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Exide Technologies

SAVING THE TRADEMARK LICENSE IN A BANKRUPTCY

A major problem for trademark licensees in the fashion world is the risk they take that their licensor will go bankrupt, and then try to end the license agreement by rejecting it as an executory contract. "Executory" is legalese for "most of this contract hasn't been performed yet, so the bankrupt would like to be relieved from performing it." A recent decision from the U.S. Court of Appeals for the Third Circuit offers a possible lifeline for such licensees.

The particular case, *In re Exide Technologies*, arose in a context about as far removed from fashion as one could find. In 1991, Exide Technologies and Enersys Delaware, Inc. entered into an agreement for Enersys to purchase substantially all of Exide's industrial battery business for \$135 million. As part of the deal, Enersys received a perpetual, exclusive, royalty-free license to continue to use the Exide trademark in the industrial battery business, while Exide retained its ability to use its trademark in other businesses. This relationship continued for roughly a decade without incident. In 2000, however, Exide decided to reenter the industrial battery business. Naturally, it wanted to regain the rights to its own trademark, but the license granted to Enersys blocked this. Exide then filed for bankruptcy in 2002, and sought to terminate the Enersys license by rejecting the 1991 contract.

The threshold issue for the court of appeals was whether the 1991 agreement was executory and therefore subject to rejection. The appellate court's answer was "no". It analyzed several factors in so concluding, most significantly four arguments Exide made that the Court of Appeals rejected. Specifically, in arguing that significant obligations remained to be performed on both sides of the agreement, Exide pointed to four Enersys obligations: (1) to satisfy a quality standards provision; (2) to observe a use restriction; (3) certain indemnity obligations; and (4) a Further Assurances Obligation, under which Enersys agreed to cooperate to facilitate the 1991 transaction. The Court found that Enersys's performance already rendered outweighed any remaining





“Can a licensee keep the license from going down with a sinking licensor?”

obligations, and that the benefit that had accrued to each party as a result of the 1991 agreement was substantial. The Court in particular identified the fact that Enersys had fully paid for the battery business by paying the \$135 million purchase price. In essence, the Court made the determination that merely ancillary obligations to a completed asset sale did not render a contract executory, and therefore subject to rejection. For asset purchasers who are not able to purchase the related trademarks outright, the *Exide* decision provides added protection that trailing trademark rights will not later be denied following a licensor’s bankruptcy filing.

Potentially even more significant for trademark licensees was Circuit Judge Ambro’s concurring opinion. He went further than the majority opinion and considered whether Enersys’ right to use the Exide mark would have been ended, had the contract been subject to rejection by Exide. Judge Ambro concluded that the answer was “not necessarily.”

Section 365(n) of the Bankruptcy Code protects licensees of “intellectual property” when a debtor-licensor files for bankruptcy by allowing the licensee, at its option, to retain its licensed rights, along with its duties. “Intellectual property” is defined under the Bankruptcy Code to include specific forms of intellectual property. Trademarks are not among them. As a result, a number of bankruptcy courts have held that when a debtor-licensor rejects a trademark license, the licensee loses its rights to use the licensed mark.

The legislative history associated with Section 365(n) indicates that Congress omitted trademarks (and trade names and service marks) from the definition of “intellectual property” not because it deemed them unworthy of protection, but owing to issues Congress deemed unique to those forms of intellectual property — specifically, the increased importance of the licensor’s ability to control the quality of the licensee’s goods. Congress excluded trademarks from the protections of Section 365(n) because it felt more study was necessary. Based on this legislative history, Judge Ambro concluded that the negative inference that trademark licensees were not entitled to any protection was inappropriate. Rather, according to Judge Ambro, courts should not allow a debtor-licensor to use Section 365(n) as a means to take back trademark rights that were fairly and fully bargained away.

Judge Ambro’s concurrence may not be binding, but it signals a potential shift in the law, at least in the Third Circuit. Should an appropriate case present itself, courts may be willing to protect trademark licensee rights even where a debtor-licensor rejects the underlying license agreement.

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Chloe v. Queen Bee of Beverly Hills

BAGGING ALLEGED COUNTERFEITERS

A question often arising in cases where trademark and copyright owners chase counterfeiters is whether they have to seek out the counterfeiters where they live or do business, or instead can force them to defend in the rights holders' home court. Where the counterfeit goods are being sold online, those questions get even trickier. The Federal Appeals Court for New York, the Second Circuit, handed down a decision during the summer that dealt with jurisdiction, online commerce and infringement of trademarks in such a situation, *Chloe v. Queen Bee of Beverly Hills, LLC*, 616 F.3d 158 (2d Cir. 2010).

Chloe, a maker of high-end handbags (say, \$1,600 per) discovered counterfeit Chloe bags being sold online by Queen Bee (at, say, \$1,200 a shot). Chloe's lawyers ordered a fake Chloe bag, which was shipped to someone's home in New York. A lawsuit alleging federal and state trademark infringement and unfair competition claims followed in the Southern District of New York. District Judge Holwell held this was insufficient to give New York jurisdiction over the defendants under New York's Civil Practice Law and Rules Section 302(a), relying largely on the logic that there was only a single counterfeit Chloe item shown to have been shipped into New York. The Second Circuit reversed and found that, on the facts here, at the pleading stage, jurisdiction was made out.

By the time the appeal came to fruition, all the defendants save one had settled or gone bankrupt. The lone man standing was one Ubaldelli, who was one of the two *de facto* partners in the Queen Bee operation and worked out of its Beverly Hills, California office. Ubaldelli was responsible for obtaining the bags Queen Bee sold, his main source being an individual named Guido who would meet with him in the Queen Bee office. The other partner, based in Alabama, ran the websites and usually, but not always, shipped online orders from Alabama. The fake Chloe bag ordered by the law firm, however, had been shipped from Beverly Hills.

The court concluded that Queen Bee's conduct could be imputed to Ubaldelli. More importantly, it concluded that the trial court had focused its consideration of Queen Bee's conduct too narrowly when it considered only the single fake Chloe item that had been shipped to New York. The Second Circuit did not decide whether the single bag alone would have been enough to bring the alleged counterfeiter into court in New York, though noting it "might well be sufficient," and instead rested on the facts that the website Queen Bee ran was highly interactive, that it offered items including the Chloe bag for sale in New York, and that in fact its records showed 52 other transactions where Queen Bee had sent items to New York. That was enough to show purposeful transaction of business in New York. Having found the so-called long-arm statute satisfied, the court also found the constitutional due process standard met.



Tiffany v. eBay

MORE FIZZLE ON THE REMAND

We reported in the Summer, 2010 *InFashion* issue on the affirmance of the dismissal of most of Tiffany's claims against eBay over counterfeits on the auction website, but noted the appeals court sent one claim back to the District Court for further consideration. That claim was Tiffany's assertion that eBay's advertising for itself constituted false advertising. The District Court's decision on this issue came down in September, and it cleared eBay.

In *Tiffany (NJ) Inc. v. eBay, Inc.*, 2010 WL 3733894 (S.D.N.Y. September 13, 2010), the District Court found that there was no evidence of consumer confusion from eBay's ads describing "Tiffany on eBay." (The statement was literally true because some genuine Tiffany items were available on eBay; the question was whether the statement was deceptive because some fakes also were on eBay.) The Court then weighed alternative theories Tiffany had offered and found they came up short, too. The claim that eBay's ads necessarily implied a falsehood was just another way of arguing they were literally false, a claim already rejected. Nor could the argument that eBay's deception was intentional carry the day, an argument raised only post-appeal and therefore waived. In any event, the Court concluded, while sufficiently clear evidence of an intention to mislead can give rise to a presumption of public deception, the record simply did not establish that eBay had set out to deceive the public. The Court laid emphasis on the numerous steps eBay had taken to educate rather than dupe the public.

SHORT TAKES

Fashionably Fordham —We congratulate Professor Susan Scafidi and Fordham Law School on the creation of the Fashion Law Institute. Diane von Furstenburg was the keynote speaker at the launch event September 8 during New York Fashion Week.

Innovative Design Protection and Privacy Prevention Act — This is the 2010 version of a bill pushed by the Council of Fashion Designers of America to provide limited protection to a variety of fashion and accessory designs, this time with the backing of the American Footwear and Apparel Association. S. 3728, introduced by New York's Senator Schumer and others in August, would create a three-year design right. For more on this, see <http://www.schiffhardin.com/binary/jacoby-roth-law360-091010.pdf>

The Public Clamor Answered — We are delighted to let you know that a complete index of all issues of this newsletter, going back to 2006, is now available online at http://www.schiffhardin.com/Fashion_and_Apparel_Industry.htm

SPECIAL REPORT

Trick or Tweet: Social Media, Branding and Legal Traps

Accessories Council program, September 16, 2010

Thanks to Facebook, along with YouTube, Twitter, MySpace, LinkedIn and a host of other social media sites, the way branding and merchandising takes place is being rewritten. But just as social media open the door to new opportunities, they can open the floor to legal traps. How to avoid those traps was the subject of a 90-minute program Schiff Hardin presented to the Accessories Council at the Fashion Center Business Improvement District offices on September 16, with lively audience interaction. We can't repeat the whole program without making this issue as long as *War and Peace*, but here are some of the highlights.

Social media can do many things – for example, letting members make new connections and broadcast (or narrowcast) a wealth of information about themselves. Less obviously, but perhaps more critically, they also create a network of information about how the members of the group behave: what they like, where they buy, how to interest them. In some respects, business has never before had a comparable ability to learn about existing or potential customers. At the same time, having all that information about individuals seems like a cross between *Brave New World* and *1984*. It's not surprising that social media and the marketing information they can provide have become the subject of intense government interest and possible regulation, especially at the Federal Trade Commission. All this presents a unique set of legal pitfalls for businesses.

Losing Control

1. Content of Postings

One of the primary ways in which social media differ from more traditional communication formats is that the conversation is not one-way — it's interactive. This loss of control has put off some companies. Not everyone is comfortable with sharing control. The risk of providing a forum for improper postings by third parties can be lessened, however, by reserving the right to remove inappropriate user-generated content. With positive content, you can provide for a license that allows you the right to keep displaying user-generated content. Remember, too, that if a third party controls the social medium site, you need to develop alternative ways of maintaining the contacts you develop.

2. Privacy Concerns

Much of the value of social media is caught up in the data developed about the participants. As you may have read recently in [The Wall Street Journal](#), some companies now gather information about social media users and use it to target advertising to them. For example, if you've visited sites about Caribbean cruising, you might be targeted for swimsuit ads. This is known as behavioral advertising. The Federal Trade Commission is looking at so-called behavioral advertising and privacy issues right now.



“ Much of the value of social media is caught up in the data developed about the participants. ”

“ It’s critical to provide guidance and training to those whom you involve with social media. ”

For the moment, however, the most stringent requirements are imposed by California law, which requires any site that a California resident ever visits (so, as a practical matter, almost all sites) to post a privacy policy that tells what personal information is being gathered and with whom it will be shared. Among other things, “personally identifiable information” includes names, physical or on-line addresses, telephone or Social Security numbers plus any other information stored in tandem with such identifiers. So if mint chocolate chip is your favorite ice cream flavor, and that information is associated with your e-mail address because you’ve ordered it so often from an on-line grocer, your favorite ice cream flavor becomes personally identifiable information, too.

Social media have stumbled over some of these issues in the past. Facebook wound up paying \$9.5 million to settle class action claims over its former Beacon function, which alerted “friends” to Facebook activity by members, such as product purchases. Sears found out that it wasn’t even enough to tell people signing up for a social media group that you would be tracking their website visits – the FTC still asserted the retailer had committed deceptive acts. The FTC has taken the strong view that such disclaimers may not be sufficient to protect the public. Similarly, a federal district court in New York recently refused to enforce a liability disclaimer between two online businesses in the face of one company’s recklessness in letting a hacker gain access.

3. State of the Law

There is no one law to check on social media issues — much of it is still evolving, as existing principles are applied to new situations. Some of the major areas of law that are impacted include:

- Intellectual property law
- Marketing and advertising law
- Labor and employment law
- Regulatory law and record-keeping

Beyond that, there are four federal statutes that deal with online issues that can arise in social media contexts. Some existing federal laws have been applied to impose or excuse liability for conduct related to social media. Section 230 of the Communications Decency Act can provide a safe harbor from liability to site operators, in some circumstances, for content posted by others. The Digital Millennium Copyright Act spells out steps which site operators can take to avoid copyright infringement claims. The Children’s Online Privacy Protection Act deals specifically with sites and access by those under 13 years of age. Finally, the Stored Communications Act restricts who can access certain kinds of online information – and poses problems for people who pry into others’ non-public postings on social media.

Other People’s Mistakes

The liveliest part of the program used real world social media mistakes, some of which led to serious legal consequences, to illustrate important lessons. For example:

- Does your intern manage the company’s social media? You need to give more guidance than just saying, “Go forth and do social media.”
- Do you suspect your employees gossip about the workplace on a password-protected site on MySpace? Don’t go snooping — you might find you’ve violated their privacy rights, the Stored Communications Act, and maybe the National Labor Relations Act, too — even if they’re not in a union.
- Have your posts crossed over from creative to created from whole cloth? Both the Federal Trade Commission and the New York Attorney General have gone after companies for “astroturfing” — that is, posting phony reviews or comments masquerading as statements from the public.
- Do you give bloggers who write about your brand goodies as a perk? Go back and read our Winter 2009-10 *InFashion* article about the FTC’s endorsement guidelines — “pay for praise” is banned unless disclosed.
- Want to run contests? Make sure you check the social media and legal rules on contests — and don’t change the rules to change the winner, as one company did.
- Are you inviting people to generate content? Be careful not to tell them what to say, or you may lose your immunity for content claims under Communications Decency Act Section 230.
- Does your privacy policy promise more than you can deliver? Is it flexible enough to let you accommodate future contingencies, such as a bankruptcy or a merger? Don’t overpromise. Preserve your rights to use data and share posted materials.

Legal Planning for Social Media

We concluded with a framework of considerations for companies using or looking at using social media. Begin by thinking through whether and how your organization should use social media in light of its needs, goals, culture and resources. For example, how much involvement do you want employees to have? If you allow some or all of them to post, will someone review items pre-posting?

It’s critical to provide guidance and training to those whom you involve with social media. You should tell them what your business hopes to accomplish, and give them general guidelines — for example, always be polite.

Keep an eye out for red flags:

- Posts discussing competitors
- Posts discussing customers, business partners, celebrities
- Posts using someone else’s text or images or intellectual property
- Are your employees telling others what to write on the site?



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- Are you giving people benefits to get them to write?
- Are posts being made anonymously or under false names?

Identify areas where you will provide not just guidance but absolute rules — “no go” zones, such as:

- Never speak for the company
- Never share confidential information
- Never be deceptive or dishonest

Because the FTC is expected shortly to issue guidelines dealing with privacy and behavioral advertising, this is an area we will continue to follow.



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