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Supreme Court: Licensee may use trademark after bankruptcy rejection, subject to license

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On May 20, the Supreme Court issued its decision in *Mission Product Holdings Inc. v. Tempnology LLC*, No. 17-1657, 2019 WL 2166392 (U.S. 2019), resolving a long-standing issue at the center of trademark and bankruptcy law: whether a trademark licensee can continue to use a licensed mark when the debtor-licensor rejected the license in bankruptcy.

The court held that such a rejection does not deprive the licensee of its right to use the mark.

Although the court found in favor of the licensee, the decision appears to have left the door open for parties to enter into contractual arrangements that place some limits on licensee rights post-rejection.

The court referred repeatedly to "special contract term[s]" that might impact whether a licensee may continue to use the trademark following rejection.

Moreover, Justice Sonia Sotomayor authored a concurring opinion in which she stated that "the court does not decide that every trademark licensee has the unfettered right to continue using licensed marks post-rejection" and "[s]pecial terms in a licensing contract ... could bear on that question in individual cases."

> The Supreme Court was not persuaded by Tempnology's argument that licensors would be forced to choose between retaining burdensome obligations associated with monitoring quality control and abandoning a valuable trademark to the public domain.

In light of Mission Product, both licensors and licensees should consider ways in which they might draft trademark licenses to preserve their respective rights in the event of the licensor's bankruptcy.

TRADEMARK LICENSES UNDER CHAPTER 11

Chapter 11 of the Bankruptcy Code provides a framework for a business to reorganize its debt while continuing its operations.

A Chapter 11 case begins when a bankruptcy petition is filed with the bankruptcy court. This creates a bankruptcy estate consisting of the assets that will be used to satisfy the claims of creditors.

Under Section 365(a) of the Bankruptcy Code, 11 U.S.C.A. § 365(a), a debtor who has filed for bankruptcy can "reject any executory contract" — in other words, any contract that requires the contracting parties to perform ongoing obligations, including a trademark or other intellectual property license.

Section 365(g) of the code, 11 U.S.C.A. § 365(g), provides that rejection "constitutes a breach" of the contract, deemed to occur immediately before the filing date of the bankruptcy petition.

Section 365 thus allows a debtor to avoid further performance under a contract that the debtor determines is no longer in its interest. However, it subjects the debtor's estate to a claim for damages resulting from the nonperformance.

Section 365(n) of the code, 11 U.S.C.A. § 365(n), specifies that for certain types of intellectual property licenses, the licensee can continue to use the IP notwithstanding the debtor's rejection, so long as the licensee continues to fulfill its own obligations under the license.

The Bankruptcy Code defines "intellectual property" to include patents, copyrights and trade secrets — but not trademarks.[1]

The legislative history indicates that Section 365(n):

does not address the rejection of executory trademark, trade name or service mark licenses by debtor-licensors. ... Trademark, trade name and service mark licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee. Since these matters could not be addressed without more extensive study, it was determined to postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts.[2]

CASE HISTORY

In 2012, Tempnology entered into an agreement with Mission Product Holdings. The agreement gave Mission an exclusive license to distribute certain Tempnology products in the United States and a nonexclusive license to use Tempnology's "Coolcore" trademarks around the world.

Before the agreement's expired, Tempnology filed a petition for Chapter 11 bankruptcy. It then filed a motion to "reject" the Mission license pursuant to Section 365(a).

The Bankruptcy Court granted the motion and held that Tempnology's rejection of the licensing agreement revoked Mission's right to use the Coolcore marks. *In re Tempnology LLC*, 541 B.R. 1 (Bankr. D.N.H. 2015).

Citing legislative history, the Bankruptcy Court determined that trademark rights are not afforded any protection under Section 365(n).

The Bankruptcy Appellate Panel reversed. *In re Tempnology LLC*, 559 B.R. 809 (B.A.P. 1st Cir. 2016).

The panel relied on the 7th U.S. Circuit Court of Appeals' opinion in *Sunbeam Products Inc. v. Chicago American Manufacturing LLC*, 686 F. 3d 372 (7th Cir. 2012).

The 7th Circuit had held in Sunbeam that although Section 365(n) "does not affect trademarks one way or the other," Section 365(g) "establish[es] that in bankruptcy, as outside of it, the other party's rights remain in place" following rejection.

The panel applied the reasoning from Sunbeam and concluded that Mission could continue using the Coolcore trademarks.

The 1st U.S. Circuit Court of Appeals reversed the BAP and reinstated the Bankruptcy Court decision. *Mission Prod. Holdings Inc. v. Tempnology LLC (In re Tempnology)*, 879 F.3d 389 (1st Cir. 2018).

The 1st Circuit agreed that Section 365(n) did not provide Mission with the rights it sought, but it rejected the Sunbeam approach to Section 365(g) "because the effective licensing of a trademark requires that the trademark owner — here debtor, followed by any purchaser of its assets — monitor and exercise control over the quality of the goods sold to the public under cover of the trademark."

The 1st Circuit panel noted that a debtor's failure to maintain such control might result in abandonment of the mark.

"Favor[ing] the categorical approach of leaving trademark licenses unprotected from court-approved rejection," the 1st Circuit concluded that the rejection left Mission with only a pre-petition damages claim.

The Supreme Court granted certiorari to resolve the division between the 1st Circuit and 7th Circuit.

SUPREME COURT OPINION

The Supreme Court ruled 8-1 in favor of Mission. It held that a debtor's rejection of a trademark license in bankruptcy has the same effect as a breach of contract outside bankruptcy.[3]

Section 365(g) says a rejection "constitutes a breach." The court observed that outside of bankruptcy, absent a "special contract term" or unique state law, a breach does not rescind rights granted under a license.

The court held that the same is true in bankruptcy: A rejection cannot revoke rights previously granted, and thus Tempnology's rejection of the trademark license did not revoke Mission's right to use the Coolcore marks.

The court rejected Tempnology's argument that Section 365(n) and other Bankruptcy Code provisions should be read to provide a list of exceptions to the general rule that rejection terminates contractual rights.

It also confirmed that rejection generally does not result in termination. It concluded that the provisions Tempnology cited, enacted at different times and in response to different problems, were intended "to reinforce or clarify the general rule that contractual rights survive rejection."

Debtor-licensors will have to consider with more care the pros and cons of rejecting a trademark license in bankruptcy.

Nor was the court persuaded by Tempnology's argument that licensors would be forced to choose between retaining burdensome obligations associated with monitoring quality control and abandoning a valuable trademark to the public domain.

The court held that Tempnology's policy arguments could not overcome what Sections 365(a) and (g) direct.

Justice Elena Kagan authored the majority opinion.

Justice Sotomayor's concurrence noted that "the court does not decide that every trademark licensee has the unfettered right to continue using licensed marks post-rejection," as "[s]pecial terms in a licensing contract or state law could bear on that question in individual cases."

Justice Neil Gorsuch authored a dissenting opinion that said there was no case or controversy because the license agreement expired on its own terms.

TAKEAWAYS

The Supreme Court's decision resolves the circuit split as to whether a bankruptcy debtor-licensor's rejection of a trademark licensing agreement deprives the licensee of its right to use the trademark.

Both licensors and licensees now have greater certainty regarding their rights during bankruptcy.

Licensees can rest easier knowing that their ability to continue business operations in the event of the licensor's bankruptcy is more secure.

Debtor-licensors will have to consider with more care the pros and cons of rejecting a trademark license in bankruptcy.

In the absence of any special contract terms or unique state law, trademark licensees have a choice when faced with the licensor's rejection of their license in bankruptcy: They can continue to use the marks, or walk away.

Either way, they may have a suit against the debtor — even if collecting substantial damages in such a suit is unlikely.

However, as the court recognized, special licensing terms may change the analysis.

Justice Sotomayor's concurring opinion points to examples of such terms provided by the American Intellectual Property Law Association.[4]

For instance, a license might include a quality-control provision that requires the licensee to provide the licensor with a prototype of the product that the licensee intends to sell with the mark.

If the contract provides that the licensor's approval of the prototype is necessary before the licensee can manufacture and sell the product, and if the licensor refuses to provide such approval, a bankruptcy court might conclude that the licensee has no right to continue using the mark.

Likewise, if a license provides that the licensor will provide one or more components to be included in a product labelled with the mark and sold by the licensee, and the licensor stops manufacturing the components, a bankruptcy court might conclude that the licensee has no right to manufacture the product using components from other suppliers.

In consultation with experienced trademark counsel, licensors should consider whether they would benefit from the inclusion of similar terms in their licensing agreements.

NOTES

[1] 11 U.S.C.A. § 101(35)(B) ("The term "intellectual property" means — (A) trade secret; (B) invention, process, design, or plant protected under title 35; (C) patent application; (D) plant variety; (E) work of authorship protected under title 17; or (F) mask work protected under chapter 9 of title 17; to the extent protected by applicable nonbankruptcy law.").

[2] S. Rep. No. 100-505, at 5 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 3200, 3204.

[3] Mission argued that its exclusive distribution rights also survived Tempnology's rejection of the licensing agreement. However, the Supreme Court found "no reason to doubt" the 1st Circuit's conclusion that Mission had waived that argument.

[4] *Mission Product Holdings Inc. v. Tempnology LLC*, No. 17-1657, brief of the American Intellectual Property Law Association as amicus curiae in support of neither party, 2018 WL 6618031 (2018).

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