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Client Alert: Supreme Court Rules that Bankrupt Brands Cannot Use Bankruptcy to Revoke Trademark Licenses

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On May 20, 2019, United States Supreme Court settled a circuit split, deciding that a bankrupt company's decision to reject an existing contract does not revoke a trademark licensee's right to continue using the licensed mark.

Section 365 of the Bankruptcy Code enables a debtor to "reject any executory contract" – in other words, a contract that neither party has finished performing 11 U.S.C. § 365(a). Such "rejection" constitutes a breach of the contract Id. at § 365(g). However, "breach" is not specially defined under bankruptcy terms. The question be-fore the Court was whether such a breach of the contract terminated the rights that would survive a breach of contract outside bankruptcy. Specifically, the Court considered these provisions in the context of a trademark licensing agreement and whether the debtor-licensor's unilateral rejection of the contract deprived the licensee of its rights to use the trademark.

In *Mission Products Holdings, Inc. v. Tempnology, LLC*, the Petitioner Mission entered into a contract with Tempnology that gave Mission a non-exclusive license to use Tempnology's trademark "Coolcore" in connection with the distribution of clothing and accessories designed to stay cool when used in exercise. Tempnology filed for Chapter 11 bankruptcy and sought to reject its agreement with Mission. The Bankruptcy Court approved Tempnology's rejection and further held that the rejection terminated Mission's rights to use Tempnology's trademarks. The Bankruptcy Appellate Panel reversed, finding that rejection does not terminate rights that would survive breach outside of bankruptcy. The First Circuit went on to reject the Panel's judgment and reinstated the Bankruptcy Court's decision. The Supreme Court's decision reversed the First Circuit and settled a split amongst the circuits.

Circuit courts in agreement with the First Circuit, including the Fourth Circuit, find that the effect of the contract rejection in bankruptcy has the effect of a contract rescission in non-bankruptcy terms, terminating the rights conferred by the agreement. The idea is that allowing a license to survive would saddle the debtor with monitoring how a trademark was being used – the type of obligation that bankruptcy law is designed to

avoid.
Conversely, circuit courts such as the Seventh Circuit held that in rejection of the trademark license, the debtor-licensor's objections under the license are terminated (including the obligation to police use of the mark), but not the licensee's right to continue using the licensed mark under the terms of the license agreement.

Following the Fourth Circuit's related patent case in *Lubrizol Enterprises v. Richmond Metal Finishers*, Congress previously attempted to address the issue by enacting Section 365(n) of the Bankruptcy Code, which stated: "the rights of an intellectual property licensee to use the license property cannot be unilaterally cut off as a result of the rejection of the license pursuant to section 365 in the event of the licensor's bankruptcy." This allowed the licensee to elect to retain its rights for the remaining term. However, trademarks are not identified as "intellectual property" under the Bankruptcy Code. Congress appeared concerned about the conflicting duty of a trademark owner to police their trademarks, otherwise resulting in a "naked license."
The Court rejected the idea that distinctive features of trademark law, namely a licensor's duty to exercise quality control over the use of the mark, should determine the outcome in this case. The Court argued: "that would allow the tail to wag the Doberman." The Court also rejected the argument that the bankruptcy estate could possess anything more than the debtor itself possessed outside of bankruptcy. In other words, if the debtor was subject to a contractual right such as a trademark license outside of bankruptcy, the trustee or debtor is likewise subject to the licensee's right. As the Court stated: "Rejection is breach, and has only its con-sequences." The Court counseled that the burdens a debtor may and may not escape in bankruptcy must be weighed against the interests of the debtor's counterparties, such as trademark licensors.

The practical effect of the ruling is that when a Chapter 11 debtor-licensor rejects a trademark license, the counterparty-licensee may continue to use the trademark under the terms of the license. The debtor-licensor can stop performing its remaining obligations under the agreement but cannot rescind the license to use the mark that has already been conveyed.

You can read the full opinion here. For an in-depth look into the practical effects of this decision, please check out our earlier Client Alert on this issue by David H. Conaway here.

If you have any questions, please contact Christina Davidson Trimmer at ctrimmer@shumaker.com or 704.945.2151.

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