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Trademark Licensees May No Longer Need to Fear Rejection (in Bankruptcy)

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In *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, the U.S. Supreme Court issued an opinion at the intersection of trademark and bankruptcy law. The Court resolved a circuit split on the issue of whether the "rejection" of a trademark license agreement by the licensor under Section 365(a) of the U.S. Bankruptcy Code (the Code) bars the licensee from continuing to use the trademark. Justice Kagan, writing for an 8-1 Court, answered with a resounding "No."

Background

In 2012, the appellant, Mission Product Holdings, a sports apparel retailer, entered into a licensing agreement with Tempnology, which granted Mission the right to use Tempnology's trademark in connection with its "Coolcore" products. Before the agreement expired, in 2015, Tempnology filed for bankruptcy and asked the bankruptcy court for permission to "reject" the parties' agreement under Section 365(a) of the Code, which allows a debtor, with court approval, to "reject any executory contract." Under Section 365(g) of the Code, a debtor's rejection of an executory contract "constitutes a breach of such contract."

After receiving permission to reject its trademark license agreement with Mission, Tempnology went one step further and asked the bankruptcy court to issue a declaratory judgment that Tempnology's rejection *also* terminated Mission's contractual right to use the Coolcore trademark. Mission objected, arguing, among other things, that Section 365(n) of the Code allowed Mission to retain its rights under the license. Section 365(n) provides an exception to Section 365(a), effectively limiting a debtor-licensor's ability to terminate certain "intellectual property" licenses without the licensee's consent.

However, the definition of "intellectual property" in Section 101(35A) of the Code does not include trademarks. The bankruptcy court therefore held that Section 365(n) did not apply to trademarks and that trademarks were "unprotected from rejection."

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The Bankruptcy Appellate Panel Ruling

Mission appealed to the Bankruptcy Appellate Panel for the First Circuit (BAP), which affirmed in part. Although the BAP agreed with the bankruptcy court's conclusion that Section 365(n) did not apply to the trademark license, it disagreed with the bankruptcy court's conclusion that rejection necessarily extinguished the rights of the nondebtor licensee. The BAP followed the U.S. Court of Appeals for the Seventh Circuit's ruling in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC.* In *Sunbeam,* the Seventh Circuit held that a debtor-licensor's rejection of a trademark license agreement did not terminate the licensee's right to use the trademark.

Following *Sunbeam*, the BAP held that, "because section 365(g) deems the effect of rejection to be a breach of contract, and a debtor-licensor's breach of a trademark agreement outside the bankruptcy context does not necessarily terminate the licensee's rights, rejection under section 365(g) likewise does not necessarily eliminate those rights."

Upon review, the First Circuit held, *inter alia*:

(i) That Section 365(n) did *not* apply to the trademark license; and

(ii) That Mission's right to use the debtor-licensor's trademarks did not survive rejection.

In so finding, the First Circuit held that Tempnology's rejection of the license agreement also meant that Mission could no longer use Tempnology's trademark. In disagreeing with the *Sunbeam* decision*,* the First Circuit reasoned that "the approach taken by *Sunbeam* entirely ignores the residual enforcement burden it would impose on the debtor just as the Code otherwise allows the debtor to free itself from executory burdens."

The Supreme Court Decision

In an 8-1 decision, with Justice Sotomayor filing a short concurrence, the Court reversed the First Circuit, holding that the licensee's right to use the trademark survived, despite Tempnology's rejection of the parties' license agreement. As stated in Justice Kagan's majority opinion: "[a] rejection breaches a contract but does not rescind it . . . that means all the rights that would ordinarily survive a contract breach," which *includes* the right to continue using a trademark, "remain in place."

The Court Confirms That Bankruptcy Law Does Not Give Trademark Licensors the Right to Extinguish the Licensee's Use of the Trademark

The Court's decision reinforces the basic principle that exists outside of bankruptcy: barring any special contract provisions or state law, when one party breaches a contract, it is the *non-breaching* party (here, Mission), not the breaching party, that has the power to choose whether to continue to exercise its rights under the contract. The Court first examined how the "law of breach works outside of bankruptcy," and Justice Kagan provided a helpful example to illustrate this point.

Tempnology's breach of the license agreement "does not revoke the license or stop [Mission] from doing what [the license agreement] allows."

In the hypothetical, a dealer leases a photocopier to a law firm and agrees to service the machine, in exchange for monthly payments from the law firm. If the dealer decides to stop servicing the machine (and therefore breaches the parties' agreement in a material way), the law firm holds the power, and it has two choices: the firm can either:

(i) Keep up its side of the bargain by continuing to pay the dealer to use the copier while suing the dealer for damages from the breach; or

(ii) The firm can "call the whole deal off, halting its own payments and returning the copier," while suing the dealer for any damages incurred.

Per that reasoning, according to the Court, Tempnology's breach of the license agreement "does not revoke the license or stop [Mission] from doing what [the license agreement] allows." Therefore, the Court noted that if "rejection of the photocopier contract 'constitutes a breach,' as the Code says, then the same results should follow" in bankruptcy (other than a "twist" as to timing and damages because of the bankruptcy).

In other words, because Section 365 of the Code specifies that a debtor's rejection of an executory contract "constitutes a breach of such contract," the Court found that the debtor-licensor's rejection did not mean that the licensee lost the ability to exercise its rights under the contract.

One of Tempnology's primary arguments was that Section 365 of the Code includes several exceptions that provide non-debtor contract parties with special rights, and trademark licenses are not expressly included in any of these statutory exceptions. For example, Section 365(n) limits the debtor-licensor's rejection power with respect to "intellectual property" licensees (e.g., patents, copyrights).

The Court noted that the Section 365(n) exception was added only when Congress intervened to address the decision in *Lubrizol Enters. v. Richmond Metal Finishers*, where the U.S. Court of Appeals for the Fourth Circuit held that a debtor's rejection of an executory contract worked to revoke its grant of patent license to the licensee.

Tempnology argued that by failing to exempt trademark agreements under any special exemptions set forth in Section 365 of the Code—such as Section 365(n)—Congress actually *intended* that a trademark licensee would retain *no rights* after rejection. The Court, however, characterized Tempnology's argument as "resting on a negative inference."

Specifically, the Court "reject[ed Tempnology's] competing claim that by specifically enabling the counterparties in some contracts to retain rights after rejection, Congress showed that it wanted the counterparties in all other contracts to lose their rights."

In rejecting this argument, the Court also reaffirmed a basic tenant of bankruptcy law: a bankruptcy estate "cannot possess anything more than the debtor itself did outside bankruptcy."

Taking Tempnology's approach, according to the Court, would erroneously result in the entity having *more* rights as a result of filing for bankruptcy.

Justice Sotomayor's concurrence was written "to highlight two potentially significant features of today's holding." First, Justice Sotomayor noted that the Court was not deciding in its opinion "that every trademark licensee has the unfettered right to continue using licensed marks postrejection." Citing to the *amicus* brief submitted by the American Intellectual Property Law Association, Justice Sotomayor suggested that "[s]pecial terms in a licensing contract or state law" may bear on the question of continued use of the license in individual cases.

Second, Justice Sotomayor highlighted the irony that the "Court's holding confirms that trademark licensees' postrejection rights and remedies are more expansive in some respects than those possessed by licensees of other types of intellectual property."

For example, Section 365(n) requires a patent licensee to continue to make full royalty payments to the debtor-licensor if the licensee elects to maintain its rights under its license, whereas a trademark licensee may now be entitled to withhold from its royalty payments any damages it has suffered as a result of the debtor-licensor's rejection of the license. Moreover, as Justice Sotomayor hinted, Congress could address this irony by creating a Code provision for trademarks; noting that "[t]o the extent trademark licensees are treated differently from licensees of other forms of intellectual property, that outcome leaves Congress with the option to tailor a provision for trademark licenses, as it has repeatedly in other contexts."

Unanswered Questions

The Court's decision leaves several important questions unanswered.

For example, what non-bankruptcy laws could limit a licensee's rights to preserve its license?

And, what contractual provisions in a trademark license could affect a licensee's ability to maintain its license? Justice Sotomayor hints at the possibilities without delving into specifics.

Finally, will the Court's decision leave bankrupt debtors' trademark rights vulnerable to arguments of abandonment and naked licensing if those debtors are not able to effectively exercise quality control over their licensees while undergoing reorganization? The Court acknowledges the potential dilemma, and Justice Sotomayor's concurrence suggests the possibility of workarounds for future licensors.