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LEGAL AND PRIVACY

Buying a brand out of bankruptcy: What are you really getting?

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Fashion brand Roberto Cavalli emerged from bankruptcy. Image credit: Roberto Cavalli

By Milton Springut

Even before the COVID-19 crisis, fashion and luxury goods brands and retailers were no strangers to the bankruptcy process.

Such names as Barneys, Sonia Rykiel, Roberto Cavalli and Diesel all went through the bankruptcy process. Now, with the severe economic impact of COVID-19, it seems likely that bankruptcy filings in the luxury and fashion world will only increase.

But bankruptcy does not necessarily mean the end of a brand.

Brands are often purchased out of bankruptcy and the operations then continued by new investors.

In the spring of 2019, Sonia Rykiel filed for bankruptcy. Though it struggled to continue its business, a Paris court eventually ordered its liquidation, and all assets were sold off. Two investors, brothers Eric and Michael Dayan, prevailed in their bid for the assets, and will now seek to reinvigorate the brand.

So even as fashion bankruptcies increase, many brands will make a comeback when they are purchased out of bankruptcy and reinvigorated.

What exactly does a purchaser receive when it purchases a "brand" out of bankruptcy proceeding? And what are the pitfalls to watch out for?

Trademarks: A unique form of property
Defunct companies will often have their assets sold off during the bankruptcy process.

For most tangible items real estate, equipment and inventory this is straightforward. The purchaser simply has acquired the property from the bankruptcy estate for some value, subject to the court's approval. This is no different than a purchase outside of bankruptcy.

The same is the case for patents and copyrights. They are freely transferrable from one company to another, and the same also holds true in a bankruptcy proceeding.

But for many fashion and luxury companies, their most valuable asset is not the patent or copyright items, but the brand itself, which is protected by trademarks, often represented by numerous registrations in multiple countries.

Trademarks are a unique form of intellectual property. More than 100 years ago, the Supreme Court stated that there is no such thing as a property right in a trademark *except* as a right "*appurtenant* to an established business."

Appurtenant is fancy legal term for relating to, or secondary to. A trademark is like a person's name it has no independent existence, but is a shortcut to refer to a business as the source of its goods and services.

In trademark law, this is closely connected to a business' goodwill, meaning its reputation among the customers for quality products, customer service and standing behind its products.

Assignment requires goodwill
A trademark cannot be transferred without transferring the goodwill of the company, because without goodwill, a trademark is meaningless. That is why every trademark assignment recites that the trademark is being assigned "along with the goodwill associated with the mark."

This rule, codified in the Trademark Act, exists to protect consumers.

Consumers rely on trademarks as a shorthand for the particular reputation of a company. When a consumer buys a "Brand X" item, she or he is assured that the Brand X company stands behind it, and that he or she will receive the same level of quality and customer service associated with that brand.

But if trademarks could be assigned without goodwill, then a completely different company could use the mark to deceive consumers into believing that they are purchasing products from the same quality operation they were used to, when in fact there is no connection between the two companies.

The requirement to transfer goodwill cannot be an empty formality. Merely reciting that goodwill accompanies the trademark assignment is not enough. There has to be some continuity with the prior business.

Where the entire business is sold as one unit, that is easily satisfied. But United States law is generally lenient, as long as there is *some* connection with the prior business.

For example, if technical information and know-how together with customer lists are transferred, goodwill passes to the buyer and supports a trademark assignment.

There is no requirement that any particular kind of asset accompanies the trademark and goodwill, but it is important to show some kind of connection with the prior company and its reputation.

In the *Sonia Rykiel* bankruptcy case, apart from numerous trademark registrations, the purchasers also acquired decades of archives and product prototypes representing the brand's creativity and designs, which it could employ in the rejuvenated business. This is a good example of how a purchaser of a trademark out of bankruptcy can show continuity of the brand.

What happens to outstanding licenses?
The now-bankrupt trademark owner may have licensed the mark prior to its business failure. What happens to these licenses after bankruptcy?

In 2019, the Supreme Court decided this issue. The Bankruptcy Code allows the trustee to reject the debtor's "executory contracts," *i.e.*, contracts for which "performance remains due to some extent on both sides." A trademark license is an ongoing contract, so it can be rejected.

But, the Court held, that does not terminate the license. It merely means that the contract was breached, and the terminated party can sue for damages.

So, purchasers of brands from a bankruptcy proceeding should be aware that any outstanding licenses to the trademarks will likely continue.

So, what does the purchaser really get?
Brands and brand reputation are often a luxury or fashion goods company's most valuable asset. Not surprisingly, purchasers are often eager to acquire these assets.

What in most important for purchasers to appreciate is that, from a legal point of view, a brand is really a shorthand for the reputation of an ongoing business.

On some level, consumers need to be assured that the same operation is continuing, so they can rely on the same brand and associated trademarks to reference that reputation.

AS THE NUMBER of bankruptcy filings in the industry increase, so to will opportunities for investors to acquire and reinvigorate valuable brands, some of which have existed for many decades.

Done right, and with the full understanding of what the purchaser is acquiring, such an acquisition can be a very lucrative business opportunity.


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