

Mission Accomplished: Supreme Court Rules Licensees May Use Licensed Marks Following Rejection in Bankruptcy

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The U.S. Supreme Court has resolved a circuit split regarding the effect of a debtor-licensor's rejection of a trademark license pursuant to the Bankruptcy Code. The Court's decision is good news for trademark licensees, as the Court has determined that licensees can continue to use trademarks licensed by bankruptcy debtors once the license agreement is rejected pursuant to Section 365 of the Bankruptcy Code. In so deciding, the Supreme Court brought clarity to the issue of what rejecting an executory contract in bankruptcy means generally – that it constitutes a breach, but not a rescission of the contract, leaving the non-debtor party with all rights it would have under non-bankruptcy law upon a breach of the contract. The Supreme Court's opinion, issued on May 20, 2019, in *Mission Product Holdings, Inc. v. Tempnology, LLC*, was authored by Justice Kagan.

Implications of the Court's Decision

As a practical matter, the Court's decision in *Mission* means that licensees under trademark agreements can use licensed trademarks for the duration of the license agreement and consistent with its terms following a licensor's rejection of the agreement. "Rejection" is one of many powers the Bankruptcy Code grants bankruptcy debtors to manage their estates. It is a statutorily sanctioned breach of a contract that frees the debtor's estate from performing obligations under what it deems to be a burdensome agreement. As the Supreme Court's decision emphasizes, however, rejection does not deprive the counterparty of a rejected contract of rights under the agreement under non-bankruptcy law. As such, the Court's decision benefits licensees of currently outstanding trademark license agreements.

Given the Court's ruling on the effect of "rejection," licensors are likely to change their licensing practices regardless of whether bankruptcy is an imminent possibility for them. Licensors may seek to negotiate licenses that are shorter, do not provide for automatic renewals, or contain covenants or contingencies that will make it easier for the licensor or a successor to terminate the agreement prior to, in or following a bankruptcy scenario.

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Licensors preparing to enter bankruptcy may begin a practice of terminating license agreements prior to filing a bankruptcy petition to avoid rejection issues altogether.

The Court's ruling also has implications for purchasers of intellectual property assets from bankruptcy estates: purchasers must live with the debtor's pre-bankruptcy licensing arrangements for the duration of its license agreements, unless those agreements can be terminated consistent with their terms and any other applicable law, or renegotiated.

In short, while *Mission* provides much needed clarity regarding the treatment of trademark licenses in bankruptcy, parties to any sort of agreement pertaining to trademark rights ought to reexamine their trademark licenses and exercise additional vigilance regarding their rights in its wake.

History of Disputes Surrounding the Rejection of Trademark Licenses in Bankruptcy

Mission resolves a longstanding split amongst federal courts regarding trademark licensees' rights following a debtor-licensor's rejection of a trademark license agreement. The issue stems from the meaning of two terms in the Bankruptcy Code. The first is the meaning of "rejection" authorized under Section 365 of the Bankruptcy Code with respect to executory contracts of the debtor. The second is Congress's definition of "intellectual property," added into the Bankruptcy Code in 1988, which specifically excludes trademarks, and the impact of this exclusion on the rights of trademark licensees compared to the rights granted to "intellectual property" licensees under Section 365(n) of the Bankruptcy Code.

Section 365(n) of the Bankruptcy Code provides special protections for licensees of "intellectual property" to contracts under which the debtor is a licensor. These include rights to use licensed intellectual property for the duration of the rejected contract, providing that the licensee continues to make royalty payments. As trademarks are excluded from the definition of "intellectual property," such protections are not available to trademark licensees.

Congress adopted Section 365(n) in 1988, specifically in response to the Fourth Circuit's decision in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). *Lubrizol* held that when a debtor-licensor in bankruptcy rejects an intellectual property license agreement, the licensee loses the right to continue using the licensed intellectual property. This change in the statute left trademark licensees in limbo – were trademark licensees entitled to the same protections as other licensees of "intellectual property" to continue to use the property licensed for the duration of the term of the license, or were trademark licensees left with only damage claims on rejection? Prior to 2010, courts generally read the omission of trademarks from the Bankruptcy Code's definition of "intellectual property" as creating a "negative inference" that Congress intended for *Lubrizol* to apply to trademark license agreements.

In 2010, Judge Thomas Ambro criticized application of the negative inference to the rejection of trademark license agreements in a concurrence to the Third Circuit's decision

in *In re Exide Technologies*, 607 F.3d 957 (3d Cir. 2010), which held that a trademark license agreement was not executory and could not be rejected. Judge Ambro noted that the Bankruptcy Code permits debtors to free bankruptcy estates from obligations to perform and “has absolutely no effect upon the contract’s continued existence.”

In 2012, the Seventh Circuit relied on Judge Ambro’s rationale in *Sunbeam Products v. Chicago American Manufacturing*, 686 F.3d 372 (7th Cir.), *cert. denied*, 133 S. Ct. 790 (2012). There, the court held that rejection of a contract gives rise to a claim for damages, as though the contract were breached prior to the debtor’s initiation of bankruptcy proceedings, but it did not “vaporize” the counterparty’s rights.

In 2015, the U.S. Bankruptcy Court for the District of New Hampshire made the decision in *In re Tempnology, LLC* that gave rise to the circuit split the Supreme Court resolved. The bankruptcy court relied on the negative inference of *Lubrizol* to hold that Mission Products, Inc. could no longer use Tempnology, LLC’s “Coolcore” trademark after Tempnology rejected the parties’ co-marketing and distribution agreement. The Bankruptcy Appellate Panel for the First Circuit relied on *Sunbeam* to reverse the bankruptcy court’s decision, then the First Circuit reinstated the bankruptcy court’s decision. The First Circuit reasoned that it would be inequitable to force debtor-licensors to choose between performing quality control necessary to trademark licensing and risking abandonment of its trademarks. The First Circuit’s decision that rejection deprived trademark licensees of continuing rights to use licensed trademarks conflicted with the Seventh Circuit’s decision in *Sunbeam*, creating a circuit split.

The Supreme Court’s Decision

The Supreme Court’s decision in *Mission* definitively rules that “[r]ejection of a contract—any contract—in bankruptcy operates not as a rescission but as a breach.” With respect to trademark license agreements in particular, the Court (citing *Sunbeam*) held that the breach effected by a debtor-licensor’s rejection “does not revoke the license or stop the licensee from doing what it allows.” Four justices join in the majority opinion, with Justice Sotomayor concurring, and Justice Gorsuch dissenting on procedural grounds.

The Court reconciled its interpretation of the effect of rejection with exceptions providing protections for counterparties to certain types of contracts, i.e. other intellectual property under Section 365(n), real estate lessees under Section 365(h), and timeshare owners under Section 365(i), concluding those exceptions were enacted to override specific judicial decisions limiting contractual non-debtor counter-party rights in order to “reinforce or clarify the general rule that contractual rights survive rejection.” The Court further points out that if a debtor could rescind previously granted interests through rejection, there would be no use for the Bankruptcy Code’s provisions granting debtors avoidance powers (rights to unwind certain transactions that took place prior to the bankruptcy).

Justice Sotomayor authored a concurring opinion to highlight two points regarding the majority decision that she deems significant. The first is that a trademark licensee does not have unfettered rights to continue using trademarks following rejection of a license agreement because applicable non-bankruptcy law still applies, leaving the licensee’s

post-rejection rights subject to the terms of the agreement, state law, and other law. The second is that license agreements for intellectual property other than trademarks remain governed by Section 365(n), which, perhaps ironically, actually provides for narrower post-rejection rights and remedies than are available to trademark licensees under the Court's ruling.

Justice Gorsuch dissented from the Court's opinion, asserting that the parties' dispute is moot, and the petition for certiorari was improvidently granted. Justice Gorsuch considers the dispute moot and any damages questionable because the agreement at issue expired by its own terms following the bankruptcy court's decision and prior to the Supreme Court's consideration of the case, without Tempnology taking any action which would give rise to a claim for damages.