Practice Update

Rejection (In Bankruptcy) Does Not Spurn Trademark Licensees

May 31, 2019

The United States Supreme Court in *Mission Product Holdings, Inc. v. Tempnology, LLC* (No. 17-1657) (May 20, 2019) resolved a deep circuit split and held that a licensees' rights under trademark licenses survive a debtor-licensor's rejection in bankruptcy, resolving an ambiguity presented in the intersection of intellectual property law and bankruptcy law that has plagued courts for decades.

Tempnology, LLC (Tempnology) manufactured exercise clothing, marketing those products under the trademark COOLCORE (and various logos). In 2012, Tempnology gave Mission Products Holdings, Inc. (Mission) a license to distribute the products and also a non-exclusive license to the trademark COOLCORE. The license agreement was set to expire by its terms in July 2016, but in September 2015, Tempnology filed a petition for Chapter 11 bankruptcy. Soon after filing the petition, Tempnology rejected the licensing agreement, as debtors are permitted to do for executory contracts – that is, contracts that are not fully performed by both parties –permitting the debtor to cease performing under the license and giving the licensee a pre-petition claim for damages for breach.

Mission was granted *certiorari* on the issue of whether rejection of a licensing agreement during bankruptcy rescinded a licensee's rights or whether it was merely a breach of the contract, in which case

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the contract would continue. To answer that question, the Court looked at the plain language of the Bankruptcy Code (the Code).

Section 365(a) of the Code provides that a debtor may assume or reject an executory contract. As noted above, a contract is executory if performance remains due to some extent on both sides. Licenses are executory because the licensor's permission to use the licensed property and other obligations are ongoing, and the licensee's duty to pay royalties is likewise ongoing.

According to § 365(g) of the Code, "the rejection of an executory contract ... constitutes a breach of such contract." (Emphasis added). The Court noted that the term "breach" is neither defined nor a specialized bankruptcy term. Therefore, its meaning is the same as in ordinary contract law outside of bankruptcy. Ordinary contract law principles allow the party **not** in breach to keep up its side of the bargain and sue for damages, or call the whole deal off and sue for (different) damages. The Court explained, however, that the choice to terminate the agreement is the **non-breaching party's** to make. The breaching party has no ability, based on its breach, to terminate an agreement. Accordingly, the Court reasoned, when a debtor rejects a license, the trademark licensee may continue to do whatever the license authorizes.

Tempnology's main argument to the contrary rested on a negative inference ("the inclusion of one is the exclusion of others"). Several provisions of § 365 identify categories of contracts under which a counterparty may retain specified contract rights notwithstanding rejection. For example, §§ 365(h) and (i) make clear that certain purchasers and lessees of real property can continue to enforce rights after a debtor has rejected the lease.

Section 365(n) similarly provides that licensees of **patents and trade secrets** retain contractual rights after rejection, but does not include trademark licenses. Under Tempnology's interpretation, Congress must have intended to exclude trademark licenses as a type of contract under which a counterparty may retain rights.

The Court rejected this view. First, the Court noted the plain language of § 365(g) states that rejection is a *breach*, and not a *rescission*. Moreover, the Court emphasized that the exceptions set forth in § 365(h) and (i) and most importantly, § 365(n), were Congressional responses to judicial rulings that were perceived to be mistaken or unjust.

> "What the legislative record [reflects] is that whenever Congress has been confronted with the consequences of the [view that rejection terminates all contractual rights] it has expressed its disapproval." Slip Op. at 13.

Section 365(n) addresses patent and trade secret licensing agreements in response to the much-criticized Fourth Circuit decision in *Lubrizol Enterprises v. Richmond Metal Finishers*, 756 F.2d 1043 (4th Cir. 1985), where the court treated the license as rescinded. "[C]ongress's repudiation of *Lubrizol* for patent contracts does not show any intent to ratify that decision's approach for almost all others." Slip Op. at 14 (emphasis in original).

Finally, Tempnology argued that trademark licenses, with their continuing quality control obligations, are uniquely unsuited to continue when the debtor-licensor believes it can no longer perform. The Court noted, however, that Tempnology's other argument – that § 365 means that a debtor's rejection of a contract terminates the counterparty's rights "unless the contract falls within an express statutory exception" – was much broader than this second, trademark-specific argument: "So Tempnology is essentially arguing that distinctive features of trademarks should persuade us to adopt a construction of Section 365 that will govern not just trademark agreements, but pretty nearly every executory agreement." The Court declined to do so.

Justice Sotomayor concurred “to highlight two potentially significant features” of the holding, in her view. First, Justice Sotomayor noted that the decision should not be read to grant every trademark licensee the unfettered right to continue using the mark post-rejection. Rather, in the view of the concurrence, a case-by-case inquiry should be made to determine whether, in fact, the licensee’s rights would survive a breach under applicable non-bankruptcy law. Second, Justice Sotomayor suggested that, because the Court’s decision sets forth separate post-rejection effects for trademark licensees versus licensees of other types of intellectual property, Congress may wish to tailor post-rejection remedies that specifically apply to trademark licensees.

Justice Gorsuch dissented on the ground the case was moot.

This case clarifies an area of bankruptcy and intellectual property law that strongly needed clarification. That clarity benefits debtor-licensors and licensees.
