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JUNE 2019

INSOLVENCY, CREDITORS' RIGHTS & FINANCIAL PRODUCTS

>> ALERT

TRADEMARK LICENSE RIGHTS SURVIVE REJECTION IN BANKRUPTCY

Settling a circuit split, the U.S. Supreme Court, in an 8-1 decision, has concluded that a trademark licensee's rights are not automatically terminated when a debtor in bankruptcy rejects the license agreement.

The case, *Mission Product Holdings, Inc. v. Tempnology, LLC* (*Mission Product*), arose from a pre-bankruptcy trademark license agreement between Tempnology, LLC, the bankrupt debtor, and Mission Product Holdings, Inc. (Mission), which was granted a non-exclusive license to use Tempnology's "Coolcore" trademarks. During the bankruptcy, Tempnology "rejected" the trademark license in accordance with the Bankruptcy Code. The Court held that, because rejection under the Bankruptcy Code operates only as a breach and not a rescission, the rejection did not deprive Mission of its right to use the trademarks under the license.

THE BOTTOM LINE

The *Mission Product* decision should resolve uncertainty created by the circuit split between the First Circuit and Seventh Circuit decisions. The Supreme Court's ruling should also reassure trademark licensees that should their licensor end up in bankruptcy, absent contract terms or state laws to the contrary, their trademark license rights will not instantly vanish.

In a concurrence, Justice Sotomayor pointed out that under this holding, rights of trademark licensees are more expansive in certain respects than what is codified under section 365(n) for patents and copyrights. Congress now has an opportunity to step in, as it did to address patent and copyright licenses explicitly, to apply protections more uniformly among trademarks, copyrights and patents. In the meantime, licensees and prospective licensees of trademarks now have assurance that the bankruptcy of a licensor will not terminate the license, bringing greater certainty and attractiveness to trademark license transactions.

BACKGROUND

Section 365(a) of the Bankruptcy Code permits debtors to assume or reject "executory" contracts, generally understood to mean contracts that are ongoing and remain unperformed on both sides. A debtor will determine to assume (or accept) contracts it deems beneficial to its business interests, and will reject (or repudiate) the others. The debtor's choices are subject to approval by the bankruptcy court under a business judgment standard. A rejection is considered a "breach" under section 365(g) of the Bankruptcy Code, which gives rise to a claim for prepetition damages by the counterparty against the estate.

The Bankruptcy Code provides for specific relief for certain counterparties should their contracts be rejected. For example, under section 365(n), a licensee of certain intellectual property, such as patents and copyrights, may elect to retain its rights under the rejected contract, but must continue making royalty payments. Further, upon written request by the licensee, the debtor-licensor must provide the intellectual property and not interfere with the rights of the licensee under that contract. Section 365(n), however, explicitly prohibits the licensee from deducting damages from its royalty payments. Section 365(n) does not apply to trademarks, as they are excluded from the definition of "intellectual property" under the Bankruptcy Code.

THE DISPUTE

In *Mission Product,* Tempnology rejected the Mission license agreement and contended that the rejection

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terminated the grant of trademark rights to Mission. In support, Tempnology argued, given that the Bankruptcy Code permits the counterparty in limited situations (e.g., patents and copyrights) to maintain its rights post-rejection and that there is no specific provision for trademark licensees, then by negative inference, a trademark licensee's rights must be extinguished upon rejection of the contract. The bankruptcy court agreed with Tempnology's view.

The Bankruptcy Appellate Panel (BAP) reversed, relying on a Seventh Circuit decision and its interpretation of 365(g) that rejection merely amounts to a breach, which has the same impact within bankruptcy as it does outside of bankruptcy. As a typical contract breach would not terminate the contract rights of a non-breaching counterparty, the BAP held that rejection does not terminate the rights of the licensee.

The First Circuit, however, rejected the BAP's ruling (and the Seventh Circuit's reasoning) and agreed with the bankruptcy court.

SUPREME COURT'S HOLDING

The Supreme Court reversed the First Circuit ruling and affirmed the reasoning of the Seventh Circuit, holding 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, outside bankruptcy, a breach by a licensor "does not revoke the license or stop the licensee from doing what it allows" (assuming no special contract terms or state laws to the contrary). The rejection in bankruptcy operates like a typical contract breach and thus, "the debtor cannot rescind the license already conveyed. So the licensee can continue to do whatever the license authorizes."

This tracks the general understanding in bankruptcy that "[t]he estate cannot possess anything more than the debtor itself did outside bankruptcy." The act of rejection cannot create a right that allows a debtor to recapture the licensed interests it had given up prepetition.

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