collateral at the time of the sale. The bankruptcy court opinion recognized that the trade creditor knew about its customer's bankruptcy and the lender's objections to the use of cash collateral, yet the trade creditor continued to ship and accepted payments without a court order authorizing the bankrupt customer's use of cash collateral in place. The appeals court did not really address the trade creditor's awareness of whether the debtor had authority to use cash collateral, making it unclear whether a creditor who sells without knowledge of a customer's authority to use cash collateral or bankruptcy filing would be susceptible to attack by the customer's bankruptcy estate. All the same, the opinion highlights the need for trade creditors to exercise an additional level of due diligence before they engage in trade with a bankrupt customer. The take-away? Make sure that the customer is “authorized to use cash collateral” (if its cash proceeds are encumbered by a lien) before trading or delivering product or services. Otherwise, payments that are received could be subject to attack and potential disgorgement as “unauthorized” post-bankruptcy payments.

Delco further suggests that creditors may be better served by delaying post-petition sales or services until the customer obtains a cash collateral order that protects trade creditor payments. Alternatively, trade creditors may consider filing a motion with the bankruptcy court seeking entry of an order authorizing a bankrupt customer to pay the creditor as a supplier of post-petition goods or services, on notice to the lender (that may object to the order sought by the creditor), before such goods or services are provided, particularly in those cases where the creditor is obligated to continue performing under a pre-bankruptcy supply or other contract with the debtor, with payment now at the risk of disgorgement.

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For This Relief, Much Thanks
FEDERAL COURT BOOTS CREDIT CARD CLASS ACTION IN NARROW READING OF FACTA; GOOD NEWS FOR MERCHANTS

Congress adopted the Fair and Accurate Credit Transaction Act, 15 U.S.C. §1681c(g) ("FACTA"), to address the growing problem of identity theft and credit card fraud (see "As A Matter of FACTA," in the March 2008 **InFashion**). The law protects consumers by limiting what account information can appear on credit card receipts. Section 113 specifically prohibits a merchant who accepts credit or debit cards "for the transaction of business" from printing out "more than the last five digits of the card number or the expiration date" on the cardholder's receipt. Moreover, FACTA lets consumers seek statutory damages ranging from \$100 to \$1,000 for *each* receipt issued in violation of its terms, *even if* the consumer suffers no actual harm as a result. Multiply that by the number of customers a busy seller can have, and there are costly storm clouds on the horizon.

Now a federal court has pierced some of the gloom with a ruling rejecting a sweeping FACTA claim. In *Broderick v. 119TCbay, LLC*, 2009 WL 2878531 (W.D. Mich. 2009), the district court dismissed a nationwide class action against a hotel seeking statutory and punitive damages that could have run into the millions.

The issue before the court was whether the hotel violated FACTA by printing only five digits on the receipt, but consisting of the first digit ("5") and the last four digits. Every MasterCard account starts with "5" and the receipt independently indicated that the charge was on a MasterCard. The court found that the hotel defendants had not violated Section 113 because they did not reveal "more personally identifying information than the last 5 digits of the credit card number or the expiration date." The court was mindful of the importance of not burdening merchants with "potentially crippling cost



and liability” in circumstances like those present in *Broderick*, where the alleged violation presented no actual consumer credit card fraud risk.

The *Broderick* decision is welcome news for merchants. It remains to be seen whether future decisions will follow a similarly well-reasoned, practical approach in analyzing claimed FACTA violations. Schiff Hardin’s **Paula Morency**, **Fiona Burke**, **Jesi Carlson** and **John Bannon** won the case.



Vive la Non-différence!

LESSONS ET LEÇONS FROM E-COMMERCE DECISIONS IN U.S., EUROPE

Two important appellate courts on opposite sides of the Atlantic tried to figure out how the business practices of two of the biggest online players — Google and eBay — meshed with trademark law this spring. At the end of the day, although the cases arose in different legal systems, their conclusions had some important similarities. In the U.S., eBay preserved most of its trial court victory over Tiffany on core trademark issues in a case about the auction of counterfeit Tiffany goods, but faces further proceedings on a false advertising claim. In Europe, Google and purchasers of search terms through its AdWords program were warned that they could be liable, in some circumstances, for trademark infringement.

***Tiffany v. eBay*: MORE FIZZLE THAN SIZZLE**

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of Tiffany’s claims over the sale of counterfeit goods through eBay auctions. *Tiffany (N.J.) Inc. v. eBay, Inc.*, 600 F.3d 93 (2d Cir. 2010). (We discussed the lower court decision in the Fall 2008 **InFashion**.) The court rejected the trademark infringement claims under federal and New York law because eBay used the Tiffany mark accurately to describe the genuine Tiffany items offered for sale and never suggested any affiliation between Tiffany and eBay. eBay’s general awareness of auctions of counterfeit Tiffany items didn’t create liability, especially because eBay promptly pulled specific listings that Tiffany challenged. “To impose liability because eBay cannot guarantee the genuineness of all of the purported Tiffany products offered on its website would unduly inhibit the lawful resale of genuine Tiffany goods,” the court said.

The court rejected a contributory infringement theory, too. Tiffany never showed that eBay took no action despite knowledge of specific instances of actual infringement. So while someone could be contributorily liable on a “willful blindness” theory, eBay isn’t.

Significantly, the Council of Fashion Designers of America filed a friend of court brief arguing that if specific infringements have to be identified, mark owners would have to monitor eBay and similar sites 24/7. The court was unpersuaded: “First, and most

obviously, we are interpreting the law and applying it to the facts of this case. We could not, even if we thought it wise, revise the existing law in order to better serve one party's interests at the expense of the other's." Tiffany also struck out on trademark dilution claims under both federal and New York law.

Tiffany did win the chance to prove its Lanham Act false advertising claim against eBay. This claim, however, didn't focus on the auctions but on what eBay said about them in ads it ran to drive traffic to its site. The ads truthfully said Tiffany items were for sale on eBay — genuine Tiffany items were being auctioned. But they also potentially were misleading, too, because not all of the auction items were genuine Tiffany. To turn this claim into gold on remand, Tiffany will have to prove that the ads tended to confuse or mislead and that a "statistically significant" part of the commercial audience was misled by them. Finally, the court said worries that this ruling will cripple e-commerce sites with false advertising claims are overblown. After all, it notes, "a disclaimer might suffice."

A LINE IN THE E-SAND: LOUIS VUITTON AND GOOGLE ADWORDS

If it was pretty clear who won the eBay appeal, both sides seemed to claim victory when the European Court of Justice (ECJ), the European Union's top court, considered whether Google's Adwords program violated trademark owners' rights by selling search words corresponding to trademarks. Is European litigation so different from its American cousin that a hotly contested result can be a win-win?

More like a spin-spin. Louis Vuitton claimed that Google was not only allowing sponsors to "buy" its trademarks as search terms yielding "Sponsored Links," but also to buy its trademarks coupled with words like "copy" or "imitation." Issues under both EU Community law and French national law had to be considered, and it was to resolve the former that the French Cour de Cassation turned to the ECJ. These included: was sale of the AdWords by itself a "use" of the Louis Vuitton trademarks by Google, for which it could be held liable? If not, could Google be liable nevertheless at some point if the trademark owner put it on notice of the specific use of the mark by the sponsor?

The part of the decision Google liked best was the ECJ's conclusion that sale of trademarks through Adwords was not an infringing "use" of the trademarks. Accordingly, Google could not be directly liable on that basis alone. But the ECJ found that the AdWord buyers do use the trademark. The court warned:

The function of indicating the origin of the mark is adversely affected **if the ad does not enable normally informed and reasonably attentive internet users, or enables them only with difficulty, to ascertain whether the goods or services referred to by the ad originate from the**



Europe's top court addresses trademark liability for AdWord buyers and Google.

proprietor of the trademark or an undertaking economically connected to it or, on the contrary, originate from a third party. [Emphasis supplied.]

So the trademark owner can pursue an AdWord sponsor for using its trademark. Google can be held responsible, too, if “having obtained knowledge of the unlawful nature of those data or of that advertiser’s activities, it failed to act expeditiously to remove or to disable access to the data concerned.” Having articulated that principle of EU Community law, the ECJ left it to the French and other national courts to apply the rule in particular cases.

So the courts in the U.S. and the EU agree that the online site operator can have liability if the trademark owner brings specific instances of infringement to the site operator’s attention and the site operator does not act. Both courts also agree that the actual direct infringer — the advertiser or the counterfeit seller — can be liable.

Where they may differ is whether and when the site operator’s knowledge of specific infringement can be inferred. For example, will it be enough if an AdWord buyer seeks to buy “Vuitton” and “knock-off” together? Under the logic of *Tiffany*, one might think not. But the record in that case showed that eBay ran “fraud engine” searches, which might have nabbed an auction describing itself as one for “imitation” Tiffany items.

As for France, a February decision by a Paris trial court, also involving Louis Vuitton, held that using marks similar to Louis Vuitton trademarks (such as “Wuitton”) to promote the online auction site violated Vuitton’s trademark rights and constituted unfair competition. The court noted in particular that when the misspellings were keyed in, the results often included references to “sacs” (bags) in the linked text. French courts consistently have held eBay to a much tougher standard where counterfeit goods are auctioned and where the auctioneers are outside authorized lines of distribution (again, see March 2008 **InFashion**).

Where Do The Ducks Go in the Winter? **‘CATCHER IN THE RYE’ CASE MAY CATCH INJUNCTION PLAINTIFFS OFF-GUARD**

When the U.S. Court of Appeals for the Second Circuit reversed a preliminary injunction barring the publication of a book called *60 Years Later Coming Through The Rye* on the ground it infringed author J. D. Salinger’s copyright in *The Catcher in the Rye* and the Holden Caulfield character, not many fashionistas may have taken note. But the April 30 decision in *Salinger v. Colting*, ___ F.3d ___, 2010 WL 1729126 (2d Cir.) made a major change in the law governing the grant of preliminary or permanent injunctive relief in copyright cases, and suggests that this new test probably will wind up being applied to trademark injunctions, too.

Our colleagues who practice in the patent area are well aware of the Supreme Court's decision in *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006). In *eBay*, the high court said the traditional four-part test for injunctive relief had to be applied to applications for injunctive relief in patent cases. The four-part test requires a plaintiff to show (1) irreparable harm absent the injunction; (2) the inadequacy of any remedy at law, such as damages; (3) that the injunction is in the public interest; and (4) that the balance of hardships favors the plaintiff.

Salinger extends the standard in the patent area to the copyright arena. Other than for a 10-day stay, the preliminary injunction was vacated. The case goes back to the trial court for it to apply this test to the particular facts of the case, and not in what Holden Caulfield (or perhaps the Supreme Court) might call a “phony” way, such as by adopting across-the-board presumptions about the existence of irreparable harm or the inadequacy of money damages.

Although the ruling does not address trademark injunction claims as such, one may infer from the general tenor of the opinion and the following sentence in a footnote that they likely will be held to the same standard: “Therefore, although today we are not called upon to extend *eBay* beyond the context of copyright cases, we see no reason that *eBay* would not apply with equal force to an injunction in *any* type of case.” (Emphasis in original.)

While this will call for a more detailed showing to support an injunction request, in many cases it may not affect the outcome. Consider the fly-by-night counterfeiter with a mail-drop address and no visible assets. A court may well be persuaded that money damages would be unrecoverable from such a defendant, and that therefore an adequate factual showing of the need for injunctive relief has been made.

VICTOR/VICTORIA: THE LAWSUIT NOT THE MOVIE

There is a new decision in the long-running trademark litigation between the well-known lingerie chain “Victoria’s Secret” and a local Kentucky sex toy shop wanting to do business as “Victor’s Little Secret.” In *V Secret Catalogue, Inc. v. Moseley*, __ F.3d __, 2010 WL 1979429 (6th Cir. May 19, 2010), an appellate court affirmed the grant of an injunction barring the Kentucky store from calling itself “Victor’s Little Secret” on trademark dilution grounds. (Trademark dilution is a legal theory allowing a famous mark’s owner to prevent the use of a name or mark that disparages or tarnishes the famous mark.)

By way of background, this is the latest decision in a litigation that not only spawned a famous U.S. Supreme Court decision in 2003 but also prompted the enactment of a new U.S. trademark statute in 2006, dealing with dilution of famous marks. Victoria’s Secret

“Therefore, although today we are not called upon to extend *eBay* beyond the context of copyright cases, we see no reason that *eBay* would not apply with equal force to an injunction in any type of case.”

claimed that its famous mark would be diluted by tarnishment through association of its “playful” lingerie with a store selling sex toys and other adult products. In 2000, the trial court granted Victoria’s Secret an injunction, finding that it had shown a “likelihood of harm” to its famous trademark.

That decision was appealed all the way to the U.S. Supreme Court, which held in *Moseley v. Secret Catalog, Inc.*, 537 U.S. 418 (2003) that the trial court was wrong only to require Victoria’s Secret to show a mere likelihood of harm, and not actual harm, to get an injunction. Before the trial court acted on remand, however, Congress reacted to *Moseley* by adopting the Trademark Dilution Revision Act of 2006, 10 U.S.C. §1125(c) (2)(c). In it, an unhappy Congress eased the proof burden on the trademark owner. Goodbye, “actual harm;” hello, “likely to cause dilution.”

The trial court again considered Victoria Secret’s injunction request, this time under the new standard. It again entered an injunction preventing Moseley’s use of the “Victor’s Little Secret” name, finding a likelihood of dilution of the famous Victoria’s Secret mark. The store complied with the injunction, changing its name to Cathy’s Little Secret, but appealed again.

The Court of Appeals for the Sixth Circuit affirmed, with one dissent. It determined that Victoria’s Secret had met its burden to show that the Victoria’s Secret mark could be tarnished by association with the Victor’s Little Secret store. In reaching its decision, it noted that there are eight judicial decisions that have concluded that a famous mark is tarnished when it is associated with a mark used to sell sex-related products. The combination of the new statutory standard and a mark associated with sexual products was sufficient to create a rebuttable presumption of tarnishment.

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